ORDER NO. 06-507

ENTERED 09/06/06

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1147

In the Matter of	)	
	)	
PUBLIC UTILITY COMMISSION OF OREGON	)	ORDER
	)	
Staff Request to Open an Investigation Related to Deferred Accounting.	)	

DISPOSITION: GUIDELINES ADOPTED

Background

In Order No. 05-1070, the Commission adopted deferred accounting principles. In that order, the Commission also determined that one issue required further investigation. Although the Commission declined to apply an interest rate different than a utility's authorized rate of return (AROR) to deferred accounts over the entire period of the deferral, the Commission determined that further investigation was warranted regarding whether a different interest rate should be applied to deferred accounts during the period of amortization. Consequently, the Commission authorized a second phase, in the above captioned docket, to consider the following questions: 1) whether a different rate of interest should be applied to authorized deferred accounts during amortization; 2) if so, what that rate should be; and 3) how it would be applied to deferred accounts that are currently accruing prospective deferrals and accounts under the provisions of the Pacific Northwest Electric Power Planning and Conservation Act of 1980 (1980 Act).

On January 24, 2006, a prehearing conference in the above captioned docket was held in Salem, Oregon. Conference participants agreed to address only the first question initially, and adopted a schedule providing for two rounds of simultaneous comments. Staff, as well as the following parties, filed comments: Idaho Power Company (Idaho Power), Portland General Electric Company (PGE), Pacific Power and Light Company (PacifiCorp), and the Industrial Customers of Northwest Utilities (ICNU).

<u>POSITIONS</u>

Staff observes that a utility's AROR reflects all of the risks associated with the utility's ability to recover the forecasted and authorized costs of service, including weather variations, operational performance, customer growth, technological innovation and regulatory review of the prudence of investments, which may include cost challenges by interest groups. As Staff summarizes, a utility's AROR reflects the utility's "regulatory risk associated with investment in the assets, economic risk with regard to performance and value of the assets and finally, political risk that the utility will not be allowed to recover its costs." Staff asserts that *none* of these risks are associated with the recovery (or payment) of deferred account balances after the Commission has approved a specific amount for amortization. Staff argues, therefore, that the utility's AROR should not be applied as the interest rate on amortized deferred accounts.

Staff also observes that, while a utility's AROR is typically applied to utility capital investments, a deferred account is a regulatory-created asset or liability, not an investment. Consequently, Staff asserts that the utilities' argument that it is inappropriate to differentiate deferred accounts from other investments, for purposes of determining a utility's return, are misplaced.

Staff further observes that a utility's AROR is not based on all sources of utility financing, but only on three financing instruments: equity; preferred stock and long-term debt. The AROR represents approximately 50 percent long-term debt, Staff asserts, which is derived from the utility's historical embedded cost. Staff argues that it is simply inappropriate to apply a utility's AROR to the short-term, incremental cost of deferred accounts. Staff also points out that the utilities maintain funds with interest rates other than the utility's AROR. For example, Staff states, utilities hold customer deposits, which, for the year 2006, earn only 4 percent interest.

ICNU also characterizes a deferred account as a regulatory asset or liability that is created by Commission authorization, and argues that a utility's AROR should only be applied to a utility's investments. ICNU also contends that a utility's AROR should not be applied to amortized deferred account balances because doing so provides a utility with an opportunity to financially benefit to the extent that a utility's AROR is higher than short-term interest rates. ICNU also contrasts amortized deferred account balances with equity investments, and questions whether a utility's return should be the same on both. ICNU urges the Commission to apply short-term interest rates to amortized deferred accounts.

PGE and PacifiCorp argue that the status quo should be maintained, with the utility's AROR being applied to amortized deferred accounts. Both PGE and PacifiCorp argue that investments are not financed discretely, and that shareholders are entitled to have the opportunity to earn the same return on all investments, including amortized deferred accounts. PacifiCorp asserts that a utility's AROR reflects a mixture of risks, including lower risks that may be associated with amortized deferred accounts.

PGE argues that applying a different interest rate to amortized deferred accounts would be a "selective and discriminatory change in Commission policy that is inconsistent with how the Commission sets rates in general rate cases." PGE characterizes the decision to be made by the Commission, in this phase of the docket, as a choice between compensating utilities for the risk they bear on an investment-by-investment basis, or continuing to compensate utilities for the overall risk they face by applying the AROR to all investments. PGE argues that the Commission already determined, in Order No. 05-1070, that it was inappropriate to evaluate risks associated with independent utility investments.

PGE also argues that a distinction between the risks that are associated with a deferred account before and after amortization is irrelevant. PacifiCorp reflects, as well, that focusing on the level of risk associated with deferred accounts after amortization, without consideration of the fact that utilities fund deferred accounts upfront when significant risk is associated with the recovery of those funds, is inappropriate. Asserting that a “singular focus on the period after amortization is inappropriate,” PGE explains:

> The relevant risk to the utility is the possibility that it will not recover its investment. For deferred accounts, that risk includes the possibility that recovery of the utility’s investment may be discounted based upon (a) a prudence review, (b) earnings test, (c) sharing or deadbands in the deferral mechanism, or (d) the incursion of costs before the filing of a deferred accounting application. These risks occur, if at all, before the Commission issues its amortization order. But that does not render the risks irrelevant. It does not eliminate the risk. In many cases, the amortization order will confirm that risk.

PGE uses PacifiCorp’s deferral of power costs during the Western power crisis, in the years 2000 and 2001, to illustrate its argument. After application of a deadband and sharing mechanism, as well as other adjustments, PGE asserts that PacifiCorp recovered just over fifty percent of the costs it sought to defer, resulting in an order authorizing amortization of $130 million. UM 995, Order No. 02-469 at 2. PGE states that the “order authorizing amortization of $130 million does not eliminate PacifiCorp’s risk,” rather it “confirms that risk.”

ICNU responds that PGE fails to fully discuss the reasons that PacifiCorp did not recover power costs incurred during the western power crisis of 2000-2001. For example, PGE fails to point out that PacifiCorp agreed, by stipulation, to a disallowance of approximately $30 million to resolve the prudence phase of UM 995. Re PacifiCorp, OPUC Docket No. UM 995, Order No. 02-469 at 2, 4 (July 18, 2002). ICNU argues that PacifiCorp may not have recovered other costs due to the deadband and sharing mechanism that the Commission adopted to protect ratepayers. Re PacifiCorp, OPUC Docket No. UM 995, Order No. 01-520 at 28 (May 11, 2001). ICNU also observes that PGE fails to mention that PGE recovered 100 percent of its deferred power costs. Re PGE, OPUC Docket Nos. UM 1008/1009, Order No. 01-231 at 2, Appendix A (Mar. 14, 2001).

PacifiCorp and PGE also complain that application of a low interest rate to amortized deferred accounts would result in asymmetric and unbalanced ratemaking. PGE asserts that it is inappropriate to lower the interest rate applied to low risk investments without increasing the interest rate applied to high risk investments. PGE argues that if the Commission lowers the interest rate applied to amortized deferred accounts, it should raise the interest rate applied to deferred accounts before amortization.

ICNU responds that deferred accounting is an exception to general ratemaking principles that do not account for changes in utility cost or revenues between rate cases. Consequently, ICNU argues, it is appropriate to make other exceptions from general ratemaking principles to handle deferred accounts.

Idaho Power asserts that its deferral situation in Oregon is unique, as compared to other utilities that serve customers in Oregon. Idaho Power explains that due to a relatively small number of customers in Oregon (approximately 18,000) and relatively low revenues (Idaho Power's 2005 normalized revenue in Oregon was $26,844,777), but high existing deferral account amounts ($11,000,000), together with the statutory amortization cap (pursuant to ORS 757.259), Idaho Power is unable to recover deferred costs in a short amount of time. Idaho Power asserts that it will take approximately three more years to recover all deferred revenues accrued prior to 2005, while it will take approximately six years to recover deferred excess power supply expenses incurred in 2005. These extended periods of time invalidate the proposed application of a short-term interest rate to amortized deferred accounts, Idaho Power argues. Idaho Power asserts that the application of a rate of return based on a utility's short-term interest rate would be appropriate only if amortization is guaranteed to be completed in less than one year.

RESOLUTION

Deferred accounting is a discrete and *exceptional* ratemaking process, and the amortization of an authorized amount of funds in a deferred account is a distinct function within the deferred accounting process. The unique nature of amortization prompted us to consider whether it is appropriate to continue applying a universal element of general ratemaking—*i.e.*, a utility's authorized rate of return—during amortization. We conclude that it is not.

In Order No. 05-1070, we determined that the deferral of certain expenses or revenues[1] separates such funds from the general ratemaking process, but does not necessarily eliminate the risks incumbent to the general ratemaking process. Instead, we viewed a utility's general level of financial risk, with regard to the ability of that utility to recover costs that were forecasted and authorized, as including the use of deferred accounting to handle costs that were not forecasted. Until a deferred account is authorized for collection by amortization, we recognize that there are attendant risks. Consequently, in Order No. 05-1070, we directed that the utility's AROR be applied to deferred accounts until amortization. In that order, however, we questioned whether

[1] Although deferred accounts may be used to track either expenses or revenues, for the sake of simplicity, we hereafter will typically refer only to the deferral of costs. Our decisions, however, shall apply to all deferrals.

those attendant risks disappear after amortization, and opened this proceeding to investigate that question.

When we authorize a deferred account to be opened, we authorize certain costs or revenues to be tracked in a balance sheet account. When we approve amortization of a specific amount of the tracked costs or revenues in a deferred account, we authorize a process whereby that approved amount will be reduced by increasing or decreasing rates over a specified period of time, typically one year. Typically, a rate adjustment is determined by dividing the amortized amount by projected annual sales of kilowatt-hours or therms. If actual sales equal estimated sales, then the amount authorized for amortization will be fully amortized at the end of the designated amortization period. Rates can be further adjusted, however, as necessary, to achieve full amortization. Pursuant to this process, amortization of a deferred account is on a dollar-for-dollar basis. Consequently, as we stated in Order No. 05-1070, we perceive little risk that the deferred account amount we authorize for amortization will not be collected by the utility.

No discussion presented in this proceeding persuades us differently. The utilities continue to focus on the risks attendant to the entire amortization process. As PGE asserts, an amortization order does not eliminate a utility's risk, but rather confirms it. While this statement may be true from the point of view that a utility will not recover more than the amount approved for amortization, the statement does not support PGE's argument that it is inappropriate to distinguish between the period before and after amortization. Rather, it does the opposite, by illustrating that amortization results in a utility receiving an approved amount of costs in rates.

What sets amortization apart from other aspects of ratemaking is the fact that a utility is authorized to actually recover an approved amount of costs. When we approve a utility's revenue requirement in a general rate case, for example, we give the utility the opportunity to recover that amount. The utility's AROR, which is part of the total revenue requirement, reflects the risks of recovery that the utility confronts in trying to collect its revenue requirement. Similarly, when we authorize a utility to set up a deferred account, we acknowledge that the utility may have the opportunity to recover the costs that were tracked in that account. Once an amount in that deferred account is approved for amortization, however, we authorize the utility to recover *that specific amount*, over a given period of time, which may be as short as one year. The question in this proceeding is whether a rate of interest other than a utility's authorized rate of return should be applied to that amount. We conclude that the answer is, yes.

Whether or not the utilities separately fund amortized accounts now, we do not discern barriers to doing so in the future. The utilities do not assert that short-term financing during the amortization period cannot be obtained. Instead, they focus on how deferred accounts are currently financed over the entire deferral period. PacifiCorp indicates that utilities currently fund deferred accounts upfront, when significant risk is associated with the recovery of the deferred costs. Although deferred accounts are created by regulation, as Staff and ICNU observe, we agree with the utilities that deferred accounts represent an investment, to the extent the utility must carry costs that are deferred. We also agree, as we already determined in Order No. 05-1070, that funding of deferred accounts, at least until some amount is amortized, should not be culled out from other utility investments.

After amortization of some specific amount in a deferred account is approved, however, we find that 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. We conclude that utilities need only be kept whole on such investments, and we resolve that a rate of return other than a utility's AROR will do so. Our determination is consistent with decisions in other states to apply interest rates other than a utility's AROR to amortized accounts.[2]

We direct Staff and parties to address, in the next phase of this docket, what the rate of return on deferred accounts should be during amortization, or how that rate of return should be established, as it may vary by utility or by deferred account. The issues raised by Idaho Power in this proceeding should be addressed in this next phase. We also direct Staff and parties to address how a new rate of return on amortized deferred accounts should be applied to deferred accounts that are currently accruing prospective deferrals, and accounts under the provisions of the Pacific Northwest Electric Power Planning and Conservation Act of 1980 (1980 Act).

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[2] *See e.g., In the Matter of the Application of Idaho Power Company for New Cogeneration/Small Power Production Rates* . . . , Idaho Public Utilities Commission, Case No. U-1006-248; Order No. 19604 (April 1985) ("We accept Idaho Power's position that it is entitled to interest to keep itself whole. We further accept the interest rates that it proposed for the accumulated amounts, based upon its actual short-term investment or borrowing rate at this time.") *See e.g., In the Matter of the Application of Avista Corporation for Authorization to Defer Costs Associated with the Hamilton Street Bridge Site*, Idaho Public Utilities Commission, Case No. AVU-G-00-1, Order No. 28512 (September 25, 2000) (Approving proposal by Avista to accrue carrying charges on deferred account using the interest rate authorized for customer deposits, which is currently 5.00% for the year 2000.) See *e.g., In the Matter of the Application of Pacific Bell, a corporation for Authority to Increase Certain Intrastate Rates and Charges Applicable to Telephone Services Furnished Within the State of California and Related Matters*, California Public Utilities Commission, Decision No. 86-01-026, 20 CPUC 2d 237 (January 10, 1986) ("For some time now we have used a variable interest rate for energy utilities' deferred energy cost accounts, and we see no reason not to use for this deferred account the same interest rate as is applied monthly to accruals under electric utilities energy cost adjustment clauses (ECAC).")

ORDER

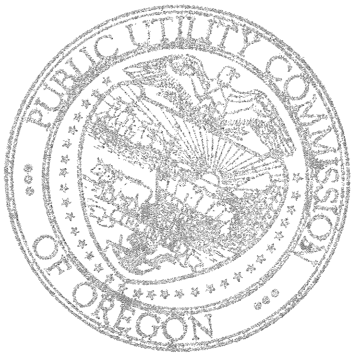
IT IS ORDERED that Staff and parties are directed, in the next phase of this docket, to determine what rate of return should be applied, or a methodology for determining what rate of return to apply, to a deferred account during amortization. We direct the Administrative Law Judge to hold a prehearing conference to determine a procedural schedule to undertake this effort.

Made, entered, and effective SEP 0 6 2006.

Lee Beyer
Chairman

John Savage
Commissioner

Ray Baum
Commissioner



A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements in OAR 860-014-0095. A copy of any such request must also be served on each party to the proceeding as provided by OAR 860-013-0070(2). A party may appeal this order by filing a petition for review with the Court of Appeals in compliance with ORS 183.480-183.484.