BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1147 (Phase III)

In the Matter of PUBLIC UTILITY COMMISSION OF OREGON Staff Request to Open an Investigation Related to Deferred Accounting.	STAFF REPLY COMMENTS

In Order No. 06-507, the Commission directed staff and the parties to this docket to determine what interest rate should apply to deferred amounts once they are approved for amortization. The Commission concluded that once deferred amounts are approved for amortization,

> the amortized amount differs from an investment in terms of the risk associated with it, and with regard to the principles of ratemaking. We find that the amortized portion of a deferred account is a short-term fixed (as opposed to forecast) investment that will be recouped.[1]

Staff proposes that the Commission apply a blended 1-3-5 year Treasury Rate to all deferred amounts after amortization is authorized. The Industrial Customers of Northwest Utilities ("ICNU") supports staff's proposal.[2]

PacifiCorp and Portland General Electric Company ("PGE") assert that if the Commission is not going to use the utilities' authorized rate of return ("AROR") as the applicable interest rate, the Commission should use the utility's embedded cost of long-term debt.

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[1] Order No. 06-507 at 6.
[2] Opening Comments of ICNU.

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Question No. 1: What is the rate of return that should be applied to deferral accounts after amortization is granted?

PGE asserts that the Commission should use three criteria in its determination of the appropriate interest rate for deferred amounts approved for amortization and asserts that these criteria are met by the utilities' embedded cost of debt. PGE's three criteria are that the interest rate used by the Commission should (1) reflect the utility's costs, (2) recognize the typical timing of deferrals, and (3) be readily verifiable and transparent. PGE's first two criteria are inconsistent with Order No. 06-507, as is its proposal to use embedded cost of debt as the interest rate for deferred amounts approved for amortization.

At issue in Phase II of this proceeding was whether a different interest rate should apply to deferred amounts after amortization is approved. In addressing the parties' arguments, the Commission rejected the argument that it is inappropriate to distinguish between the period before and after amortization.[3] The Commission further concluded that once a deferred amount is approved for amortization, it is a "short-term, fixed (as opposed to forecast) investment that will be recouped."[4]

Notwithstanding these conclusions in Phase II, PGE argues that the interest rate for deferred amounts approved for amortization should recognize the typical timing of *deferrals*. PGE explains that this period includes the period after the deferral application and before the deferral itself is approved, (which could be 6 to 12 months), the period before amortization, (which could be two to three years), and amortization. PGE's assertion is not well taken. The Commission's Phase II order makes clear that the Commission believes it is appropriate to distinguish between the period prior to the amortization order and the period after.

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[3] Order No. 06-507 at 5 (noting that a particular statement of PGE's "does not support PGE's argument that it is inappropriate to distinguish between the period before and after amortization.").

[4] Order No. 06-507 at 6.

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Similarly, PGE's criterion regarding the utility's costs refers to the costs the utility incurs immediately upon the deferral event and for which the utility "await[s] recovery while the Commission engages in an often protracted two-stage process."[5] Again, this assertion is not consistent with the Commission's order in that PGE's argument blurs the period before amortization is approved with the period after the amortization order. In Order No. 06-507, the Commission noted that once deferred amounts are approved for amortization, the deferred amount is a short-term, fixed investment. The Commission noted that even if utilities do not currently separately fund amortizing accounts, there appeared to be no barrier to doing so.

PacifiCorp argues that if the Commission is not going to use AROR, its embedded cost of debt is the only other appropriate interest rate. PacifiCorp's proposal is based in part on its assertion that it does not fund deferred accounts through discrete issuances of short-term debt instruments. PacifiCorp asserts that the Commission acknowledged this when it held in its Phase II Order that utilities should not cull out the funding of unamortized deferred accounts from other utility investments.[6] PacifiCorp further argues that imposing short-term costs of debt on deferred amounts approved for amortization would present a mismatch of costs and that due to the volatility of the short-term debt rate, applying it to amortized amounts would be procedurally complex and administratively burdensome.[7]

First, while the Commission did say that deferred amounts should not be culled out from other utility investments pre-amortization, this conclusion does not hold true for deferred amounts once an order approving amortization has been issued. The Commission expressly held that after amortization is approved, a deferred amount differs from other utility investments "in terms of the risk associated with it, and with regard to the principles of ratemaking."[8] The

[5] Portland General Electric Company's Opening Comments at 2.
[6] Pacific Power Initial Comments Phase III at 2.
[7] Pacific Power Initial Comments Phase III at 2.
[8] OPUC Order No. 06-507 at 5.

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Commission also noted that although utilities may not currently fund such amounts with short-term debt, there appeared to be no prohibition to doing so.[9]

Second, PacifiCorp's concerns regarding the volatility of short-term debt rates, the need for administrative ease, and the potential for mismatch of costs if such a short-term rate is applied, do not lead, exclusively, to the use of the utility's embedded cost of debt. These concerns are also addressed by using staff's proposal for a blended 1-3-5 year Treasury Rate.

Using the utilities' embedded cost of debt as the appropriate interest rate is not appropriate because there is no correlation between this historic cost and the forward-looking cost associated with any deferred amounts approved for amortization.[10] First, the terms of the debt included in the utilities' embedded cost of debt exceed the terms of the amortization periods for the utilities' deferred accounts. The utility's embedded cost of debt is an average of the utility's historic costs to fund debt with terms that are sometimes longer than thirty-years. In fact, the average maturity of PGE's embedded cost of debt based on Results of Operations for 2006 is approximately 22 years. Similarly, based on PacifiCorp's testimony in UE 179, its average maturity of embedded cost of debt is nearly 21 years.[11]

Second, the embedded cost of debt include costs of long-term debt issued years, and maybe decades, ago. The risks inherent in the bond market and specific to each company twenty years ago are likely markedly different than the forward-looking risks associated with a deferral that has been approved for amortization today. The embedded cost of a utility's debt is not intended to and will likely never match the forward-looking cost of funding a "short-term, fixed (as opposed to forecast) investment that will be recouped."

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[9] OPUC Order No. 06-507 at 6.

[10] PGE's and PacifiCorp's embedded costs of debt, as established in their last two general rate proceedings, are 6.48 percent and 6.32 percent, respectively.

[11] Attached - See Attachments A and B.

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Question No. 2: How should the post-amortization rate of return be established?

PGE notes that the interest rate to be applied to deferred amounts approved for amortization should be "readily verifiable and transparent."[12] PacifiCorp's comments make clear that it would prefer to avoid administrative and procedural complexity. Staff agrees with both PGE and PacifiCorp on these points. Staff's proposal to determine the interest rate by taking an average of 1-3-5 year Treasury Rates published the last two Fridays of each December is an administratively simple process and results in a rate that is readily verifiable and transparent.

Question No. 3: Are there exceptions that should apply to Idaho Power?

As noted in its opening comments, staff does not recommend a specific exception for Idaho Power. However, under staff's proposal, a utility may ask for a specifically-determined interest rate for deferral amounts that have an amortization rate that exceeds three years. Staff believes the criteria for the exception should be based on the risks inherent in a fixed (as opposed to forecast) investment that will be recouped. Further, the parties should consider that staff's proposal uses the average 1-3-5-year Treasury rate for very short amortization periods as well as those near three years in length. Staff envisions the exception will be used sparingly and for more extreme cases.

Question No. 4: How should the rate of return be set for accounts that are currently accruing prospective deferrals?

PGE states that there are two different types of deferred accounts that accrue prospective deferral amounts during amortization. PGE explains that the first type of account is one in which amounts that have been deferred in the past are amortized while the account continues to defer current amounts, which are then considered for amortization in a future period. The second type of ongoing deferral use a balancing account where the amortization amount is set to achieve a zero balance to recover or refund both (1) amounts that have been deferred in the past, and (2)

[12] Portland General Electric Company's Opening Comments at 1.

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amounts that are expected to be deferred during the amortization period.[13] For the first type of account, PGE proposes that the utilities separate the components of the account and apply AROR to the "deferral-only balance" and the amortization rate to the amortization-only balance or, apply a weighted average of the two rates. For the latter type of deferred account, PGE proposes that the Commission apply only the AROR.

Staff disagrees with PGE's proposal to apply AROR to balancing accounts. First, to the extent the Commission has authorized a utility to amortize amounts in a balancing account, the risk associated with those amounts is minimal. Accordingly, it is appropriate to apply a rate that is different than the utility's AROR to those amounts. Further, the amortization period of amounts in balancing accounts that are approved for amortization is generally one year. It is appropriate to apply staff's proposed blended 1-3-5 year Treasury Rate to such amounts.

Staff is unclear as to what PGE intends regarding first type of deferred account that accrues prospective deferrals. However, it is staff's position that when a deferred amount has been approved for amortization, it is appropriate to apply the Commission determined interest rate to that amount, no matter whether the deferred account continues to accumulate amounts that are not yet approved for amortization.

Question No. 5: How should the rate of return be set for accounts under the provisions of the 1980 Act?

PacifiCorp argues that the Commission should not require utilities to change the interest rate they currently apply to BPA accounts. In support of this argument, PacifiCorp asserts that ORS 757.259 approval is not needed for the balancing account for Residential Exchange Payments, that PacifiCorp calculates monthly carrying charges on the BPA balancing account only when there is a credit balance, that the short-term rate used by BPA was authorized in a September 29, 1981 letter to PacifiCorp from the Assistant Commissioner, and that "the

[13] Portland General Electric Company's Opening Comments at 4.

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treatment of the BPA balancing account * * * is unique."[14] Similarly, PGE asserts that ORS 757.259 approval is not needed to pass all of BPA's residential exchange benefits to customers. Neither PacifiCorp's nor PGE's assertions regarding the "BPA balancing accounts," persuasively demonstrate that the Commission should treat these accounts differently than other deferred accounts.

First, the issue is not the creation of the account, but the amount of interest that utilities may recover from customers. The Commission has authority to determine the interest rate to apply to these accounts.

Second, the fact that PacifiCorp received authorization in 1981 for the interest rate it currently applies is not material. All the utilities may be required to change the previously-authorized interest rate they have applied to deferred amounts approved for amortization. That PacifiCorp had authorization to use a particular interest rate for this account does not mean that this account should be exempt from any interest rate determined in this docket.[15]

Third, staff does not believe that the fact that PacifiCorp will apply an interest rate to these amounts in Oregon that differs from the interest rate applied in other states is a persuasive argument against a different interest rate.

Finally, to the extent PacifiCorp chooses not to apply any interest to charges owed by customers in the balancing account, PacifiCorp may continue to do so under staff's proposal.

Question No. 6: Should there be a materiality threshold under which the post-amortization return is not reset?

PGE and PacifiCorp both argue that the Commission should establish a materiality threshold to minimize administrative effort and cost. Staff disagrees. If the amounts are

[14] Pacific Power Initial Comments at 5-6.

[15] Staff notes that PacifiCorp's use of the short-term rate is inconsistent with its proposal to apply embedded cost of debt to deferred amounts approved for amortization.

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sufficient to warrant amortization, they should be sufficiently material for application of the interest rate determined in this docket.

Question No. 7: Should the newly established post-amortization rates of return apply to existing deferrals or should it be applied on a prospective basis.

PacifiCorp asserts that any Commission-approved interest rate should only be applied to prospective deferrals because retroactive application of legislation and regulations is "strongly disfavored and should be avoided."[16] PacifiCorp relies on no authority to support this statement, and staff believes that there is none in Oregon.[17] The Oregon Supreme Court has held that barring constitutional limitations, the legislature is free to impose any special conditions it desires upon its enactments. [18] This is true even when the retroactive application affects economic interests.[19] And, this is true when the enactment at issue is one of an administrative agency rather than the legislature. [20] Accordingly, if this Commission desires to apply any newly-determined rate to existing deferrals, it may, and is not, as PacifiCorp suggests, obligated to "avoid" doing so.

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[16] Pacific Power Initial Comments at 7.

[17] Pacific Power may have relied on the 1981 Court of Appeals opinion in *Whipple v. Howser*, 51 Or App 85, 624 P.2d 648 (1981), for its statement that retroactive legislation and regulations are disfavored. In that case, the Oregon Court of Appeals did state that "retroactive application of new laws is disfavored" and held that certain legislation should not be applied retroactively." However, the Court of Appeals was reversed by the Supreme Court. The Oregon Supreme Court held that barring constitutional limitations, the legislature is free to impose any special conditions it desires upon its enactments, and that the judiciary's role on review is to discern whether the legislature intended retroactive application; not to make its own policy judgments. *Whipple v. Howser*, 291 Or 475, 480, 632 P2d 782 (1981). Staff is not aware of an Oregon opinion since the Court of Appeals' 1981 opinion in *Whipple v. Howser* that includes the "disfavored" language.

[18] *Whipple v. Howser*, *supra*, 291 Or at 480.

[19] *See e.g.*, *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 15 (1975) ("It is by now well established that legislative Acts adjusting the burdens and benefits of economic life come to the Court with a presumption of constitutionality, and that the burden is on one complaining of a due process violation to establish that the legislature has acted in an arbitrary and irrational way."

[20] *See May Trucking Co. v. Department of Transportation*, 203 Or 564, 573, 126 P.3d. 695 (2006).

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PGE asserts that any newly-determined interest rate should apply to amounts approved for amortization for prospective deferrals and to deferred amounts that have not yet been authorized for amortization. PGE asserts that any newly-determined interest rate should not apply to amounts currently being amortized. Staff disagrees. Currently, when the Commission modifies a utility's authorized rate of return, the new rate is applied to existing deferred accounts, including those already amortizing. In the same manner, there is no reason the new interest rate adopted in this proceeding should not apply to deferrals currently being amortized. The Commission has held that the utility's AROR exceeds the risk associated with these amounts.

DATED this 3rd day of October 2007.

Respectfully submitted,

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5	$200,000,000	1,000,000,000
10	$500,000,000	5,000,000,000
10	$200,000,000	2,000,000,000
10	$200,000,000	2,000,000,000
30	$300,000,000	9,000,000,000
30	$200,000,000	6,000,000,000
30	$300,000,000	9,000,000,000
20	$419,943,000	8,398,860,000
18	$48,972,000	881,496,000
19	$4,422,000	84,018,000
20	$19,772,000	395,440,000
21	$16,203,000	340,263,000
22	$28,218,000	620,796,000
23	$46,946,000	1,079,758,000
24	$18,750,000	450,000,000
25	$19,609,000	490,225,000
sum	$2,522,835,000	19 avg years

Source: FMBs Exhibit 301

20	$8,000,000	160,000,000
20	$20,000,000	400,000,000
20	$20,000,000	400,000,000
20	$25,000,000	500,000,000
20	$3,000,000	60,000,000
20	$1,000,000	20,000,000
20	$2,000,000	40,000,000
20	$3,000,000	60,000,000
30	$15,000,000	450,000,000
30	$5,000,000	150,000,000
30	$5,000,000	150,000,000
30	$4,000,000	120,000,000
20	$10,000,000	200,000,000
30	$15,000,000	450,000,000
30	$8,000,000	240,000,000
30	$12,000,000	360,000,000
30	$50,000,000	1,500,000,000
30	$10,000,000	300,000,000
30	$25,000,000	750,000,000
30	$26,000,000	780,000,000
30	$4,000,000	120,000,000
30	$5,000,000	150,000,000
30	$11,000,000	330,000,000
30	$27,000,000	810,000,000
30	$15,000,000	450,000,000
30	$30,000,000	900,000,000
30	$2,000,000	60,000,000
30	$2,000,000	60,000,000
30	$5,000,000	150,000,000
30	$12,000,000	360,000,000
30	$16,000,000	480,000,000
30	$20,000,000	600,000,000
30	$100,000,000	3,000,000,000
10	$200,000,000	2,000,000,000
12	$125,000,000	1,500,000,000
sum	$841,000,000	21.5

Source: PPL Exhibit 301, MTNs tab

total avg maturity (years)	20.9

30	$46,500,000	1,395,000,000
30	$16,400,000	492,000,000
28	$8,300,000	232,400,000
30	$17,000,000	510,000,000
30	$15,000,000	450,000,000
25	$45,000,000	1,125,000,000
30	$8,500,000	255,000,000
30	$5,300,000	159,000,000
30	$22,000,000	660,000,000
30	$9,365,000	280,950,000
30	$8,190,000	245,700,000
30	$121,940,000	3,658,200,000
30	$15,060,000	451,800,000
19	$40,655,000	752,117,500
30	$21,260,000	637,800,000
[redacted]		
30	$11,500,000	345,000,000
25	$70,000,000	1,750,000,000
25	$45,000,000	1,125,000,000
30	$50,000,000	1,500,000,000
30	$45,000,000	1,350,000,000
30	$63,000,000	1,890,000,000
28	$22,485,000	629,580,000
28	$9,335,000	261,380,000
28	$6,305,000	176,540,000
30	$24,400,000	732,000,000
34	$12,675,000	430,950,000
sum	**$760,170,000**	28 avg. years

Source: PPL Exhibit 301, PCRBs tab

avg years

Term	Proceeds	
10	100	1000
8	0	0
10	50	500
10	50	500
20	50	1000
30	50	1500
30	20	600
30	175	5250
25	100	2500
12	50	600
10	149.25	1492.5
35	23.6	826
35	97.8	3423
35	21	735
25	20.2	505
25	16.7	417.5
24	9.6	230.4
24	5.1	122.4
Sum	988.25	21.5 Avg Years

Source: December 2006, Workpapers 19, PGE's Regulated Results of Operations for 2006

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CERTIFICATE OF SERVICE

I certify that on October 3, 2007, I served the foregoing upon the parties in this proceeding by electronic mail and by sending a true, exact and full copy by regular mail, postage prepaid, or by hand-delivery/shuttle, to the parties accepting paper service.

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