BEFORE THE OREGON PUBLIC UTILITIES COMMISSION

UE 178

In the Matters of OREGON PUBLIC UTILITY COMMISSION STAFF directing: **Portland General Electric Company (PGE)** **To file tariffs establishing automatic adjustment clauses under the terms of SB 408.**	**BRIEF** **KEN LEWIS and UTILITY REFORM PROJECT**

PGE should not benefit (and ratepayers suffer) from a double-standard on applying earnings tests to determine whether the difference between (1) income taxes actually paid by the utility and (2) income taxes charged to ratepayers should be surcharged or refunded.

UM 1224 was fully briefed in April 2008, yet no decision has been issued. That docket concerns the $26.5 million of income taxes charged to PGE ratepayers during the last 3 months of 2005, a period during which PGE and its corporate parent, Enron, paid no income taxes at all. PGE and Staff in UM 1224 both take the position that PGE should not be required to refund excess income tax collections (quantified by Staff at $26.5 million during those 3 months), because PGE's earnings during a 12-month earnings review period (which included the 3 months) were below the authorized rate of return on investment. The arguments of Lewis and URP were set forth in their opening and reply briefs in UM 1224, which are posted on the OPUC website and for which we have already requested official notice.

If the lack of such earnings during 2005 enables PGE to avoid making a refund of excess income taxes then charged to ratepayers, then an abundance of earnings during 2007 should likewise prevent PGE from surcharging ratepayers when income taxes paid (allegedly) exceed the amount charged to ratepayers. Ratemaking which imposes surcharges despite contemporaneous excess earnings during the period at issue, but does not require refunds because of contemporaneous deficient earnings, results in unjust, unfair, unreasonable, and unlawful rates, and it violates the rule against retroactive ratemaking.

I. PGE EARNED FAR IN EXCESS OF ITS AUTHORIZED RATE OF RETURN ON INVESTMENT IN 2007.

This is proven by PGE's "OPUC REGULATORY REPORTING RESULTS OF OPERATIONS January 2007 through December 2007" [hereinafter "PGE 2007 Results of Operations Report"], for which official notice has been granted.

The PGE 2007 Results of Operations Report shows "Regulated Adjusted Results" for 2007 produced a "Return on Equity" of 11.58%. PGE 2007 Results of Operations Report, p. 1, col 5. This is higher than PGE's 10.1% authorized rate of return for 2007. The PGE 2007 Results of Operations Report uses the rate order in UE 180 (OPUC Order No. 07-015) as establishing the authorized rate of return applicable to 2007: 10.1%.

Another way of quantifying the 2007 overearning is that, under OPUC Order No. 07-015 (App F, p. 1, col 5, line 23), PGE was authorized to earn $143,306,000 in net operating revenues for 2007. In reality (under Regulated Adjusted Results for 2007),

PGE earned $180,224,000. The difference is earnings of $36,918,000 for 2007 in excess of the level authorized by OPUC Order No. 07-015.

These excess earnings generated additional income tax liability and payments for which PGE now seeks to surcharge ratepayers some $17.1 million.

II. IMPOSING A DOUBLE STANDARD ON WHETHER TO REFUND OR SURCHARGE DIFFERENCES BETWEEN INCOME TAXES PAID AND INCOME TAXES CHARGED TO RATEPAYERS WOULD PRODUCE RATES THAT ARE NOT JUST, FAIR, OR REASONABLE.

It would be fundamentally unfair to allow the utility to surcharge ratepayers for an alleged deficiency in past income tax collections, despite surplus profits during the alleged deficiency period, while not requiring the utility to refund ratepayers for excess past income tax collections, because of lower than expected profits during the excess collection period. This double-standard creates a "heads the utility wins, tails the ratepayers lose" scenario. The Oregon courts routinely reject "heads-I-win--tails-you-lose" propositions. See, e.g., ***Owens v. Bartruff***, 297 Or 610, 615, 687 P2d 1072 (1984). Utility commissions also reject such policies, even when proposed by their ratepayer advocate staff (Department of Ratepayer Advocates).

> DRA's position that rates should be adjusted retroactively if the study is favorable to ratepayers, but not if it is adverse to ratepayers, is not reasonable, and will not be adopted. Not only does it come close to the forbidden retroactive ratemaking, but, more importantly, it discourages new studies in any area of regulation. Heads I win, tails you lose, is no way to regulate.

Re Southern California Edison Co., California PUC Decision 93-01-027 (1993).

Assume that the utility has a $10 million deficiency in income tax collections in Year 1 (due to low profits) and then has $10 million in excess income tax collections

Year 2 (due to high profits). Under the PGE-Staff position, the utility would surcharge ratepayers for the $10 million deficiency but not refund to ratepayers the $10 million in excess collections.

The OPUC must be consistent in accounting, or not accounting, for past earnings in the refund-surcharge decision. The only path consistent with the rule against retroactive ratemaking is to apply no earnings test when deciding whether to refund or surcharge based on differences between past income tax payments and income taxes charged to ratepayers. This would require rejecting the PGE-Staff position in UM 1224. Accepting the PGE-Staff position in UM 1224 would render the PGE-Staff desired outcome in this UE 178 docket unfair, unjust, and unreasonable.

III. IMPOSING A DOUBLE STANDARD ON WHETHER TO REFUND OR SURCHARGE DIFFERENCES BETWEEN INCOME TAXES PAID AND INCOME TAXES CHARGED TO RATEPAYERS WOULD VIOLATE THE RULE AGAINST RETROACTIVE RATEMAKING.

The PGE and Staff position (in favor of allowing the lack of past earnings to preclude refunds (while not allowing a surplus of past profits to preclude surcharges) clearly violates the rule against retroactive ratemaking, which the OPUC has expressly followed for at least 20 years. It was set out in an opinion letter from the Attorney General to then-Commissioner, Charles Davis, who defined retroactive ratemaking as:

> "the setting of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match expenses plus rate-of-return with the rate actually established." ***State ex rel Util. Consumers Council v. P.S.C.***, 585 SW2d 41, 59 (Mo 1979) (hereafter ***Consumers Council***)* * * .

Another court stated the rule slightly differently:

"Technically, retroactive rate making occurs when an additional charge is made for past use of utility service, or the utility is required to refund revenues collected, pursuant to then lawfully established rates, for such past use."   * * *

"* * * Prospective rate making to recover unexpected past expense, or to refund expected past expense which did not materialize, is as improper as is retroactive rate making."

State ex rel Utilities Com'n. v. Edmisten, 291 NC 451, 232 SE2d 184, 194-95 (1977).

Or Opinion of the Attorney General OP-6076 (*Davis*), 1987 WL 278316 (March 18, 1987). This rule necessarily precludes applying past profits or losses in future rates.

As the Commission noted in OPUC Order No. 02-227 (pp. 8-9):

The filed rate doctrine is a companion to the rule against retroactive ratemaking, and these two concepts are cornerstones of Oregon regulatory law. Then Commissioner Charles Davis explained the connection between the filed rate doctrine and the rule against retroactive ratemaking as follows:

There is a rule of law that utility rates may not be made retroactively in absence of express statutory authority. . . . 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.

Testimony of Commissioner Charles Davis on HB 2145, March 21, 1987, at 3.

Under the filed rate doctrine and the rule against retroactive ratemaking, the Commission's ratemaking function must be prospective unless the Legislature authorizes that it be otherwise. The Oregon Attorney General Opinion No. 6076, March 18, 1987, 1987 WL 278316, at 5, notes that where the rule against retroactive ratemaking does not implicate constitutional concerns, the Legislature may authorize the Commission to act retroactively. The Oregon Legislature has authorized retroactive ratemaking in two cases: ORS 757.215(4) and (5) (permitting refunds for

> interim and nonsuspended rates) and ORS 757.259 (permitting deferred accounting orders).

Note that neither of these exceptions apply to the PGE UM 1224 excess income taxes charged to ratepayers. That PGE income tax overcollection was properly deferred, pursuant to URP request under ORS 757.259. But PGE's absence of profits during the deferral period was never deferred pursuant to any statute. PGE filed no request to defer for future collection its alleged revenue shortfall. A legally deferred amount cannot be offset against an amount that was not legally deferred (and probably never could be).

IV. APPLYING AN EARNINGS TEST AMOUNTS TO AN IMPERMISSIBLE GUARANTEED RATE OF RETURN.

The rationale for the double-standard endorsed by Staff and PGE must at its core be based on the discredited notion that PGE is *guaranteed* by the Commission to earn no less than its authorized rate of investment every calendar year.

It is an axiom of utility regulation that "[a]n authorized rate of return is not a guarantee of any level of revenues or return." (Internal quotation marks omitted.) ***Connecticut Light & Power Co. v. Public Utilities Control Authority***, 176 Conn 191, 208, 405 A2d 638 (1978). "We continue to emphasize that this commission does not guarantee any utility a rate of return or a return on equity." ***Re Washington Water Power Company*** (Case Nos. U-1008-101, U-1008-102, Order No. 12783), 17 PUR4th 70 (Idaho Public Utilities Commission 1976).

> As is well known to all concerned, the authorized rate of return is nothing more than a target, and the actual rate of return may vary considerably,

> either up or down. The rate of return authorized in the original case is not guaranteed, although rate design is agreed on and tariffs are filed to attain the authorized rate of return.

Gas Service Company v. Kansas State Corporation Commission, KanApp2d 592, 631 P2d 263 (1981).

Generally, "guaranteeing" a rate of return is simply bad public policy as it insulates the utility from poor management decisions. It removes any incentive for a regulated company to come before the Commission and prove an *entire* rate case if it is in fact under-earning and seeks a rate increase. This pernicious effect on efficient utility management was expressed by the North Carolina Utilities Commission:

> The Commission cannot guarantee that Duke will, in fact, achieve the levels of return on rate base and common equity herein found to be just and reasonable. Indeed, the Commission would not guarantee the authorized rates of return even if we could. Such a guarantee would remove necessary incentives for the Company to achieve the utmost in operational and managerial efficiencies.

Re Duke Power Company (Docket No. E-7, Sub 408), 100 PUR4th 343, 1989 WL 418577 (North Carolina Utilities Commission 1989).

The double-standard advocated by PGE and Staff has the effect of guaranteeing PGE's rate of return in low earnings years. Merely because of low earnings, say PGE and Staff, a large adjustment to rates ($26.5 million plus 3 years of interest) should not be returned to ratepayers.

V. ARGUMENTS OF INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES ADOPTED.

Ken Lewis and URP adopt the arguments of the Industrial Customers of Northwest Utilities, filed today in this docket.

Dated: March 13, 2009

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I hereby certify I FILED the foregoing BRIEF OF KEN LEWIS and UTILITY REFORM PROJECT by e-mail upon the OPUC, followed by mail of the original and 8 copies this date to the Oregon Public Utility Commission, and further I certify that I served a copy by placing a true copy in a sealed envelope and deposited in the U.S. Postal Service at Portland, Oregon, with first class postage prepaid, to:

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Dated: March 13, 2009

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