BEFORE THE
PUBLIC UTILITY COMMISSION
OF
OREGON

DR 10 /UE 88 /UM 989

In the Matters of

The Application of Portland General Electric Company for an Investigation into Least Cost Plan Plant Retirement,
DR 10

The Revised Tariffs Schedules for Electric Service in Oregon Filed By Portland General Electric Company,
UE 88

PORTLAND GENERAL ELECTRIC COMPANY's Application for an Accounting Order and for Order Approving Tariff Sheets Implementing Rate Reduction.
UM 989

STAFF OPENING BRIEF

JUNE 20, 2007

The issue presented to the Commission is simply stated: "[w]hat, if any, remedy can the Commission determine and provide to PGE ratepayers, through rate reductions or refunds, for the amounts that PGE collected in violation of ORS 757.355 between April 1995 and October 2000."[1] This question is not one of first impression in Oregon. The Oregon Supreme Court has answered this question in the negative, specifically stating in a 1956 opinion in *McPherson v. Pacific Power & Light Company*, that the legislature did not grant the Public Utility Commissioner authority to award reparations for unreasonable or unjustly discriminatory rates.[2]

That the statutes under which the Commission operates mean what the Supreme Court said in *McPherson v. Pacific Power & Light Company* is supported by examination of the statutes under which the Commission operates. It is indisputable that the Commission's authority to regulate utilities is broad. Nonetheless, the Commission is bound to exercise its authority within the confines of both the state and federal constitutions and within the limits imposed by the legislature. Put another way, the Commission's authority "cannot go beyond that expressly conferred upon it."[3] The Legislature has not given the Commission statutory authority to order refunds in the circumstances presented in this case. Accordingly, the Commission cannot do so.

A. The Commission's authority to set rates is legislative and the Commission acts prospectively.

The origins of the Public Utility Commission and ratemaking in Oregon provide context for this examination of the Commission's statutory authority. Prior to the

[1] June 6, 2007 Ruling.
[2] *Pacific NW Bell v.* Sabin, 207 Or 433, 449, 296 P.2d 932 (1956).
[3] *Id.*

creation of a commission to regulate public utilities, ratemaking was performed by the Legislature. In 1907, the Legislature created a Railroad Commission and enacted a comprehensive regulatory system for railroad rates that mirrored those in Wisconsin.[4] In 1911, the Oregon Legislature extended the Railroad Commission's authority to public utilities.[5]

When the Legislature was engaged in ratemaking, it only made rates for the future. When the Commission inherited the job of ratemaking from the Legislature, it inherited the same power as the Legislature to make rates for the future. As the Supreme Court stated in a 1952 opinion,

> [A]ll rate orders [of the Public Utility Commissioner] are prospective in character; that is they prescribe rates governing future shipment. Hence, the power to prescribe them, like the power to write laws, **is legislative in character**.[6]

The legislative nature of ratemaking has been repeatedly emphasized by Oregon's appellate courts. In 1982, the Oregon Court of Appeals noted,

> Utility regulation, including ratemaking, is a legislative function subject only to the constitutional limits and those of the Commissioner's express, legislatively delegated broad powers.

B. The Commission's authority to set retroactive rates, rather than prospective rates, is defined by the Legislature.

In 1923, the Legislature modified the statutes governing the Commissioner's regulations of railroads to allow the Commissioner to engage in retroactive ratemaking in a limited circumstance. Specifically, the legislature authorized the Public Utility Commission to order "reparations" to a customer who complained that the existing "lawful rates" were nonetheless excessive

[4] 1907 Or Laws Ch 53.
[5] 1911 Or Laws Ch 279 §§ 41 and 51.

> It is therefore apparent, when we construe §62-126 in connection with the other sections therein referred to, that the legislature had in mind, in enacting that section, to confer upon the public utilities commissioner authority when investigating rates to award reparation in those instances in which he should find that shippers had been damaged by the application of unjust and unreasonable rates.[7]

In 1956, the Oregon Supreme Court decided *McPherson v. Pacific Power & Light Company*, and clarified that while the Legislature had granted the Public Utility Commissioner authority to order reparations for application of unjust and unreasonable carrier rates, the Legislature did not grant the Commission power to award "reparations" against utilities for charges collected under rates later determined to be unjust or unreasonable:

> Turning to the statutes dealing with utilities * * * we find that the Commissioner has no authority to award reparations, either for unreasonable or unjustly discriminatory rates, or for overcharges[.][8]

The *McPherson* Court's conclusion that the Commissioner did not have authority to award reparations for charges paid to the utility under rates later found to be unjust and unreasonable relied heavily on a comparison of the statutes governing the Commissioner's authority over railroads and his authority over utilities. The Court noted that **"**to determine the jurisdiction of the commissioner over a particular business, one must refer to the substantive statutes governing that business[,]" and concluded that in absence of a Legislative grant of authority to award reparations to utility customers for rates later found to be unjust and unreasonable, the Commissioner had none.[9]

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[6] *Valley & Siletz Railroad Co. v. Flagg*, 195 Or 683, 715, 247 P2d 639 (1952) (emphasis added).
[7] *Id.* at 47.
[8] *McPherson, et al. v. Pacific Power & Light, supra*, at 439.
[9] *Id.*

The Court's analysis in *McPherson* holds true today. The Commission must examine the "substantive statutes" to determine whether it has authority to award refunds. As discussed below, the Legislature has adopted no statutes since the Court's opinion in 1956 to alter the conclusion reached by the *McPherson* court.

Before turning to the substantive statutes at issue, staff notes that one court, the Marion County Circuit Court, has concluded that the Oregon Supreme Court's opinion in *McPherson. v. Pacific Power & Light Company* is not applicable to the question presented here because the rates at issue in this case have been overturned by a court on appeal. This court stated in its 2003 Opinion and Order overturning the Commission's decision in Docket No. UM 989:

> Notably, the *McPherson* Court did not address the Commission's authority upon remand after judicial review overturning the rates previously approved by the Commission. And *McPherson* certainly does not state that the Commission has no authority to consider past problems in setting new rates after the old rates are overturned on appeal.[10]

The Marion circuit court's rejection of the *McPherson* opinion is illogical. In essence, the circuit court concludes that it can enlarge the jurisdiction of the Commission by judicial order. This assumption is inconsistent with the court's role on review, and the indisputable fact that rate-making is a legislative function.

Contrary to the court's first suggestion, it cannot, in fact, order the Commission to something that the Commission does not have statutory authority to do on its own. Second, the Court's conclusion that the Commission can "consider past problems in setting new rates after the old rates are overturned on appeal," impermissibly interferes with the Commission's exercise of its legislative rate-making function. That the court cannot tell the Commission how to set rates is indisputable. This role is exclusively the

Commission's, and the court cannot usurp this role. In an 1896 opinion, the Oregon Supreme Court announced:

> State government being divided into three coordinate branches,--executive, legislative**,** and judicial,--it is most essential to the preservation of the autonomy of government that there be no encroachment of one branch upon another. And to this end the just limitations of the constitutional powers accorded to either branch should be nicely defined and jealously guarded.[11]

C. Oregon's statutes do not authorize the Commission to order a utility to refund amounts collected under rates previously authorized by the Commission.

The statutes under which the Commission operates are comprehensive, and spell out how rates are established. Under ORS 757.205(1), a utility must file with the commission schedules "showing all rates * * * which it has established and which are in force at the time." Under ORS 757.220, a utility has to give the Commission 30 days' notice of any proposed change in rates. ORS 757.210 and ORS 757.215 authorize the Commission to investigate rates and to suspend them during its investigation. After the Commission decides what the rates should be, it may approve the proposed rates, or may order the utility to file new "compliance tariffs" in accordance with that decision.[12] Pursuant to ORS 757.225, the rates on file with the Commission are the only lawful rates and utilities are obligated to charge customers in accordance with those rates.

> No public utility shall charge, demand, collect or receive a greater or less compensation for any service performed by it within the state, or for any service in connection therewith, than is specified in printed rate schedules as may at the time be in force, or demand, collect or receive any rate not specified in such schedule. The rates names therein are the lawful rates until they are changed as provided in ORS 757.210 to 757.220.

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[10] (Opinion and Order at 2.)
[11] *State ex rel Taylor v. Lord*, 28 Or 489, 527, 42 P 471 (1896).
[12] *See* e.g., *Citizens' Utility Board v. PUC*, 128 Or App 650, 663, 877 P2d 116, *rev den* 320 OR 272 (1994).

These statutes, particularly ORS 757.225, evince the Legislature's intent to adopt the "filed rate doctrine." This conclusion regarding the "filed rate doctrine" is confirmed, and explained, by examination of other cases in which the courts have relied on similar statutes to reach the same conclusion. For example, a 1990 opinion from the United States Supreme Court explains the filed rate doctrine as follows:

> The duty to file rates with the [Interstate Commerce] Commission § 10762, and the obligation to charge only those rates, see § 10761, have always been considered essential to preventing price discrimination and stabilizing rates. "In order to render rates definite and certain, and to prevent discrimination and other abuses, the statute require[s] the filing and publishing of tariffs specifying the rates adopted by the carrier, and make these the *legal* rates, that is, those which must be charged to all shippers alike." *Arizona Grocery Co. v. Atchison, T. & S. F.R. Co.*, 284 US 370, 384, 76 L.3d. 348, 52 S.Ct. 183 (1932).
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> Given the close interplay between the duties imposed by §§ 10761-10762 and the statutory prohibition on discrimination, see §10741, this Court has read the statute to create strict filed rate requirements and to forbid equitable defenses to the collection of the filed tariff. * * * The classic statement of the "filed rate doctrine," as it has come to be known, is explained in *Louisville v. Nashville R. Co. v. Maxwell*, 237 U.S. 94, 59 L.3d. 853, 35 S. Ct. 494 (1915). In that case, the Court held that a passenger who purchased a train ticket at rate misquoted by a ticket agent did not have a defense against the subsequent collection of the higher tariff rate by the railroad.[13]

Similarly in Oregon, a utility is obligated to file its rates with the Commission and charge only those rates.[14]

The conclusion that the Oregon Legislature adopted what the United States Supreme Court refers to as the "filed rate doctrine," is not dispositive of the question before the Commission, however. This is because it is possible for a jurisdiction to adopt

[13] *Maislin Industries, U.S. Inc., et al. v. Primary Steel, Inc., et al.*, 497 U.S. 116, 110 S. Ct. 2759, 111 L.Ed.2d 94 (1990).
[14] *See* ORS 757.205 and ORS 757.225.

the filed rate doctrine, but also allow for retroactive remedies when the filed rate is later found to be unreasonable, unjust or unlawful.[15]

Accordingly, it is necessary for the Commission to determine whether the Legislature has granted the Commission authority to act retroactively, rather than prospectively, and order a utility to refund to customers charges collected under rates authorized by the Commission but later found to be unreasonable, unjust or unlawful. Although the Legislature has granted the Commission authority to engage in retroactive ratemaking in a few circumstances, no statute authorizes the Commission to engage in this type of retroactive ratemaking.[16]

The conclusion that the Commission has only limited authority to engage in retroactive ratemaking is supported by a 1987 Attorney General Opinion. In 1987, prior to enactment of ORS 757.259, the Public Utility Commissioner asked the Attorney General for advice as to whether he could create balancing accounts for utilities that would accrue costs such as net variable power costs and then allow the utilities to amortize the accrued balances into rates.[17] The Attorney General concluded that the Commissioner could not. The Attorney General observed that such "deferred accounting

[15] *See e.g., North Carolina ex rel Utilities Commission v. Conservation Council,* 320 SE 2d 679 (N.C. 1984).

[16] A Commission determination that it is authorized by the Legislature to order refunds when a rate order is reversed and remanded by an appellate court would not necessarily dispose of the question presented. This is because even assuming the Commission had *statutory* authority to order the refunds; the Commission would still have to consider whether such refunds would violate any *constitutional* provisions. For example, ordering refunds of the "return on" Trojan that PGE received could result in confiscatory rates. This is because a consequence of the refunds would be that PGE would not be allowed the return of Trojan costs allowed by the Commission in UE 88 in that it would have to refund to customers the carrying charges it recovered 1995-2000.

[17] Op Atty Gen No. 6076 (March 1, 1987).

orders" would violate the prohibition against retroactive ratemaking and that the Commission could not do so in absence of explicit legislative authority.[18]

The Attorney General explained at length what he meant by the prohibition on retroactive ratemaking. He noted that the roots of the prohibition are found in several rules and legal principles. First, the United States Supreme Court has concluded that regulatory agencies are precluded from using past profits as a basis to reduce future rates because doing so would result in confiscatory rates.[19] Second, future rates that incorporate past losses may be so high as to violate the constitutional standards that rates be just and reasonable.[20] Third, ratemaking is a legislative act. Legislative acts are prospective; retroactivity, even where permissible, is not favored except upon the clearest mandate.[21]

A few months after the Attorney General's Opinion, the Public Utility Commissioner presented testimony to the Senate Committee on Business, Housing and Finance in support House Bill 2145, which would explicitly authorize retroactive ratemaking through deferred accounting. The Commission explained the reasoning underlying the prohibition against retroactive ratemaking as follows:

> From the customer's viewpoint, the principle underlying the prohibition against retroactive ratemaking is that the customer should know what a utility service costs him at the time he takes it. The posted tariff on the day of service represents a contract between the customer and the utility. The customer should not expect to pay more and the utility should not expect to get less.[22]

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[18] A few months after the Attorney General issued his opinion, the Legislature passed House Bill 2145, which allowed the Commissioner to engage retroactive ratemaking through deferred accounting.

[19] Op Atty Gen No. 6076 at 9, *citing Los Angeles Gas Co. v. R.R. Comm'n*, 289 US 287, 313, 53 S Ct 637, 77 L Ed 1180 (1933) (holding past profits cannot be used to sustain confiscatory rates for the future).

[20] Op Atty Gen No. 6076 at 16-17.

[21] *Claridge Apartments Co. v. Comm'r*, 323 US 141, 164, 65 S Ct 172, 89 L Ed 139 (1944).

[22] Attachment 1; Testimony of Charles Davis on HB 2145 before the Senate Committee on Business, Housing and Finance, May 21, 1987.

D. The Court of Appeals' 1992 opinion in *Pacific Northwest Bell v. Katz* does not compel any particular result in this case.

In 1992, the Court of Appeals addressed the Commission's authority to order a telecommunications company to refund to customers amounts collected under what the Commission had classified as "interim rates."[23] In its order mandating the refunds, the Commission held that the refunds were permissible under ORS 759.185(4), which allowed the Commission to order a telecommunications utility to refund charges collected under interim rates.[24] The trial court, which reviewed the order prior to the Court of Appeals, reversed the Commission's order, concluding that the rates at issue were in fact permanent rates authorized by the PUC and that the Legislature had not authorized the Commission to order a telecommunications utility to refund charges collected under such rates. The circuit court noted that if its conclusion the rates were permanent was erroneous, its ruling that the refunds were impermissible would also be erroneous. [25]

The Court of Appeals reversed the decision of the circuit court and affirmed the order of the Commission, but on a different ground than that relied on by the Commission. The Court of Appeals concluded that the rates were not interim rates, but noted that they were "temporary rates that did not comply with the revenue requirement ordered by the Commission," and that the general grant of authority under ORS 756.040 was sufficiently broad to allow the Commission to allow refunds in the circumstances presented:

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[23] *Pacific Northwest Bell Telephone Co. v. Katz*, 116 Or App 302, 307, 841 P2d 652 (1992).
[24] *Id.*
[25] *Id.*

> To hold that PUC does not have the power to order a refund of amounts over ***collected under temporary rates that failed to comply with an ordered revenue reduction*** would be inconsistent with its regulatory role and statutory duties. Such a holding would deprive PUC of much of its power to protect customers from abusive delay tactics or, as in this case, unexpectedly long delays in implementing an ordered revenue reduction. PNB is not entitled to retain excess revenues collected under an interim rate schedule that was not in compliance with the authorized revenue level[.][26]

Here, there is no suggestion that the rates are anything other than permanent rates *filed in compliance with the revenue requirement ordered by the Commission*. The facts presented in this case are distinguishable from those presented in *Katz.* It is certainly not clear that the Court of Appeals would reach the decision it reached in *Katz,* in these circumstances, and in fact such a conclusion would be contrary the Supreme Court's holding in *McPherson*. Notably, Judge Warren wrote a strong dissent in the *Katz* case, concluding that the majority erred in "imply[ing] a power under a general grant of authority that exceeds the scope of a specific grant of authority."[27]

E. Ratepayers had a remedy to prevent PGE from collecting charges for "return on" Trojan.

The fact that ratepayers cannot receive refunds in the circumstances presented in this case does not mean they were left without a remedy. The Legislature allows persons contesting a rate decision of the Commission to ask the reviewing court to suspend or stay a Commission order. *Former* ORS 756.580, in effect through December 31, 2005, provided:

> After the commencement of a suit under ORS 756.580, the circuit may, for cause shown, upon application to the circuit court * * * suspend or stay the operation of the order of the commission complained of until the final

[26] *Id.*, at 310 (emphasis added).
[27] *Id.*, at 312.

> disposition of such suit, upon the giving of such bond or other security, or upon such conditions as the court may require[.]

Although the 2005 Legislative Assembly significantly modified the process for judicial review of a Commission order so that review is now like that allowed for other agency orders, the Legislature kept the provision in *former* ORS 756.590 allowing a petitioner to seek a court stay.[28] Accordingly, if a person seeks judicial review of a Commission order on the ground the Commission has allowed a utility to charge rates that are unlawful, unreasonable or unjust; the person can ask the reviewing court to stay the order so the utility is not allowed to collect under the rates.

As already discussed, one of the policy reasons underlying the prohibition on retroactive ratemaking in Oregon is to ensure that customers know the cost of service at the time the customer takes it. The conclusion that a stay is the only remedy the Legislature has authorized to protect ratepayers from paying rates that the Commission has approved (or allowed to go into effect) is consistent with that policy. If a Commission rate order is stayed, the price of electricity will still be clear and easily known. The same is not true if the Commission concludes that refunds are permissible. Under this conclusion, electricity rates for the same time period could be changed retroactively, and on multiple occasions (*e.g.*, if the refunds the Commission approves on the first remand are appealed).

F. Case law from jurisdictions with statues similar to Oregon's supports the conclusion that the Commission does not have authority to order refunds in this case.

A review of case law in other jurisdictions is helpful only if the case law is based on statutes similar to those in Oregon. This is because ultimately, the jurisdictions'

[28] ORS 756.610.

resolutions of issues like that presented here, turns on the jurisdictions' statutes. Examination of those jurisdictions with statutes most like those in Oregon shows that those jurisdictions have interpreted their statutes to prohibit refunds for charges collected under tariffs later found to be unlawful or unreasonable.

Indiana. When the Oregon Legislature created the Railroad Commission, it adopted statues that mirrored those in Wisconsin. Indiana appears to be the only other state that copied the Wisconsin statutes in the early 1900's and still retains the original provision that is substantially identical to ORS 757.225. The Indiana Court of Appeals has interpreted its statutes consistent with the interpretation of Oregon statutes urged by staff. Meaning, the Indiana Court of Appeals has concluded that although an Indiana court may invalidate a commission order, the utility's compliance with that order does not become retroactively unlawful:

> Orders of the Indiana Utility Regulatory Commission are deemed presumptively valid and in force until found otherwise on appeal. *See* Ind. Code § 8-1-3-6. Indiana law imposes a duty upon public utility providers to obey the orders of the Commission. *See* Ind. Code § 8-1-2-109; Ind. Code § 8-1-2-112. This duty remains in effect at all times in which orders are in force, including the time in which an appeal is pending. This being so, it is clear that after the Commission granted I & M's petition and ordered the modification in the service area in 1984, I & M could not take the law into its own hands and refuse compliance; I & M had no choice but to obey the Commission's order. Indeed, failure to comply with the Commission's order would have subjected I & M to potential penalty, Ind. Code § 8-1-2-109, potential liability to General Motors for injury caused by its wrongful actions, Ind. Code § 8-1-2-107, and other remedial measures exacted by the Commission, Ind. Code § 8-1-2-4.
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> * * * * *
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> That the Commission's order was later invalidated by our supreme court does not render I & M's actions retroactively "unlawful" for purposes of recovery under Ind. Code § 8-1-2.3-4. It would be illogical and manifestly unreasonable to exact penalties upon I & M as punishment for its actions in the present case for I & M was merely complying with an

> order of the Commission, which under Indiana law, it had no option to ignore. *See Atlantic Coast Line Railroad Co. v. Florida* (1935), 295 U.S. 301, 311, 79 L.Ed. 1451, 55 S. Ct. 713 (inequitable to compel railroad to make restitution for benefit received while acting pursuant to order of interstate commerce commission later voided where carrier was not at liberty to take law into own hands and such disobedience would potentially result in criminal and civil penalties); *Illini Coach Co. v. Illinois Highway Transp. Co.* (1960) 25 Ill. App. 2d 168, 166 N.Ed. 2d 161 (no damages recoverable by motor carrier where competing carrier operated pursuant to order of state commerce commission with which it was obligated to comply even though subsequently voided by state supreme court).[29]

Ohio. Ohio has a statute substantially similar to ORS 757.225, as well as a statute with a stay provision like that in ORS 756.610 and *former* ORS 756.590. The Ohio Supreme Court has held that these statutes make clear that Ohio's General Assembly did not intend that a utility would offer refunds to customers for rates approved by the Commission but later found to be unlawful.

> The question * * * arises as to the status of the rates set by the commission, during the pendency of the appeal. The only basis upon which plaintiff could recover would be that such rates were excessive when collected. We have previously determined that under the statutes of Ohio the utility has no choice but to collect the rates set by the order of the commission, in the absence of a stay of execution pursuant to Section 4903.16, Revised Code. We have determined further that the General Assembly provided *that there is no automatic stay* of any order, but that it is necessary for any person aggrieved thereby to take affirmative action, and if he does so is required to post bond.
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> [I]t is our conclusion that rates of a public utility in Ohio are subject to a general statutory plan of regulation and collection; that any rates set by the Public Utilities Commission are the lawful rates until such time as they are set aside as being unreasonable and unlawful by the Supreme Court; and that the General Assembly, by providing a method whereby such rates may be suspended until final determination as to their

[29] *United Rural Electric Membership Corp v. Indiana Mich. Power Co.*, 648 NE2d 1194, 1197, 648 NE2d 1194 (Ind Ct App 1995).

> reasonableness or lawfulness by the Supreme Court, has completely abrogated the commonlaw remedy of restitution.[30]

The Ohio Supreme Court reiterated this conclusion in a 2004 opinion,

> The owner's association contends that CTTS's ratepayers are entitled to a refund of the difference between rates paid during the commission-approved rate base with no deduction for CIAC and rates determined with the appropriate CIAC deduction. Neither the commission nor this court can order a refund of previously approved rates[.][31]

Illinois. Illinois also has a statute that prohibits utilities from charging "a greater or less or different compensation" than the rate so approved by the commission.[32] In a 1954 opinion, the Illinois Supreme Court rejected the appellant's claim that it was entitled to a refund of rates collected pursuant to an order reversed on appeal. In addressing the claim, the Court first noted that the question turned on whether there was statutory authority for such a refund:

> * * * Where the charges collected by the carrier were based upon rates which had theretofore been established or approved by the public authority, the fact that such rates are subsequently reduced affords no right of action for damages or for the recovery of the difference between the old and new rates upon the ground that the prior rate was unreasonable, unless such right is conferred by the governing statute, as is held to be the case in some jurisdictions.[33]

The Illinois court concluded that no such authority existed. In doing so, the Commission noted the absence of a statute authorizing refunds, the legislative nature of rate setting, the fact that utilities were statutorily required to charge the rate set by the

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[30] *Keco Industries, Inc., et al. v. The Cincinnati & Suburban Bell Telephone Co.*, 166 Ohio St. 254, 258-59, 141 NE 2d 465 (1957).
[31] *Green Cove Resort I Owners' Association v. Public Utilities Commission of Ohio*, 103 Ohio St.3d 124, 130, 814 NE2d 829 (2004).
[32] Ill. Rev. Stat. 1953, chap. 111 2/3, par. 37.
[33] *Mandel Brothers, Inc. v. Chicago Tunnel Terminal Co.*, 2 Ill.2d 205, 209, 117 NE2d 774 (1954).

Commission, and the fact that the legislative assembly authorized reviewing courts to stay a rate order during pendency of an appeal.[34]

Alabama used to have a statute substantially identical to ORS 757.225. While that statute was in effect, the Alabama Supreme Court concluded that no refunds for rates approved by the Commission but later reversed by an appellate court were authorized.[35]

G. The Circuit Court's rejection of case law from Ohio, Indiana and Illinios was based on an incorrect premise.

In its opinion finding that the Commission erred in concluding that the filed rate doctrine precluded it from ordering refunds for Trojan charges (in its review of the Commission's order in Docket No. UM 989), the circuit court summarily rejected PGE's reliance on the Ohio, Alabama and Illinois cases discussed above. The court noted that both the Ohio and Alabama courts had relied on the following passage in the Illinois Court's opinion in *Mandel*:

> The fundamental issue in this case is whether a rate which has been approved by the Commerce Commission after a hearing as to its reasonableness can be termed an "excessive" rate for the purpose of awarding reparations. We hold that it cannot, even though the rate approved by the Commission has subsequently been set aside upon judicial review.[36]

The circuit court asserted that *Mandel* had been "sharply limited in its application even in its originating jurisdiction," by the Illinois 1987 Supreme Court opinion in *Independent Voters of Illinois v. Illinois Commerce Commission,* and thus eschewed any

[34] *Id.*, at 209-212.
[35] *See e.g., Alabama v. Alabama Public Service Comm'n*, 293 Ala. 553, 73-74, 307 So 2d 521 (1975).
[36] Opinion and Order at 3, quoting *Mandel Brothers, Inc., supra*, at 775-76.

reliance on the interpretations of the Alabama, Ohio and Illinois supreme court of statutes similar to those in Oregon.[37]

The circuit court's conclusion that the application of *Mandel* had been sharply limited by *Independent Voters of Illinois* was incorrect. In fact, the Illinois Supreme Court stated just the opposite in a 1992 opinion, holding:

> In *Independent Voters,* * * * , this court reaffirmed its decision in *Mandel Brothers, Inc. v. Chicago Tunnel Terminal Co.* * * * , holding that, in a situation where the Commission has approved rates as just and reasonable but those rates are later reversed on appeal, section 9-252 of the Act [allowing the Commission to order a utility to issue refunds for "excessive" rates] *does not apply.* * * * In *Mandel Brothers*, this court determined that rates approved by the Commission as just and reasonable rates could not be "excessive or unjustly discriminatory" for the purposes of ordering reparations even if those rates are later reversed by a reviewing court. * * * The *Mandel Brothers* holding was based on the statutory scheme of the Act which requires the utility to charge rates approved by the Commission throughout the appellate process *unless the reviewing court stays or suspends the new rates.* * * * The *Mandel Brothers* court reasoned that, because the utility is required to charge rates set by the Commission, these rates cannot be deemed to be excessive rates as a basis of a claim for reparations.
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> The *Mandel Brothers* holding **was reaffirmed by this court in both *Independent Voters and Citizen Utilities Co. v. Illinois Commerce Comm'n*** * * *.[38] We now reaffirm the *Mandel Brothers* holding for a third time. The Commission, once it approved rates in Rate Order I as just and reasonable rates, cannot now require Edison to pay reparations for those rates, even though Rate Order I was reversed on appeal. The Commission's function is legislative in nature and the rates that it sets are prospective in operations. (See *Mandel Brothers*, 2 Ill. 2d at 210.) To allow the Commission to now order "reparations" from rates that it originally set would violate the well-established rule against retroactive ratemaking.[39]

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[37] Opinion and Order at 4, *citing Independent Voters of Illinois v. Illinois Commerce Commission,* 510 NE 2d 860 (1987).

[38] The Court issued two opinions titled *Independent Voters and Citizens Utilities Co. v. Illinois Commere Comm'n*, and re-affirmed the *Mandel* holding in both of them.

[39] *The People ex rel Hartigan, et al., v. The Illinois Commerce Commission, et al.*, 148 Ill.2d 348, 395-96, 592 NE2d 1066 (1992) (italics in original; bold added; internal citations omitted).

Contrary to the circuit court's opinion, case law from Ohio, Indiana and Illinois is instructive on the proper interpretation of Oregon's statutes.

In support of its conclusion that the Commission does have authority to order refunds in this case, the circuit court relied on a North Carolina Court of Appeals case. The North Carolina Court concluded that,

> [R]etroactive ratemaking occurs when . . . the utility is required to refund revenues collected pursuant to the then lawfully established rates for past use * * * The key phrase here is "lawfully established rates." A rate has not been lawfully established simply because the Commission has ordered it. If the Commission makes an error of law in its order from which there is no timely appeal the rates put into effect by that order have not been "lawfully established" until the appellate courts have made a final ruling on the matter." [40]

The North Carolina Court's decision is based on its conclusion that rates authorized by the regulatory commission are not "lawfully established" until an appellate court has finally ruled on them. The courts in the Indiana, Ohio and Illinois cases discussed reached a different conclusion – that a judicial order reversing the regulatory agency's rate order did not retroactively make the rates unlawful. Oregon law compels the Commission to reach the conclusion reached by the courts in Indiana, Ohio and Illinois, that a judicial order reversing a Commission order does not retroactively void the rate order.

ORS 757.225 specifies:

> No public utility shall charge, demand, collect or receive a greater or less compensation for any service performed by it within the state, or for any service in connection therewith, than is specified in printed rate schedules as may at the time be in force, or demand, collect or receive any rate not specified in such schedule. *The rates named therein are the lawful rates until they are changed as provided in ORS 757.210 to 757.220.*

[40] *North Carolina ex rel Utilities Commission v. Conservation Council*, 320 SE2d 679, 685-86 (N.C. 1984).

What this means is that the rates on file are the only lawful rates, and they continue to be the lawful rates until the moment the Commission approves new tariffs that supercede the old. *This conclusion holds true, however, even if the last sentence of ORS 757.225 did not exist*. The Public Utility Commission has exclusive authority to set utility rates. Ratesetting is a legislative function and the Commission sets rates prospectively. A court cannot usurp that function by setting rates itself, or ordering the Commission to change rates, retroactively or otherwise. Accordingly, even when a court reverses a rate order, those rates are effective until changed by the Commission, unless the Court stays the rate order under ORS 756.610.

Staff notes that the Oregon Supreme Court has voiced skepticism that ORS 757.225 means that Commission rates are the "lawful" rates until superceded by new rates because ORS 757.225 specifies that they are lawful until changed as provided in ORS 757.210 to 757.220, and omits any reference to other statutes that may lead to a rate change:

> We share plaintiffs' skepticism of the proposition that is at the heart of PGE's argument -- that ORS 757.225 manifests a legislative intent that PUC-approved rates be treated as conclusively lawful for all purposes "until they are changed as provided in ORS 757.210 to 757.220." We find it significant that, although the public utility statutes provide more than one process for changing the filed rates for a utility, ORS 757.225 refers to only one such process -- the utility-initiated process "provided by ORS 757.210 to 757.220." If PGE's interpretation of ORS 757.225 were correct, then *only* rate changes adopted pursuant to the utility-initiated ratemaking process at 757.210 to 757.220 would be valid. A necessary corollary of that interpretation would be that rate changes adopted under any alternative process provided in the statutes, including the ratepayer- or PUC-initiated process set out at ORS 756.500 to ORS 756.515, would *not* produce a binding change to the "lawful" rate. Those two propositions do not persuade us.[41]

First, as noted above, the conclusion that the rates approved by the Commission are the "lawful" rates does not depend on the last sentence of ORS 757.225. This conclusion is also found in the body of appellate case law conclusively establishing that ratemaking is solely the province of the Commission, is legislative, and prospective.

Further, staff disagrees with the Supreme Court's conclusion that the Legislature's exclusion of reference to other statutes that may lead to a rate change means that the Legislature could not have intended ORS 757.225 to mean that rates in force are the "lawful" rates pending the subsequent change. Another reasonable interpretation is that the Legislature overlooked the possibility of a rate change under ORS 756.500 to ORS 756.515 or other statutes when enacting that particular language in ORS 757.225.

Staff notes that neither the Commission nor the Court is entitled to insert words into the statute or omit them, and does not suggest that the Commission do so. Staff's point is that the fact the Legislature did include references to all statutes under which a tariff change can come about does not *compel* the interpretation of the statute offered by the Supreme Court, nor does it compel any particular result in this case. Notably, reading the statute as it is does not produce an absurd result in this case. The tariffs approved by the Commission in UE 88, and all PGE's subsequent rate changes to date, have been pursuant to tariffs examined by the Commission under ORS 757.210.[42]

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[41] *Dreyer, et al. v. PGE*, 341 Or 262, 278-79, 142 P.3d 1010 (2006).

[42] Staff notes that the Oregon Supreme Court appears to have given the term the "filed rate doctrine," a different meaning than given that term by the United States Supreme Court. As noted above, the filed rate doctrine means that the utility must charge customers the rates authorized or allowed to go into effect by the Commission; no more no less. It would be a mistake to refer to the reasoning underlying staff's analysis of why the Commission cannot order refunds in this case as the "filed rate doctrine." While staff's analysis includes this doctrine, it does not rely on it exclusively.

H. The conclusion that the Commission does not have authority to order refunds in the circumstances presented in this case is consistent with the holistic nature of ratemaking.

The conclusion that the Commission does not have authority to order PGE to refund to customers money it collected for "return on" Trojan from 1995 to 2000 is consistent with the "holistic" nature of ratemaking. While ratesetting is so complex that the Legislative Assembly created the Commission to do it, the overall goal of ratemaking is simple. Rates must be "fair and reasonable" and must reflect a balancing of "the interests of the utility investor and the consumer."[43]

Ratemaking results in a price that customers pay for electricity, natural gas, telecommunications, or water. Rates must be "fair and reasonable." However, the Commission has discretion to determine what is "fair and reasonable," so it follows that one cannot say there is only one correct price at which the Commission must arrive when it sets rates. Further, there is no specific formula set out in Oregon statutes that tells the Commission how to arrive at the price it chooses in a given case.

Ratemaking generally entails a three-step process. First, regulators must determine how much revenue a utility is entitled to collect. After they determine the level of revenue, they must decide how to apportion responsibility for payment of it among industrial, commercial and residential customers. Finally, they must design rates. This phase of the process includes such things as deciding whether to increase charges for electricity or natural gas during periods of high usage, in order to discourage usage during those times.

The Commission refers to these three phases as (1) revenue requirement; (2) rate spread, and (3) rate design.

1. Ratemaking formula

The National Association of Regulatory Utility Commissioners (NARUC) has published a formula that is used by the Commission, as well as by virtually all state regulators, to determine how much revenue a utility is to receive. Before one walks through the formula, it is helpful to know what it is designed to do. Simply put, its purpose is to set rates that provide a utility opportunity to collect enough revenue (1) to recover its reasonable expenses of providing service; and (2) to allow it a reasonable return on investments it has made to provide service.

The NARUC formula is as follows: $R = E + (V - d)r$.

"R" stands for revenue requirement. This is a projection of the annual amount of money that a utility will receive from its rates.

"E" stands for operating expenses. This includes the necessary and ordinary business expenses that a utility normally incurs in providing service to its customers. E takes into account such things as wages, taxes, costs of fuel, costs of power purchased from other utilities, maintenance on plants, etc.

"V" stands for rate base. This is probably the most misunderstood term in ratemaking. Even those who are familiar with the ratemaking process believe that rate base refers to all expenses, of whatever kind and character, which are incurred by utilities. In other words, they believe that rate base means the basis of rates. It doesn't.

Rate base is a term of art with a very narrow meaning. It refers primarily to the net book value of the used and useful plant (that is, the plant in service), on which utility investors are permitted to earn a return. Rate base also includes such items as stored fuel and cash working capital, which make up a very small percentage of rate base. As

[43] ORS 756.040.

applied to an electric utility, rate base consists of, for the most part, the dollars originally invested in generation, transmission and distribution plant. It is something that exists only as a theoretical concept for the purpose of fixing rates for investor owned utilities. Public utility districts, municipal utilities, cooperatives and federal power marketing agencies, since they have no investors, do not have rate bases.

"d" stands for accumulated depreciation. It represents the sum of annual depreciation charges. Depreciation, of course, reflects the fact that plant wears out. It is also the means by which customers return to shareholders capital that the utility has invested. Depreciation is subtracted from rate base so that shareholders receive only a return on the undepreciated portion of their investment.

In $R = E + (V - d)r$, depreciation appears in two places. As stated above, it is "d" in the formula, an amount subtracted from "V," or rate base, so that utilities earn a return only on undepreciated investment. "d" also appears as an expense in "E." Depreciation is recognized as a noncash expense relating to capital investment, the means by which a utility receives a return of capital from its customers. For purposes of the ratemaking formula, "E" is comprised of operating expenses and depreciation.

"r" stands for rate of return. Some call "r" the cost of money or cost of capital. Investor-owned utilities raise money, as do most large corporations, through issuing common stock (equity), preferred stock, or debt. Assume a utility raises forty percent of its capital through the issuance of equity, while ten percent is financed through preferred, and the remaining fifty percent through debt. The 40-10-50 ratio is known as the company's capital structure. In determining what rate of return to allow on rate base less accumulated depreciation, a regulator must first decide what rate of return should be

allowed on each type of capital by weighing each component based upon the percentage of each in the capital structure. By way of example, if the returns on equity, preferred stock and debt are fourteen, eleven, and nine percent respectively, and if the capital structure is 40-10-50, then "r" would equal 12.0 percent. ((.14x40) + (.09 x 10) + (.11 x 50) = 12). The term "r," then, represents the weighted average cost of capital for a utility.

A simple example will illustrate how (V-d)r works. Assume that the regulator allows inclusion of a $1000 plant in rate base (V). Assume also that the plant is to be depreciated on a straight-line basis over ten years (i.e., $100 per year for ten years). Finally, assume that the regulator has determined the utility's rate of return to be ten percent. With no depreciation of the plant, the utility would earn $100 in revenue from inclusion of the plant in rate base. One derives that figure by multiplying $1000 x 10% or .10. Of course, a plant begins to depreciate as soon as it goes on line, so the regulator provides for depreciation immediately. In this example, the regulator would include $100 in "E" for depreciation and $900 in rate base, less the depreciation of $100. A ten percent return on the $900 yields $90, so the utility receives $190 in revenue ($100 from depreciation and $90 from return on rate base).

All regulatory bodies use a "test year" to establish the dollar value of the components of "E" and "V-d." A test year is a year of actual experience that is adjusted to remove abnormalities and is then used to establish revenue requirement. As adjusted, it represents a reasonably accurate picture of the future.

Another simple example will illustrate how the NARUC formula works. Assume that a utility has yearly expenses of one hundred million dollars and a rate base minus depreciation of one billion dollars. Assume also the 40-10-50 capital structure and the 12

percent rate of return found in the example above. That utility's revenue requirement, i.e., the amount it is entitled to collect from its rates in the test year, would be $220 million ($220 million = $100 million + ($1 billion) 12%).

The bottom line is that the formula is designed to allow a utility to receive enough revenue to (1) recover its prudent expenses and (2) afford its shareholders an opportunity to earn a fair return on prudent investment. "E" accomplishes the former; "(V – d)r" permits the latter.

2. A key point about the ratemaking formula

Note that R = E + (V - d)r allows different regulators to arrive at the same revenue requirement in different ways. Fifty regulators could arrive at the same revenue requirement in 50 different ways. In fact, there are so many variables in the formula that there are literally an infinite number of ways that an infinite number of regulators could use to arrive at a given result.

While regulators look at a number of issues in setting rates, what is important is that the bottom line--the price--be "fair and reasonable." A number of parts make up the whole, but there are an infinite number of combinations of those parts that can allow us to arrive at the same whole.

An example may explain the holistic nature of ratemaking:

Assume you go to a restaurant where everything on the menu is priced ala carte. You order a salad, soup, an entree, a side dish, dessert and ice tea. Bread comes with your meal, but it's not on the menu.

If the menu shows that the salad is $4 and your bill lists it at $6, then you're entitled to $2 off, assuming all of the other prices are correct.

But ratemaking is not like ordering from an ala carte menu. It is more like ordering from a menu that offers a full meal at a fixed price, one with bread, soup, salad, entree and side dish, plus dessert and ice tea. If the price for everything is $40, and the waiter tells you that the salad accounts for $6 of the total, does it follow that you should pay only $38, given the $4 price on the ala carte menu? Or should you ask yourself whether $40 is a fair price for the package, especially when you're smart enough to know that the restaurant could have arrived at a $40 price by charging you only $4 for your salad and assessing you $1 extra for ice tea and $1, rather than zero, for bread?

While we are dealing with a price for utility service, not with ordering off an ala carte menu or a full meal menu, the example is nevertheless helpful in helping us understand how ratemaking is holistic. After all, customers are paying a rate for utility service that covers all elements of revenue requirement. They are not making separate payments for each element of revenue requirement.

Court decisions are also instructive. They stand for the proposition that courts are not interested in single issue ratemaking. Rather than delve into each element of revenue requirement, courts reviewing rate orders take a broad view, focusing on the overall effect of the orders.

An example is *Federal Power Commission v. Hope Natural Gas Pipeline*.[44] *Hope* is the leading case regarding the constitutionality of rates set by a regulator. The United States Supreme Court stated that:

> The ratemaking process under the Act, i.e. the fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interests. Thus we stated in the *Natural Gas Pipeline Co.* case that 'regulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate

[44] 360 US 591, 64 S Ct 281, 88 L Ed 333 (1944).

> concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[45]

Simply put, *Hope* states that a regulator should set rates designed to allow a regulated industry to recover reasonable expenses and earn a reasonable return on investment that serves customers.

But the court said more. It adopted what regulators know as the doctrine of end result:

> Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry * * * is at an end. The fact that the method employed to reach that result may contain infirmities is not then important.[46]

Forty-five years after *Hope*, the United States Supreme Court, in *Duquesne Light Co. v. Barasch*, reaffirmed the doctrine of end result for constitutional challenges:

> The economic judgments required in rate proceeding are often hopelessly complex and do not admit of a single correct result. The Constitution is not designed to arbitrate these economic niceties. Errors to the detriment of one party may well be canceled out by countervailing errors or allowances in another part of the rate proceeding. The Constitution protects the utility from the net effect of the rate order on its property. Inconsistencies in one aspect of the methodology have no constitutional effect on the utility's property if they are compensated by countervailing factors in some other aspect. [47]

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[45] *Id.*, at 603.
[46] 320 US at 602.

[47] 488 US 299, 314, 109 S Ct. 609, 102 Led 2d 646 (1989).

The two leading cases show that, with respect to constitutional challenges, the United States Supreme Court recognizes the holistic nature of ratemaking. The issue in those cases is the net effect of the order, not whether the court agrees with every element of it.

The conclusion that the court can order the Commission order PGE to refund to customers the amounts it collected from 1995 to 2000 for "return on" Trojan is inconsistent with the United States Supreme Court's recognition of the holistic nature of ratemaking and the end result doctrine in *Hope and Duquesne*. Meaning, the fact that the rates authorized by the Commission allowed PGE to recover "return on" Trojan in violation of ORS 757.335 does not mean that the rates, overall, were unjust and unreasonable. In fact, no court has reached that conclusion.

Notably, it appears that the Commission could have provided PGE the same recovery of Trojan investment without violating ORS 757.355 by allowing PGE a return on the investment. The Commission allowed PGE a return of 87 percent of the company's investment in Trojan. There is no problem with that.[48] But the Commission also allowed PGE return on the Trojan investment through 2011, the end of the original accounting life in Trojan.[49] And the Court of Appeals said there was a problem with that.

Of course, the Commission--**legally**--could have given PGE the same recovery of its Trojan investment--in real economic terms--by accelerating return of 100 percent (not 87 percent) of the investment and allowing no return on it. Had the Commission adopted such an approach in its 1995 order, customers in the early years would have paid higher rates than they paid under the order the Court of Appeals found to be in violation of ORS 757.355.

[48] *Citizens' Utility Board v. PUC*, 154 Or App. 702 (1998).
[49] OPUC Order No. 95-332.

We note that even the Utility Reform Project (URP), which is seeking redress from PGE in Marion County Circuit Court, as well as in the remand of these dockets, shares our view that rates can be illegal, yet still "fair and reasonable." On page 9 of a Supplemental Brief filed in the Court of Appeals in connection with docket UM 989 (Utility Reform Project, et. al, v. Oregon Public Utility Commission, CA No. A123750), URP makes such a statement. URP is making the statement to support its claim that a circuit court may have authority to award damages when rates are both illegal and "fair and reasonable."

While staff may not agree with UPR's position regarding circuit court jurisdiction, it thinks UPR is right when it points out that illegal rates can still be "fair and reasonable." In fact, that is the case in these dockets. As we point out above, the PUC could have written an order to give PGE the same money, in real economic terms, for its Trojan investment as the company received under the illegal order. Only the timing of the recovery would have been different.

Rates that are illegal, but also "fair and reasonable" invoke the well-settled legal doctrine of harmless error. The Commission, in setting rates for the recovery of Trojan investment, may not have connected the dots in the right way, but at the end of the ratemaking process, it arrived at a reasonable price for electricity service.

I. Even if the Commission has authority to order PGE to refund amounts PGE recovered for "return on" Trojan, its authority is limited to amounts PGE collected under the Commission's order in Docket No. UE 88.

The Commission's order in Docket No. UE 88 was superceded by another rate order eight months later. Neither that order, or other orders that superceded it (prior to the Commission's 2000 order in Docket No. UM 989), were appealed. In absence of any

challenge to these orders, there is simply no authority for the Commission to order PGE to refund amounts obtained under those orders.

CONCLUSION

Staff recommends that the Commission conclude it has no authority to determine and provide to PGE ratepayers, through rate reductions or refunds, a remedy for the amounts that PGE collected in violation of ORS 757.355 between April 1995 and October 2000.

DATED this 20th day of June 2007.

Respectfully submitted,

HARDY MYERS
Attorney General

s/Stephanie S. Andrus
Stephanie S. Andrus, #92512
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SENATE BUSINESS, HOUSING AND FINANCE
Bill No. 2145
Exhibit D
Date MAY 21 1987
Rep Eachus/P.U.C

BEFORE THE SENATE BUSINESS, HOUSING & FINANCE COMMITTEE

HOUSE BILL 2145

Testimony of Charles Davis
Oregon Public Utility Commissioner

May 21, 1987

Background

To explain the reasons for this legislation, it is first necessary to describe some principles used in setting utility rates.

Utility rates are set for the future. All rates now in effect are based on expectations of utility company expense for this period. Those expectations were based on facts presented at the time the Commissioner set rates. As with any forecast, those expectations of the future can never be exactly correct. Whether or not a utility has net earnings during the time today's rates are in effect, the utility cannot ask for an increase in rates to make up past losses or improve past earnings.

If in looking to the future the utility expects its present rates will not cover its expenses and provide a reasonable rate of return for its investors, it may apply to the Commission for authorization to increase its rates. In doing so, its proof of need is based on its future expectations.

There are a few circumstances in which expenses unanticipated at the time rates were approved by the Commissioner would have been included in rates had the Commissioner known of them. These often are the result

of governmental action. In part, that's what HB 2145 seeks to address. For example, the Oregon Legislature mandated certain weatherization programs. Since the expense of these programs to the utilities could not be predicted accurately, the Public Utility Commissioner authorized the companies to accumulate those costs for a time before rates were increased to recover them.

Similarly, the Nuclear Regulatory Commission has on prior occasions reduced the cost to Portland General Electric for processing spent fuel from Trojan. PGE, therefore, had collected more from its customers, for this purpose, than it would need. The management of PGE did not achieve these savings by superior management. The company realized the savings as the result of governmental action.

In all these instances, it is not a question of <u>whether</u> the changes in revenue or in expense resulting from government action will be included in rates charged for service, it is a question of <u>when</u> that should begin. It would be almost impossible to conduct a utility rate review each time these mandated changes occur. Hence, it has seemed reasonable to defer consideration of these governmentally imposed reductions or increases in expense to the next formal review of all expenses to be incurred by the utility in providing service.

There is a rule of law that utility rates may not be made retroactively in absence of express statutory authority. This rule prohibits a utility from recovering past costs in

future rates and prohibits a regulator from taking a utility's past profits, lawfully earned.

From the customer's viewpoint, the principle underlying the prohibition against retroactive ratemaking is that the customer should know what a utility service costs him at the time he takes it. The posted tariff on the day of service represents a contract between the customer and the utility. The customer should not expect to pay more and the utility should not expect to get less. To the extent past costs are reflected in future rates or past utility profits are taken away in future rates, they benefit or burden future purchasers of the service (not necessarily the same ones who caused the cost) and compromise this principle.

HB 2145

This measure is designed to allow the Commission to make rates retroactively in certain situations. Generally speaking, it allows the Commission to include in rates those costs which have been imposed retroactively upon a utility by another governmental agency and which the utility therefore had no opportunity to predict in a rate proceeding. In such case, the utility could not have increased its rates in anticipation of the retroactive levy.

Secondly, the proposed measure allows the Commission to make rates retroactively in cases where the utility asks that a cost be deferred or the Commission believes income amounts should be deferred and not reflected in rates until a later date. A rate-making delay may be preferable either

because (a) the full extent of the costs, that is, the net cost, will not be known until a future time, or (b) a rate change, otherwise authorized, should be matched with other costs or benefits or matched in time with other rate changes.

In both of these situations, if the amounts in question are later amortized in rates, the rates are said to be made retroactively because they reflect recovery of expenses or income already incurred by the utility, as opposed to amounts expected in the future. However, I believe that there are instances in which retroactively made rates are in the public interest. HB 2145 gives the Commission the authority to make retroactive rates in these instances.

The Attorney General's Office has advised the Public Utility Commission that current statutes do not allow the deferral of ratemaking to accommodate many of these changes in expense or income between formal rate proceedings. Attachment 1 is a copy of the Attorney General's Opinion, issued March 18, 1987.

In my judgment, the practice of deferred recognition for some kinds of transactions is appropriate. HB 2145 would give the Commission explicit authority to follow this practice. Attachment 2 is a listing of deferred accounts as of December 31, 1986. The listing shows the variety of circumstances under which deferred accounts have been created. HB 2145 would establish the conditions for future rate recognition of these deferrals as well as for creation of new deferred accounts and eventual rate treatment.

My staff has discussed HB 2145 with all known interested parties, including representatives of regulated utilities, industrial customers, and consumer groups. The engrossed House Bill results in part from those discussions as well as from continuing review by the Attorney General's office.

Section-by-Section Analysis

The bill specifies the circumstances under which deferred amounts may be allowed. The provisions of the bill are permissive, not mandatory. The PUC may authorize deferrals, but is not required to. Public notice is required. The Commission will assess the reasonableness of deferral by requesting public comment before the deferral is allowed. (Section 2(2)) The only exception to the notice requirement is where a governmental body imposes amounts retroactively.

All parties and ratepayers are protected by the requirement that general rate case procedures be used before rates are changed to include deferred amounts. (Sec. 2(4)) Those procedures include notice to all parties, filing of evidence by the utility, and hearings if requested. Section 2(4) also requires a review of the utility's earnings at the time of application. The earnings review will allow the Commission to determine whether amortization of deferred income or expense amounts is warranted based on the utility's earnings; if earnings are higher than authorized, expense amortization through rates will not be appropriate.

An additional safeguard is provided by Section 2(3). To encourage timely action by utilities, deferrals may begin no earlier than the date of application. If an increased expense level begins in January, but an application is not made until July, the January through June increases in costs must be absorbed by the company.

Section 2(6) represents a final protection for ratepayers. The section provides a 3 percent cap on the sum of all amortizations in any one year. The provision should serve to prevent rate shock from deferrals.

Some examples of the types of situations covered by the bill may be useful. I will present them in the order in which they appear in the bill.

Sec. 2(1)(a) Amounts lawfully imposed retroactively by order of another governmental agency.

Retroactive tax increases would be covered by this provision. Although not common, there have been occasions when this has occurred. In recent years there have been special property tax assessments, and the Federal Tax Reform Act of 1986 disallowed use of most investment tax credits retroactive to the first of the year. If these amounts are material, recovery in rates could be permitted.

Sec. 2(2)(a) Amounts incurred by a utility resulting from changes in the wholesale price of natural gas or electricity approved by the Federal Energy Regulatory Commission (FERC).

The FERC has responsibility for setting wholesale natural gas and electricity rates. Particularly for gas distribution companies, these costs may be quite significant. This subsection would allow deferral if necessary to match up both refunds and cost increases with the timing of a general rate change or to coordinate with other income or expense changes.

Sec. 2(2)(b) Balances resulting from administration of Section 5(c) of the Pacific Northwest Electric Power Planning and Conservation Act of 1980 (Regional Act).

The Regional Act established a mechanism through which residential and certain other customers of investor-owned electric utilities (IOU's) were to get benefits associated with the federal hydroelectricity system. The Bonneville Power Administration (BPA) administers the process. IOU's file with the BPA on behalf of eligible customers and pass the benefits on through regular billings. The BPA has frequently adjusted the amounts payable to IOU's. The PUC has authorized a deferral mechanism to assure that ratepayers get the appropriate benefit as finally settled. This subsection would authorize continued use of this "true-up" procedure.

Sec. 2(2)(c) Amounts incurred by a utility which the Commission finds should be deferred in order to minimize the frequency of rate changes, or the fluctuation of rate levels, or to match the costs borne and benefits received by ratepayers.

This subsection covers the many occasions when a legitimate ratemaking income or expense item is changing and the PUC believes rates should be adjusted as a result, but finds that rate changes should take place at some subsequent time.

For example, expense reductions might occur in thesecond quarter of a year, but it is known at the time that an expense increase, perhaps a wholesale rate change, will occur in the fourth quarter of the year. To avoid a rate decrease followed in short order by a rate increase, it may be preferable to accumulate the expense decreases and use them to offset, in whole or in part, the subsequent expense increase.

We currently have an example of such a situation. The Tax Reform Act of 1986 reduces Pacific Power & Light Company's federal income tax charges for 1987. Rates could be reduced early in 1987 for this change. But the BPA has filed notice of an expected rate increase effective October 1, 1987. It could be appropriate to defer and accumulate certain of the benefits arising from the tax expense decreases, with interest, and use them to offset BPA-related cost increases.

The subsection also refers to permitting deferrals to match costs and benefits. Considerations of this type led to spreading costs of weatherization programs over a ten-year period. The reasoning was that weatherization measures would produce benefits lasting for some time. It seemed inappropriate to charge costs only to ratepayers at the time the weatherization expenses were incurred.

Section 2(5) provides authorization for completion of amortizations begun, continued deferral of amounts already existing, and continued use of accounts authorized as of the effective date of the bill. To the extent rate action has not already been ordered, however, we intend to apply the procedures embodied in Section 2(4). In addition, utilities will have to apply for reauthorization of existing accounts. Public notice will be required and hearings will be held at the request of any interested party.

This legislation would clarify the authority of the Commission to use deferred accounting when it is deemed by the Commission to be in the public interest to do so.

I urge your adoption of HB 2145.

Jack Socolofsky from the Attorney General's office and Bill Warren from my staff are here to assist in answering questions you may have.

ah/1123H

CERTIFICATE OF SERVICE

I certify that on June 20, 2007, I served the foregoing upon all parties of record in this proceeding by delivering a copy by electronic mail and by mailing a copy by postage prepaid first class mail or by hand delivery/shuttle mail to the parties accepting paper service.

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