ORDER NO. 20-106

ENTERED Apr 06 2020

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1909

In the Matter of PUBLIC UTILITY COMMISSION OF OREGON, Investigation of the Scope of the Commission's Authority to Defer Capital Costs.	NOTICE

DISPOSITION: NOTICE OF RESCISSION OF ORDER NOS. 18-432 and 19-053, REQUEST FOR EXCEPTIONS ON DRAFT ORDER

In this notice, we rescind Order Nos. 18-423 and 19-053 pursuant to ORS 756.568, and establish a schedule for parties and other interested persons to submit exceptions with respect to a proposed order that we intend to issue to replace those orders, attached as Appendix A.

In Order No. 18-423, we reached a conclusion that ORS 757.259(2)(e) conferred no authority on the Commission to allow deferrals of any costs related to capital investments. In Order No. 19-053, we affirmed that conclusion and denied the Joint Utilities' request to reconsider or rehear that order.

We have had an opportunity to review Order Nos. 18-423 and 19-053 for a number of reasons. These include our need to defend the orders on appeal, and a desire to ensure that the various statements in the orders regarding regulatory principles and ratemaking methodologies applied by the Commission are clear and accurate, that the Commission's and parties' efforts in docket UM 2004 are necessary and warranted, and that the orders appropriately consider the Commission's authorities and duties in general.

That review has led us to the conclusion that ORS 757.259(2)(e) provides this Commission broader authority than we determined in Order Nos. 18-423 and 19-053, and that we are not limited in our ability to defer capital project costs by accounting principles. We have reexamined the text of ORS 757.259(2)(e) and its legislative history through a broader ratemaking lens, in an effort to best determine the intent of the legislature with reference to the statute's overarching policy objectives. The attached proposed order sets forth our reasoning and conclusions.

Parties may file exceptions to the proposed order within 21 days, no later than April 27, 2020. Parties should include in their exceptions filing the legal, policy, and any other reasons why the Commission should not issue the order as proposed, along with any recommended revisions to the proposed order. We intend to issue a final order in docket UM 1909 in no more than 60 days, on or before June 5, 2020.

Additionally, we suspend docket UM 2004 until after we issue a final replacement order in this proceeding. We opened docket UM 2004 in Order No. 19-053 to explore the implications of our conclusion that we lacked authority to authorize deferrals of costs associated with capital investments, and to address options to address recovery of those costs consistent with our legal authority and the public interest. After a new order is issued in docket UM 1909, we will work with Staff and parties to reexamine the scope of docket UM 2004.

Made, entered, and effective Apr 06 2020.

Megan W. Decker
Chair

Letha Tawney
Commissioner

Mark R. Thompson
Commissioner

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1909

In the Matter of PUBLIC UTILITY COMMISSION OF OREGON, Investigation of the Scope of the Commission's Authority to Defer Capital Costs.	PROPOSED ORDER

PROPOSED DISPOSITION: AUTHORITY DETERMINED TO DEFER CAPITAL COSTS

We conclude that ORS 757.259(2)(e) provides the Commission the authority to defer all cost components related to a utility's capital projects, including both depreciation expense and the cost of financing capital projects. We explain that the Commission reserves its discretion over when to grant such deferrals, and that any request for deferral of a capital project will be analyzed closely under our well-established deferral policy.

I. INTRODUCTION

At the November 21, 2017 Regular Public Meeting, we opened an investigation to clarify the scope of our legal authority to authorize deferred accounting for capital investments under ORS 757.259(2)(e). The Alliance of Western Energy Consumers (then, Industrial Customers of Northwest Utilities and Northwest Industrial Gas Users), Oregon Citizens' Utility Board, Northwest Intermountain Power Producers Coalition, Avista Corporation, dba Avista Utilities, Cascade Natural Gas Corporation, Idaho Power Company, Northwest Natural Gas Company (NW Natural), PacifiCorp dba Pacific Power, Portland General Electric Company (PGE), and the Staff of the Public Utility Commission of Oregon participated as parties to this proceeding.

This proceeding focuses on the meaning of the legislature's allowance for deferrals of "identifiable utility expenses or revenues" in ORS 757.259(2)(e). In brief, the parties present two interpretations. As more fully described below, the utilities argue that we may allow deferrals of any cost, including those related to capital investments. Staff and the other parties contend that we may allow a utility to defer costs related to the return of

investment (provided through depreciation expense), but not costs related to the return on capital investment (provided by the rate of return).

II. DEFINITIONS

There are various terms that could be used to describe the concepts discussed in this order, such as "cost of capital," "capital project costs," "cost of financing," and "rate of return." For clarity, we define below the terms used in this order. We recognize that different terms may be used in other Commission orders, or within other proceedings at the Commission.

- "Capital projects" refers to utility assets (*i.e.* utility plant) that have a useful life of more than one year, and usually many years, and where the utility finances costs associated with the asset, typically using debt, equity, or some combination.

- "Capital project costs" refers to all costs associated with a utility's capital projects. This includes both depreciation expense and the cost of financing.

- "Depreciation expense" refers to the portion of the utility asset that is deemed "used up" and expensed by the utility in a given time period. Depreciation expense is normally calculated based on the useful life of the utility asset.

- "Cost of financing" refers to the costs that a utility incurs, or is deemed to incur, in order to finance capital projects. It includes both the utility's cost of debt as well as its cost of equity.[1]

- "Cost of debt" refers to the utility's costs associated with financing of capital projects by incurring debt to other parties, including commercial paper, loans, lines of credit, or the issuance of bonds.

- "Cost of equity" refers to the utility's costs associated with financing capital projects by providing ownership interest in the company to investors in exchange for funds.

[1] We recognize that what we refer to as "cost of financing" is often referred to as a utility's "cost of capital," because it represents the costs to a utility of raising capital to invest in its business. However, "cost of capital" may also commonly be used by some to refer to the general costs of capital projects, including both depreciation expense and financing costs. Thus, to avoid confusion, we primarily rely on the terms described above instead of "cost of capital" more generally.

III. BACKGROUND

Under ORS 756.040, the Commission balances the interests of the utility investor and the customer in setting fair and reasonable rates. Rates are fair and reasonable if they provide adequate revenue "both for operating expenses of the public utility * * * and for capital costs of the utility, with a return to the equity holder that is: (a) [c]ommensurate with the return on investments in other enterprises having corresponding risks; and (b) [s]ufficient to ensure confidence in the financial integrity of the utility, allowing the utility to maintain its credit and attract capital."[2] Traditionally, we set rates for a future period based on a forecast of the utility's expected costs and revenue needs, but the utility's actual costs will vary. Some cost projections will be too high, while others will be too low. Between rate cases, the utility may receive higher-than-projected benefits from lower-than-projected costs, and also may absorb detriments associated with higher-than-projected costs.

We are generally prohibited from adjusting rates retroactively to address deviations between forecast and actual costs. The judicially recognized rule against retroactive ratemaking prohibits a utility regulator from setting rates that allow a utility to recover past losses or that require it to refund past profits. The rule stems from the fact that ratemaking is a legislative act and must be applied prospectively absent explicit legislative direction to the contrary. Thus, when we set rates, we generally do it by reviewing future expected costs.

ORS 757.259(2)(e) creates a statutory exception to the rule against retroactive ratemaking, by authorizing this Commission to allow utilities the opportunity to include identifiable utility expenses or revenues in future rates under certain circumstances. This statute permits a utility to track identifiable expenses or revenues through the use of "deferred accounting" for possible inclusion in a future rate proceeding. In essence, a deferral allows an amount to be carried forward into the future, for potential recovery from or refund to customers, when that amount would otherwise be unable to be added to rates under the rule against retroactive ratemaking. Over the years, we have occasionally used deferred accounting to address utility expenses or revenues outside of the utility's general rate case proceedings to the benefit of both ratepayers and utilities.[3]

The issue presented in this proceeding is whether ORS 757.259(2)(e) permits the deferral of capital project costs and, if so, whether that includes depreciation expense as well as the cost of financing.

[2] ORS 756.040(1).
[3] For a discussion of the use and mechanics of deferred accounting, see *In re Staff's Request to Open an Investigation into Deferred Accounting*, Docket No. UM 1147, Order No. 05-1070 at 2-3 (Oct 5, 2005).

ORS 757.259(2)(e) provides:

> Upon application of a utility or ratepayer or upon the commission's own motion and after public notice, opportunity for comment and a hearing if any party requests a hearing, the commission by order may authorize deferral of the following amounts for later incorporation in rates:
>
> * * * * *
>
> (e) Identifiable utility expenses or revenues, the recovery or refund of 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 appropriately the costs borne by and benefits received by ratepayers.

IV. POSITIONS OF THE PARTIES

A. Joint Utilities

The Oregon investor-owned energy utilities—PGE, PacifiCorp, Idaho Power, NW Natural, and Cascade (collectively, Joint Utilities)—interpret ORS 757.259(2)(e) to provide the Commission broad deferral authority. The Joint Utilities contend that we should interpret "expenses" consistent with its standard dictionary definition. Because some dictionaries define "expenses" as synonymous with "costs," the Joint Utilities contend that ORS 757.259(2)(e) authorizes the deferral of all costs impacting a utility's revenue requirement, including costs of obtaining capital.

The Joint Utilities contend that this interpretation is supported by the legislative history of ORS 757.259. The Joint Utilities explain that the Commission introduced 1987 House Bill (HB) 2145, which is now codified as ORS 757.259, to authorize its existing practice of allowing a utility to track expenses for later inclusion in rates—a practice that included deferrals of the revenue requirement effect of capital investments. The Joint Utilities emphasize that, in legislative hearings, representatives from the Commission described this practice and provided specific examples where the agency had deferred costs related to capital investments, and that the then-serving Commissioner confirmed that these accounts deferred recognition of the reasonable cost of capital, or financing costs, for the company.

The Joint Utilities also highlight that, throughout the legislative process that culminated with the passage of HB 2145, the legislators, the Commission, and agency representatives

used the terms "costs" and "expenses" interchangeably, and never identified any type of identifiable costs that would not be deferrable under the bill. The Joint Utilities note that there was never any indication that the bill would limit or change the existing Commission practice, and that the legislature expressly grandfathered all deferrals granted by the Commission prior to passage of ORS 757.259—many of which included deferrals of cost of capital. The Joint Utilities add that this legislative history undermines Staff's argument, set out below, that the legislature intended "expenses" to be given its specialized meaning when used in the Commission's standard ratemaking formula. The Joint Utilities emphasize that the ratemaking formula was never addressed during the multiple committee hearings, nor cited in any written testimony referenced in the legislative history of HB 2145.

Finally, the Joint Utilities argue that Staff's position here is contrary to its own support of comprehensive revenue requirement deferrals since the passage of ORS 757.259. In separate briefs, each utility provides examples where the Commission authorized, with Staff's support, the deferral of all revenue requirements, including capital costs.

B. Staff

Staff interprets ORS 757.259(2)(e) narrowly, and concludes that the Commission is legally constrained from deferring costs associated with the *return on* capital investment, or what we refer to as financing costs in this order. Staff contends that "revenue" and "expense" are terms of art in utility ratemaking, and that we must therefore interpret them in the regulatory context. Specifically, Staff argues that, rather than rely on a dictionary definition, we must give the term its meaning when used in the specific ratemaking formula R = E + (V-D)r, where:

R is revenue requirement

E is allowable operating expenses

V is the value of the utility's plant or property used to provide service

D is accumulated depreciation, and

r is the rate of return allowed on the rate base.

Staff explains that, while depreciation expense is one of the allowed operating expenses in the formula under "E" (operating expenses), a utility's rate of return is not. Rather, Staff explains that the rate of return is found in the "(V-D)r" portion of the formula.

Thus, using the ratemaking formula to define "expenses," Staff concludes that we have the legal authority to approve a deferral for costs associated with the *return of* a utility investment (depreciation expense), but not for costs associated with a *return on* utility investment (financing costs).

Staff contends that the legislative history confirms that the legislature intended that ORS 757.259 be construed consistent with ratemaking definitions and principles. Staff emphasizes that the legislature was provided copies of a glossary of ratemaking terms, as well as a copy of an opinion from the Attorney General that concluded any retroactive ratemaking orders of the Commission, including those that deferred the revenue requirement effects of capital investments, were impermissible unless expressly authorized by the legislature.

Staff acknowledges that the legislative history contains statements that suggest that HB 2145 would permit the practice of deferring costs associated with capital investments, but concludes that the legislative history is not entirely consistent. Staff asserts that some legislative history suggests that deferral of changes in the cost of financing were not intended. More importantly, Staff states that the legislature failed to provide the Commission with operative language upon which the Commission can rely to defer a utility's return *on* investment. Absent such express language, Staff contends that the Commission is not at liberty to "give effect to any supposed intention or meaning in the legislature, unless the words to be imported into the statute are, in substance at least, contained in it."[4]

The Oregon Citizens' Utility Board and the Alliance of Western Energy Consumers support Staff's arguments. They concur in Staff's view that we lack the legal authority to defer costs associated with financing costs for later inclusion in rates. They contend that the plain text of ORS 757.259(2)(e) and its legislative history shows that the legislature did not intend to allow deferral of costs associated with a utility's financing costs and may have intended to expressly foreclose that option.

V. DISCUSSION

When interpreting a statute, our goal is to determine the legislature's intent—that is, what purpose it "had in mind" when it enacted the statute in question.[5] The courts have laid out a two-step process for this inquiry. First, we begin with the text and context of the statute itself, which serves as "the best evidence of the legislature's intent."[6] In this

[4] Staff Opening Brief at 7 (Feb 16, 2018), *citing Whipple v. Howser,* 291 Or 475, 480 (1981).
[5] *See, e.g.*, *State v. Johnson*, 339 Or 69, 81 n 7 (2005).
[6] *Portland General Electric Company v. Bureau of Labor and Industries*, 317 Or 606, 610 (1993).

first-level analysis, we also may examine legislative history to help discern legislative intent.[7] If ambiguity (two or more plausible interpretations of the subject text) remains as to the legislature's intent after a textual analysis and review of legislative history, we may undertake a second-level analysis and resort to general maxims of statutory construction.[8]

Oregon courts have identified three classes of statutory terms—exact, inexact, and delegative. Exact statutory terms convey a relatively precise meaning, and their applicability in a given context depends upon agency fact-finding. Inexact terms are less precise, but are understood to embody a complete policy statement by the legislature despite the fact that inexact terms may be capable of contradictory applications, all of which may be within the dictionary meaning of the term. Inexact terms require the agency to apply a definition of the word that is within the legislative policy. Delegative terms express incomplete legislation, which the agency is then given the delegated authority to complete.

We agree with the parties that "expenses" and "revenues" are inexact statutory terms as used in ORS 757.259(2)(e). The terms express a complete legislative policy judgment, but their precise scope is not obvious.[9] We therefore must determine the scope the legislature intended, by reference to its overarching policy objectives.[10]

The dictionary definitions of "expenses" and "revenues" are expansive enough to encompass both of the competing interpretations offered by the parties and provide little help for that reason. We therefore consider the meaning of those terms in the ratemaking context and based on the legislative history.[11]

Although we agree with Staff that we should interpret ORS 757.259(2)(e) consistent with ratemaking principles, we decline to rely on the use of the general ratemaking formula offered by Staff to determine what costs may be deferred. The courts have held that terms of art must, in general, be "well-established" to be acknowledged in the statutory construction context.[12] The terms "expenses" and "revenues" are commonly used in

[7] *State v. Gaines*, 346 Or 160, 171 (2009).
[8] *Id.* at 172.
[9] *See Springfield Educ. Ass'n v. Springfield Sch. Dist. No. 19*, 290 Or 217, 224-25, (1980).
[10] *Id.* at 226.
[11] "In construing statutes, we do not simply consult dictionaries and interpret words in a vacuum. Dictionaries, after all, do not tell us what words mean, only what words can mean, depending on their context and the particular manner in which they are used." *State v. Cloutier*, 351 Or 68, 96 (2011), *citing State v. Fries*, 344 Or 541, 546 (2008).
[12] *Beaver Creek Cooperative Telephone Company v Public Utility Commission*, 182 Or App 559, 571 (2002), *citing McIntire v. Forbes*, 322 Or 426, 431 (1996). *See also Comcast Corp. v. Department of Revenue*, 356 Or 282, 296 (2014), *citing Department of Revenue v. Croslin*, 345 Or 620, 628 (2009), *Department of Transportation v. Stallcup*, 341 Or 93, 99-102 (2006) (noting that when the legislature uses technical terms from a specialized field, however, courts instead look to the meaning and usage of those

Commission proceedings, but have not been defined with precision as discrete terms of art. In addition, as the Joint Utilities point out, no ratemaking formula was addressed during HB 2145's legislative history, and certainly not one specific articulation of the ratemaking formula. Although we have traditionally used that formula to set rates, we are not required to do so. The courts have recognized that we are "not obligated to use any single formula or combination of formulas to determine what are, in each case, just and reasonable rates."[13] Absent any legislative discussion of the standard ratemaking formula—particularly one that this Commission is not required to use—we are not persuaded that the legislature "had in mind" this particular ratemaking formula when it enacted ORS 757.259(2)(e).[14]

Instead, we read ORS 757.259(2)(e) and the intended meaning of its terms to ensure our interpretation is "consistent with or tends to advance a more generally expressed legislative policy."[15] "Whether certain facts are within the intended meaning depends upon the policy that inheres in the term by its use in a statute which is intended to accomplish certain legislative purposes."[16]

Under this reading, we believe that the legislature intended that the terms "expenses or revenues" be inclusive of any costs or benefits to a utility that may arise in the course of its business, and that the Commission considers when setting a utility's rates.

We begin with the purpose of ORS 757.259. The Commission sought passage of HB 2145 to create a statutory exception to the rule against retroactive ratemaking, and thus was focused on the recovery of costs that would be ineligible for later rate recovery. This is reflected in ORS 757.259(2), which specifies that the purpose of a deferral is to allow for a "later incorporation in rates" of the amount deferred. Additionally, in ORS 757.259(2)(e) the legislature charged the Commission with determining whether a deferral of "identifiable utility expenses or revenues" should be authorized in order to "match appropriately the costs borne by and benefits received by ratepayers." In other words, the purpose of a deferral is to allow for a later rate-setting exercise to take into account a cost or benefit that would normally be eligible for rate recovery, but for the fact that it occurs in a prior period. We examine the treatment of capital project costs in ratemaking and on the utilities' books, to the extent used for regulatory purposes, in light

terms in the discipline from which the legislature borrowed them, considering the overall statutory scheme in which the term appears, and the meaning that that term has for regulators in the field).

[13] *Pacific Northwest Bell Telephone Company v. Eachus*, 135 Or App 41, 56 (1995), *citing Pacific Northwest Bell Telephone Company v. Sabin*, 21 Or App 200, 224 (1975).

[14] We note that other variations on the formula for cost-of-service ratemaking sometimes include a separate element for tax expense. We would not interpret that formula to exclude taxes from being considered a utility expense.

[15] *Springfield*, 290 Or at 226.

[16] *Id.* at 225.

of the statutory purpose to allow deferral of all costs or benefits that would normally be eligible for rate recovery in a forward-looking rate setting exercise.

In our standard rate-setting process, costs generally eligible for recovery in rates include both financing costs and depreciation expense associated with capital projects. With regard to financing costs, we allow utilities to account for, as part of their Construction Work In Progress (CWIP) balance, their financing costs incurred during construction with an Allowance of Funds Used During Construction (AFUDC).[17] When the project is complete and in service, these amounts are capitalized and become part of the book value of the asset—essentially being added to the total capital project investment balance. Additionally, in a rate case, once a capital project is placed in service, we generally allow the net book value of that investment (including the capitalized costs of financing during construction) to be counted in the utility's rate base. In a rate case we also allow the utility to recover its on-going financing costs on that asset's net book value, through adding to rates an allowed return that is applied to that value.

Similarly, when a capital project is placed in service, the utility begins to record depreciation expense as the asset depreciates, and we generally allow a utility to add depreciation expense to rates to allow for a recovery of the investment it made in the capital project. The asset is depreciated over its lifespan and, as noted above, depreciation expense is one of the allowed expenses used to calculate a utility's revenue requirement for purposes of ratemaking.

Although we address both financing costs and depreciation expense in the exercise of our ratemaking authority, the issue at the center of this case is that in the standard rate-setting process, we do this only on a forward-looking basis. In other words, the rule against retroactive ratemaking generally precludes a utility's ability to fully recover these costs. A utility begins depreciating a capital project as soon as it is placed in service—regardless of whether it is included in customer rates yet.[18] The now in-service project is captured during the next rate case and included in rate base at its depreciated book value. As a result, due to the prohibition on retroactive ratemaking, the utility will not, through normal ratemaking, have an opportunity to recover (1) the depreciation accumulated from the in-service date through the date the plant is included in rates, or (2) the financing costs associated with any amounts depreciated prior to the date the plant is included in rates. Both represent legitimate utility costs incurred to provide service that would be considered in establishing rates, but for the fact that they occurred in a prior period.

[17] While the use of AFUDC addresses financing costs during construction, AFUDC does not account for ongoing financing costs after plant is placed in service.
[18] *See, e.g.*, 18 CFR 108 & 403. *See also* OAR 860-027-0045 (adopting FERC's Uniform System of Accounts for electric companies).

The legislative history supports our conclusion that the legislature intended the terms "expenses or revenues" in ORS 757.259(2)(e) to be interpreted broadly, consistent with our ratemaking authority to include both depreciation and financing costs in rates. In introducing HB 2145, then-Commissioner Davis testified that "this subsection covers the many occasions when a legitimate ratemaking income or expense item is changing and the Commission believes rates should be adjusted as a result, but finds that rate changes should take place at some subsequent time."[19] Notably, and as discussed throughout the legislative process, that practice included deferrals of the full revenue requirement of capital projects (*i.e.*, including depreciation and cost of financing).[20] Other Commission representatives confirmed during legislative hearings that the proposed legislation would authorize a continuation of the Commission's deferral practice.[21] Given the legislature's awareness that the Commission's existing practice included capital project costs deferrals, it is reasonable to conclude that the terms "expense" and "revenues" was intended to include capital project costs.[22] We disagree with Staff's position that the legislative history is inconsistent on this point.[23]

Additionally, the originally proposed bill would have authorized as eligible for deferral "amounts incurred by a utility." Based on an amendment offered by NW Natural, "amounts incurred by" was amended to "utility expenses or revenues," and "or refund" was added in order to ensure that the Commission had the authority to use deferrals symmetrically, with the ability to defer revenues or income, rather than just utility costs.[24] There is no indication that the use of the term "expenses" in incorporating this

[19] Testimony, House Environment and Energy Committee, HB 2145, March 11, 1987, Exhibit B at 7 (Testimony of Charles Davis, Oregon Public Utility Commissioner); *see also* Audio Recording, House Environment and Energy Committee, HB 2145, March 11, 1987, Tape 57, Side A.

[20] *See, e.g.*, Audio Recording, House Environment and Energy Committee, HB 2145, March 11, 1987, Tape 57, Side A (discussion of Colstrip 3 and 4), March 25, 1987, Tape 73, Side A (discussion of plant investments at Colstrip 4, Jim Bridger, and Wyodak), April 8, 1987, Tape 96, Side A (explaining that the purpose was to allow "a variety of expense or revenue items" to be included in deferred account balances, and referencing Colstrip 4), Tape 97, Side A (referring to Colstrip deferral); Testimony, Senate Business, Housing and Financing Committee, HB 2145, May 21, 1987, Exhibit D, Attachment 1 at 13-14, Attachment 2, (Testimony of Charles Davis, Oregon Public Utility Commissioner and attachment).

[21] Audio Recording, House Environment and Energy Committee, HB 2145, March 11, 1987, Tape 57, Side A (confirming that the proposed bill would "directly authoriz[e]" what the Commission had been doing and describing plant at Colstrip 3 and 4 coming into service as an example).

[22] *See* note 20, *supra*.

[23] Staff points to an explanation of why, under the Commission's existing practice, it had authorized deferral of large capital investments like Colstrip 4, but had never deferred changes in load or cost of capital on a standalone basis, as indicating the legislature did not intend to allow for changes in the cost of financing to be included in "expenses". Audio Recording, House Environment and Energy Committee, MB 2145, March 11, 1987, Tape 57, Side A (explaining that Colstrip 4 was "a very discrete, large investment too, whereas a load change or a cost of capital change is a rather amorphous item.")

[24] *See* Audio Recording, House Environment and Energy Committee, HB 2145, March 25, 1987, Tape 73, Side A (explaining that NW Natural did not believe the bill addressed the kind of balancing account "that is

change was intended to restrict the types of costs that would be eligible for deferral. Further, during the development of HB 2145, the Commission provided definitions for some basic utility accounting and ratemaking terms to the legislature.[25] The defined terms, however, did not include "expenses" or "revenues"[26] and, during the legislative process, legislators and Commission representatives used a variety of terms, including "costs" and expenses," and "revenues" and "benefits" interchangeably.[27]

For the reasons described above, we conclude that ORS 757.259(2)(e) empowers the Commission to authorize the deferral of capital project costs, including depreciation expense and financing costs.

In reaching this decision, we acknowledge that ORS 757.259(2)(e) authorizes the deferral of utility expenses or revenues that are "identifiable." We conclude that under our ratemaking practices, depreciation expense and financing costs associated with specific capital investments are "identifiable" for purposes of the statute.

As a general matter, depreciation is determined by Commission-approved depreciation rates and the undepreciated balance of the associated plant. Thus, depreciation expense is generally readily identifiable.

tied to the revenue side of utility regulation" and proposing the language be amended to "utility expenses or revenues" "to make it clear that legislative authorization went to that type of account"), April 8, 1987, Tape 96, Side A (describing the purpose of the change by stating "if you're going to defer on one side of the equation, defer revenue for the utilities, [] we ought to be able to defer on the other side"), Tape 97, Side A; Audio Recording, Senate Business, Housing and Financing Committee, HB 2145, May 21, 1987, Tape 99, Side B (describing changes made in legislative process as including authorizing "deferral of certain amounts which would include benefits to the ratepayers").

[25] In response to a request from Representative Parkinson, the Commission provided a copy of the glossary from the Public Utilities Manual published by Deloitte Haskins & Sells, as well as a list of nine definitions more directly related to the proposed legislation. House Environment and Energy Committee, HB 2145, March 30, 1987, Exhibit F. *See also* Audio Recording, House Environment and Energy Committee, HB 2145, March 25, 1987, Tape 73, Side A (requesting glossary of terms).

[26] House Environment and Energy Committee, HB 2145, March 30, 1987, Exhibit F.

[27] *See, e.g.*, Testimony, Senate Business, Housing and Financing Committee, HB 2145, May 21, 1987, Exhibit D at 3-4 (Testimony of Charles Davis, Oregon Public Utility Commissioner); Audio Recording, House Environment and Energy Committee, HB 2145, March 11, 1987, Tape 56, Side B ("we are looking not only at cost changes but income items that would benefit ratepayers as well" "expense reductions" "reductions of costs" "increases in costs" "you deferred those costs, why in some of the other items that reduce the expenses don't you defer those costs?"), Tape 57, Side A (references to "expenses" and "costs" throughout); April 8, 1987, Tape 96, Side A ("costs pertinent to this act be included in deferred account balances" "we would expect the utility to apply for cost increases in most instances and we'd like the opportunity for the staff or the utility's customers to apply for decreases"); Tape 97, Side A ("the authority to defer benefits to the ratepayers as well as revenues requirements for the utilities balances it out"), Audio Recording, Senate Business, Housing and Finance Committee, HB 2145, May 21, 1987, Tape 99, Side B ("not only costs to the utility but also for benefits to the ratepayer").

The cost of financing includes both the cost of debt and cost of equity. In general rate cases, we identify a utility's existing long-term debt issuances, which are averaged to determine a utility's long-term cost of debt going forward. We do this based on documentation of the utilities' issuances. Additionally, although we do not regularly consider utilities' short-term debt issuances, such as commercial paper, when setting general rates, the costs associated with these instruments would also be identifiable based on documentation. We thus find that utilities' cost of debt is generally able to be identified.

A utility's cost of equity is also something that the Commission identifies, and we do this for a utility's total portfolio of investments through general rate cases, where experts testify about what a reasonable return for equity holders would be, given the unique circumstances and risks associated with the specific utility. In those proceedings, we determine a cost of equity by identifying a return to a utility's shareholders that is "[c]ommensurate with the return on investments in other enterprises having corresponding risks," and that is "[s]ufficient to ensure confidence in the financial integrity of the utility, allowing the utility to maintain its credit and attract capital."[28] Because we, as a matter of course and expertise in utility regulation, determine utilities' cost of equity, we find that this cost is generally identifiable.

As discussed above, we find that depreciation expense, the cost of debt, and the cost of equity are generally identifiable for ratemaking purposes. We, however, emphasize that any exercise of our discretion to authorize a deferral and to determine whether a utility's costs of financing a particular capital project are sufficiently identifiable for purposes of deferral, will be evaluated on a case-by-case basis in light of the specific circumstances. For many capital projects, depreciation costs may be identifiable based on the utility's approved depreciation schedule or other documentation. It may also be that a utility's cost of debt or cost of equity from its most recent rate case could be reasonably used to determine financing costs for a particular project. However, considering our general rate case treatment of debt is limited to the long-term average cost of debt, and considering that a utility's cost of equity varies with current market conditions and its capital structure, the analysis for the financing costs associated with a particular capital project might need to be further considered in order for such costs to be identifiable. Because of these considerations, we would expect an applicant to demonstrate how its financing costs associated with a particular project are reasonably identified.

We reiterate that, in determining whether to exercise this regulatory tool, we will continue to ensure that utility rates and services are in the public interest. This

[28] ORS 756.040(1).

Commission has broad authority to set rates under a comprehensive and flexible regulatory scheme.[29] Deferral is but one of many ratemaking tools available to the Commission. We reiterate that deferrals should be used sparingly, and that in exercising our discretion under ORS 757.259(2)(e) we will consider whether there are other more appropriate regulatory tools to address recovery of the identified costs or revenues or incentivize actions consistent with regulatory policy.[30] We will continue to review deferral applications on a case-by-case basis, and will consider the particular circumstances of each request under our well-established deferral policy.[31]

By finding that we have the legal authority to defer capital project costs, we do not intend to signal that such requests would be granted freely. There are many instances in which a utility should utilize the standard general rate case process to recover its capital project costs, and we recognize that the public interest is often best served by that process, rather than by use of deferrals. In particular, we note that, under traditional ratemaking, a utility continues to recover a return of and return on the plant balances included in rate base during its last rate case, even though the value of the assets has depreciated since the case. Normally, this benefit to the utility is countered to some extent by the fact that the utility continues to make capital investments that are not placed into rates during that period. A capital project deferral changes that overall balance in the utility's favor. This reduces the effect of regulatory lag on the utility by providing a utility with the opportunity to seek recovery of the new capital project costs through deferral without, in most cases, accounting for ongoing depreciation of plant in current rates. Regulatory lag is a regular aspect of utility ratemaking, and does not necessarily prevent a utility from maintaining a healthy credit rating or attracting capital. The risk and extent of the effect of regulatory lag is commonly evaluated and understood by those who invest capital in utilities. In light of this and other potential dynamics, any request for deferral of a capital project will need to be analyzed closely. We also intend to analyze closely the duration of and any interest rate applicable to a deferral that may already include financing costs on a capital project.

Finally, we emphasize that any decision to defer capital project costs is not an authorization or determination that such amount will necessarily be included in rates in the future. Any deferred costs will remain subject to Commission review prior to amortization in rates. We retain our discretion to review any particular deferral requests in light of the circumstances presented, including the application of any of the considerations set forth in this order.

[29] *See Multnomah County v. Davis,* 35 Or App 521, 525, (1978).
[30] *See* Docket No. UM 1147, Order No. 05-1070 at 2 (Oct 5, 2005).
[31] *Id.*

VI. ORDER

IT IS SO ORDERED.
Made, entered, and effective _____.

Megan W. Decker
Chair

Letha Tawney
Commissioner

Mark R. Thompson
Commissioner

A party may request rehearing or reconsideration of this order under 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 860-001-0720. A copy of the request must also be served on each party to the proceedings as provided in OAR 860-001-0180(2). A party may appeal this order by filing a petition for review with the Circuit Court for Marion County in compliance with ORS 183.484.