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VIA ELECTRONIC FILING

PUC Filing Center
Oregon Public Utility Commission
P.O. Box 2148
Salem, OR 97308-2148

Re: PacifiCorp's Opening Comments Phase II
Docket No. UM 1147

Enclosed for filing are PacifiCorp's Opening Comments Phase II in the above-referenced matter. A copy of this filing has been served on all parties to this proceeding as indicated on the attached certificate of service.

Very truly yours,

Katherine A. McDowell

KAM:knp
Enclosure
cc: All parties of record

Oregon
Washington
California
Utah
Idaho

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UM 1147

In the Matter of PUBLIC UTILITY COMMISSION OF OREGON Staff Request to Open an Investigation Related to Deferred Accounting	**PACIFICORP'S OPENING COMMENTS PHASE II**

I. INTRODUCTION

In Order No. 05-1070, adopting deferred accounting principles, the Commission called for further investigation regarding the Commission's existing policy of applying an interest rate to deferred accounts that is equal to the utility's authorized rate of return. *In re Staff Request to Open an Investigation Related to Deferred Accounting*, UM 1147, Order No. 05-1070 at 13-14 (Oct. 12, 2005). PacifiCorp submits these opening comments in support of continuation of the Commission's current policy.

In Phase I of UM 1147, Staff proposed use of a lower interest rate for deferred accounts based on the premise that deferred accounts present less risk of recovery than other utility investment. Staff Comments at 7 (Oct. 7, 2004). However, the Commission has never sorted through PacifiCorp's investments in this manner and imputed lower returns than the Company's weighted cost of capital based upon the perceived low risk of recovery. Nor has the Commission ever proposed to permit increased returns on investments when the risk of recovery appears high. This is because: (1) the risk of recovery of a particular expenditure is irrelevant to traditional cost of capital analysis; and (2) PacifiCorp's investments are not financed discreetly and instead rely on PacifiCorp's overall mix of debt and equity. For these reasons, PacifiCorp respectfully requests that the Commission retain its current policy of applying a utility's authorized cost of capital to deferred account balances.

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II. ARGUMENT

A. The Commission Should Retain Its Policy of Applying a Utility's Authorized Cost of Capital to Deferred Account Balances.

Historically, a utility's deferred accounts have earned interest based on that utility's cost of capital, as approved in the utility's most recent general rate case. Order No. 05-1070 at 12. The Commission's long-held position has been that "any dollar is fungible and can be used for alternative purposes, and accordingly, each item for which a return is allowed should receive the same return." Staff Comments at 2 (Jan. 18, 2005). In Phase I of UM 1147, Staff challenged this theory, arguing that utility investments are distinguishable in terms of risk of investment recovery. *Id.* Accordingly, Staff recommended that deferral accounts, authorized by the Commission under ORS 757.259(2)(b) or (c), should be set quarterly at the rate of a 1-year Treasury. *Id.* at 1. For all other deferred accounts, Staff recommended an average of the 1-, 3-, and 5-year Treasury rates, recalculated each quarter. *Id.*

Deferred expenses represent amounts expended by shareholders to serve the public. Staff's proposal ignores the fact that PacifiCorp's investments are not financed discreetly and instead rely on PacifiCorp's overall mix of debt and equity. Therefore, it is inappropriate to consider the individual risk profiles of recovering specific accounts to establish individualized returns. Shareholders are entitled to the same return on these funds as they are authorized to receive on other capital dedicated to public service. Accordingly, the Commission should continue its policy of applying a utility's authorized overall rate of return to deferred balances.

Staff's proposal also fails to take into account that a utility's overall rate of return reflects a mixture of risks. PacifiCorp's overall rate of return is a weighted average that reflects a spectrum of financial risks associated with investments that are amortized over varying time horizons and entail a range of financial risk. Order No. 05-1070 at 14 ("rate of return * * * reflect[s] * * * overall level of financial risk faced by the utility with regard to

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forecasted costs and revenues). Staff acknowledges that "deferrals in and of themselves reduce the overall riskiness of a company." Staff Comments at 3 (Jan. 18, 2005). Yet, Staff appears to ignore the fact that a utility's overall return on equity also reflects a reduced risk associated with some shorter-term investments.

PacifiCorp does not believe the Commission should depart from its historic application of the company's overall rate of return to deferred accounts and begin assigning individual rates of return to investments piecemeal. The Commission has previously recognized that rates should "provide the utility's investors an opportunity to earn a return that is commensurate with those earned in *enterprises* of similar risk and sufficient to enable the company to attract capital." *In the Matter of Qwest*, UT 125/UT 80, Order No. 00-191 at 25 (italics added). The Commission has not historically established rates of return on the basis of risk commensurate with those earned on *projects* of similar risk. The Commission should not depart from its long-standing practice of authorizing a rate of return based on the risks of similar enterprises to instead assign rates of return piecemeal based on the risks of individual investments.

B. Imposing A Lower Rate of Return on Deferred Accounts Would Be Asymmetric and Therefore Unfair and Unreasonable.

In Phase I of UM 1147, Staff and customer groups claimed that allowing interest on deferred accounts at the rate of return authorized on all a utility's investments results in a utility earning more than is commensurate with the risk of recovery for deferred accounts. Staff Comments at 2-3 (Jan. 18, 2005); ICNU Comments at 17 (Jan. 18, 2005); CUB Comments at 10-11 (Jan. 18, 2005). However, Staff's proposal would selectively lower the interest rates for deferred accounts without making corresponding adjustments for higher risk investments.

PacifiCorp has a wide range of assets that carry varying degrees of financial risk. Investments with a higher risk of recovery do not receive a higher return. If Staff's theory is

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to be applied consistently and equitably, the cost of capital applicable to investments that are of higher risk must be increased to reflect the individual risk of those specific investments. Any change in Commission policy must be symmetric in its allocation of burdens and benefits to customer groups and utilities, otherwise the policy fails to be fair and reasonable.

C. The Risk of Recovery of a Particular Expenditure is Irrelevant to Traditional Cost of Capital Analysis.

In Phase I of UM 1147, Staff argued that deferrals do not pose the same earnings and economic risks as do rate-based, long-lived assets. Staff Comments at 2 (Jan. 18, 2005). Staff claimed that the risk is lower for deferred account balances because "an order authorizing amortization of amounts accumulated, or accumulating, in a deferred account has the effect of 'guaranteeing' the money stream against fluctuations in revenue drivers such as loads and weather." Staff Comments at 5 (Oct. 7, 2004). Therefore, Staff argued, the disparity in risk of recovery between different assets should be captured in the interest rates that apply to the assets. Staff Comments at 2 (Jan. 18, 2005).

The risk of recovery of a particular cost is not an appropriate consideration in setting the interest rate on deferred accounts. Utilities must fund and pay financing costs or attract capital to fund deferred accounts. These funds are often expended prior to Commission authorization of a deferred account. If it is the intention to apply an interest rate that reflects the degree of risk when funds are expended, then it is inappropriate to discuss post-authorization risk and apply a correspondingly reduced rate retrospectively.

Moreover, at the time funds are expended, there is considerable risk of less than full recovery of expenditures. Not all associated costs are recovered when a deferred account is authorized. In many situations, utilities incur some expenses before the filing of a deferral application. In addition, authorization of deferred accounting requires several layers of review, each of which entails a possibility of reduced recovery or no recovery at all. Regulatory risk is also not fully mitigated once a deferred account is authorized. Indeed,

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Staff has acknowledged that the Commission may subsequently modify prior decisions allowing deferred accounting. Staff Comments at 3 (Jan. 18, 2005). Thus, there are substantial regulatory risks associated with deferred accounts.

Utilities fund deferred accounts just like any other capital investments to which the Commission applies the utility's weighted cost of capital in the ratemaking process. Utilities should be able to recover their costs of funding deferred accounts (which is the same as its cost of funding other utility investments), no matter what the risk of recovery once an account is authorized. Anything less imposes a loss on the utility for funding deferred accounts. Revenues to support deferred accounts set at a lower return rate exposes the company to more risk by not covering its total costs.

D. Staff's Proposal is Too Cumbersome to Be Applied Efficiently.

In Phase I of UM 1147, Staff proposed application of a blended 1-, 3-, and 5-year Treasury rate, which it claimed was designed to be administratively simple. Staff Comments at 3 (Jan. 18, 2005). Staff's proposal is far from simple. Staff suggested using a calculation based on the average of the daily rates quoted for the first two weeks of the month immediately preceding the start of the new quarter. Staff Comments at 5 (Oct. 7, 2004). However, Staff acknowledges that spot prices would need to be used as of the date of Commission order authorizing deferral and updated as of the same day of the month for each subsequent three-month period. Staff Comments at 1 (Jan. 18, 2005).

Staff's proposal to use blended rates updated each quarter adds significant complexity to the tracking and auditing of deferred account balances. PacifiCorp does not identify specific types of financial sources with particular financial need. Rather, PacifiCorp's financial sources are collectively treated as a general source of funds whose weighted average cost is used to determine its authorized cost of capital. To identify debt costs to specific deferred costs is to suggest that there is specific debt funding for deferred accounts.

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In addition, the Commission has no "authorized" short-term interest rate. The Commission would have to determine on a case-by-case basis the short-term debt rate that should apply. This determination is likely to be fraught with complexity and difficulty, not the least of which is the fiction that short-term debt can be tagged and allocated to specific deferred accounts.

III. CONCLUSION

The Commission should retain its long-standing practice of applying the utility's authorized overall rate of return to deferred balances. Deferred expenses represent amounts expended by shareholders to serve the public. Shareholders are entitled to the same return on these funds as they are authorized to receive on other capital dedicated to public service.

If, however, the Commission decides to depart from its long-time policy of applying a utility's authorized cost of capital to deferred account balances, PacifiCorp believes that an evidentiary hearing is required to resolve this issue.

DATED: March 16, 2006.

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