ORDER NO. 05-1070

ENTERED 10/05/05

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: DEFERRED ACCOUNTING PRINCIPLES ADOPTED

In recent years, the use of deferred accounting generated criticism by customer groups about the frequency and scope of deferrals, as well as raised concerns from utilities about uncertainties associated with the processes. To address such issues, we opened this docket on April 27, 2004, to clarify and revise, as necessary, policies regarding the application of the deferred accounting statute, ORS 757.259. After considering the comments of affected utilities, customer groups, and Staff of the Public Utility Commission of Oregon (Commission), we adhere to the principles underlying our decision in Order No. 04-108, as upheld in Order No. 04-357, and retain our discretion to review deferred accounts based on the nature of the event and the magnitude of the event's impact on a utility's costs or revenues. We also affirm the use of a flexible, fact-specific review approach that acknowledges the wide range of reasons why deferred accounting might be beneficial to customers and utilities. In addition, we determine that we will further explore, in a second phase of this proceeding, whether to apply a different interest rate to deferred accounts during amortization. Finally, we decline to revise our policies as to application procedures, and limitations to deferrals at this time.

Procedural Background

On July 22, 2004, a prehearing conference was held in Salem, Oregon. Conference participants were unable to reach consensus on a full procedural schedule at that time, however, due to disagreement about the procedural nature of the docket and the need for development of an evidentiary record. This question was addressed in two rounds of initial comments by Staff and all parties on October 7, 2004, and October 21, 2004. Parties filing comments included the Citizens' Utility Board of Oregon (CUB), Northwest Industrial Gas Users (NWIGU), Idaho Power Company (Idaho Power), Portland General Electric Company (PGE), Northwest Natural Gas Company (NW Natural), Cascade Natural Gas, Pacific Power and Light Company (PacifiCorp), and Industrial Customers of Northwest Utilities (ICNU).

On October 25, 2004, a status conference was held. At the status conference, the presiding administrative law judge made an oral ruling regarding the scope of the proceeding, which was further explained by a memorandum issued on November 5, 2004. The purpose of the proceeding was clarified to be definition of the Commission's policies regarding ten specific issues related to deferred accounting. Although parties were encouraged to identify sub-issues that might require future factual development, parties were notified that fact-specific determinations would not be made in this phase of the proceeding. Pursuant to the adopted schedule, the parties filed substantive comments on January 18, 2005 and February 18, 2005. The Commission heard oral arguments on April 11, 2005.

Background on Deferred Accounting

Deferred accounts provide a means to address utility expenses or revenues outside of the utility's general rate case proceeding and are a statutorily authorized exception to the general prohibition against retroactive ratemaking. The use of deferred accounts allows a utility to capture and track costs and revenues without passing them to customers until a later time, as authorized by the Commission.

For almost 20 years, the Commission has used deferred accounting to benefit both ratepayers, *see, e.g., In the Matter of Citizens' Utility Board,* UM 374, Order No. 91-830 (approving deferred accounting for Measure 5 property tax reductions), and utilities, *see, e.g., In the Matter of Portland General Electric Compan*y, UM 784/ UM 1039, Order No. 02-400 (reauthorizing deferred accounts for conservation programs and power costs). The Commission has used deferrals for a variety of reasons, including to: address costs that are hard to forecast or arise from extraordinary and unanticipated events; implement legislative mandates or unique ratemaking mechanisms; and encourage utility or customer behavior consistent with regulatory policy.

Despite the longstanding use of deferrals, the Commission did not articulate comprehensive principles regarding the implementation of the deferred accounting statute prior to docket UM 1071, in which we denied a request by PGE to defer certain costs related to poor hydro conditions. *See In the Matter of Portland General Electric Company*, Orders No. 04-108 and 04-357. There, we explained that a decision regarding a request to defer costs under ORS 757.259 involves two stages of review, and clarified that we may deny authorization to defer costs at either stage.

One stage of review involves a determination of whether a proposed deferral meets the criteria set forth in subsections (a) through (e) of ORS 757.259(2). These subsections identify types of monies, whether expenses or revenues, that the legislature has given the Commission discretion to defer. Past controversy has predominately involved disputes about ORS 757.259(2)(e), a catch-all provision that allows deferral of

> [i]dentifiable 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 the benefits received by ratepayers.

The other stage entails an exercise of Commission discretion under ORS 757.259(2), providing in part (*emphasis* added):

> Upon application of a utility or ratepayer or upon the commission's own motion * * * the commission by order *may* authorize deferral of the following amounts for later incorporation in rates[.].

As we explained in Order No. 04-108, in exercising this discretion, we consider two interrelated factors: the type of event that caused the deferral; and the magnitude of the event's effect. These two considerations interact with each other so that neither is dispositive without the other. With regard to the type of event causing the deferral, we drew a distinction between risks that can be predicted to occur as part of the normal course of events, classified as stochastic risks, and risks that are not susceptible to prediction and quantification, classified as scenario risks. We concluded that risks that are reasonably predictable and quantifiable are generally not appropriate for deferral unless the second consideration, the magnitude of the financial impact of the event on the utility, is substantial enough to warrant deferral. *See* Order No. 04-108 at 9. If, in our discretion, we deem a requested deferral to be inappropriate, we may deny it without further consideration. Alternatively, if we deem a requested deferral to be appropriate, we must verify that it is legally authorized before we approve it.

Shortly after the UM 1071 decision, the Commission opened this docket to broadly examine the use of deferred accounting, to evaluate the success and failures of the practice, and to establish how the Commission should use deferred accounting in the future.

DISCUSSION

Parties submitted comments in response to ten areas of concern, which provided significant guidance to the Commission. To articulate a clear set of principles in a way that can be easily applied, we respond to the parties comments by addressing the following six topics:

- **I. Statutory Requirements**
- **II. Exercise of Commission Discretion**
- **III. Deferred Accounting Procedures**
- **IV. Alternatives to Deferrals**
- **V. Limitations on Deferrals**
- **VI. Interest Rates**

We address each topic separately.

I. Statutory Requirements for Deferrals

Positions of the Parties

We begin our discussion with the statutory threshold for a deferred account. Subsections (a) to (e) of ORS 757.259(2) identify amounts eligible for deferral under a deferred accounting mechanism. Most of the controversy related to these statutory requirements is focused at subsection (e), a catch-all category under which many deferred accounting applications are submitted.

Staff asserts that utilities should do more to show that their applications for deferrals meet the statutory requirements. Specifically, Staff argues that to demonstrate that a deferral would minimize the frequency of rate change under ORS 757.259(2)(e), utilities should show that absent deferral, the amount of an ongoing cost or revenue change would otherwise cause a general rate change, or that the deferral would allow cost recovery over an extended period of time to avoid a large one-time increase. *See* Staff comments, 7 (Oct 7, 2004). Staff also argues that, to demonstrate that a deferral would match ratepayer benefits and costs under subsection (e), the utility should show that particular costs or revenues would have longer-term benefits than just the current period, so a deferral would allow cost recovery to be spread out over time to more accurately match benefits received. *See id.*

ICNU urges the Commission to adopt the standard used to support the deferral request in UM 995, in which the Commission found that PacifiCorp, under the circumstances, could have filed for interim rate relief in lieu of its deferred accounting application. *See* ICNU comments, 22 (Jan 18, 2005) (citing Order No. 01-085 at 12). ICNU proposes that the utility show severe financial stress or "'some other such reason' in which "'the utility should show that its ability to serve the public at reasonable rates will be jeopardized.'" *See id.* at 23 (quoting Order No. 87-1017 at 53). ICNU also cites Commission precedent for interpretation of the requirement that costs match benefits to customers and argues that, under ORS 757.259(2)(e), the Commission should adopt a "benefit over time" requirement: "deferred accounting is appropriate when a utility can demonstrate that the costs it is incurring at present will result in a demonstrable benefit to customers in the future." *See id.* at 24-25 (citing Order No. 92-1128 at 9).

CUB argues that isolated extraordinary events, which would not otherwise be included in a rate case, should not be subject to a deferred account. Sustained extraordinary events would be included in a subsequent rate case, CUB explains, and are therefore appropriate for deferral. *See* CUB comments, 16-17 (Jan 18, 2005). CUB also asserts that costs and benefits should be closely matched; for instance, costs related to a 1 in 50 year hydro event should be amortized over 50 years. *See id.* at 17-18.

PGE states that, consistent with the text of the statute, the Commission has interpreted subsection (e) as a two-prong alternative test, in which the proposed deferred account must either minimize the frequency or fluctuations of rate changes or match the costs and benefits received by ratepayers. *See* PGE comments, 23 (Jan 18, 2005). PGE argues that there is no statutory basis for the interpretations promoted by ICNU, and that those were isolated occurrences which are not representative of Commission practice. *See* PGE comments, 10-12 (Feb 18, 2005). In particular, PGE cites ORS 757.215 and its legislative history in arguing that the standard for interim rate relief is "reasonableness," not severe financial distress as argued by ICNU. *See id.* at 11. Additionally, PGE rebuts ICNU's argument that the present costs must benefit customers over time, by citing Order No. 04-686 in which the Commission approved a deferral accounting application for a current cost for the benefit of current customers. *See id.* at 12-13.

PGE further argues that stronger evidence showing that the application meets the statutory requirements under ORS 757.259(2)(e) is not required, as argued by Staff, unless a party challenges the utility's claim. *See* PGE comments, 24 (Jan 18, 2005). PacifiCorp also makes this argument. *See* PacifiCorp comments, 13 (Jan 18, 2005). Other utilities acknowledge that they bear the burden of showing that they meet the statutory requirement, but assert that rigid guidelines should not be established. *See* Idaho Power comments, 7 (Jan 14, 2005); NW Natural comments, 4 (Jan 18, 2005).

<u>Conclusions</u>

We decline to adopt additional standards to determine whether an application meets the requirements of ORS 757.259(2)(e). PGE is correct that subsection (e) sets out a two-prong test, in which the proposed deferred account must either minimize the frequency or fluctuations of rate changes or match the costs and benefits received by ratepayers. Whether either of these standards is satisfied requires an examination of the facts presented on a case-by-case basis.

As PacifiCorp notes, whether a deferral will minimize the frequency of rate changes depends primarily on the size of the cost to be deferred and the utility's options for rate filings, including requests for interim rate relief. As the Commission found in docket UM 995, a utility might meet this standard by showing that the deferral would prevent an interim rate filing. *See* Order No. 01-085 at 12. We adhere to the Commission's past practice, which utilizes a flexible, fact-specific approach that acknowledges the wide range of reasons why deferred accounting might be beneficial to customers.

Finally, we reiterate that, as with other requests for agency action, an applicant is initially responsible for both the burden of persuasion and the burden of production in support of a deferred accounting request. The burden of production shifts to other parties to present evidence that rebuts what an applicant presented. However, the burden of persuasion always rests with the applicant, regardless of opposition to the filing. Thus, for example, an applicant does not necessarily meet its burden merely by presenting unrebutted evidence. The evidence must be persuasive enough to satisfy all requirements required by statute.

II. Exercise of Commission Discretion

Position of the Parties

After determining that an application for a deferred account qualifies under ORS 757.259, we then consider whether to exercise our discretion to grant the application. *See* Order No. 04-108 at 8. In UM 1071, we addressed guidelines for the exercise of Commission discretion under ORS 757.259(2), stating that the type of risk (stochastic or scenario) plays an important role in determining when the Commission would allow a deferred account. *See* Order No. 04-108 at 9. Staff follows up on that distinction here by proposing a matrix for evaluating deferral accounts according to the triggering event. *See* Staff comments, 3 (Oct 7, 2004). In the proposed matrix, if the triggering event for the deferral could be classified as stochastic, the financial impact on the utility must be substantial for the Commission to approve the deferral account. If the triggering event is scenario in nature, the impact must be material. For certain other Commission-approved events, such as a change in taxation, the account would be approved regardless of impact.

Customer groups support the matrix as "a more objective method of evaluating the risks and impacts posed by the event behind a particular deferred accounting application." ICNU comments, 11 (Jan 18, 2005). ICNU supports a thoughtful review of whether a deferral account should be authorized, because once opened, it creates a presumption of recovery and initiates a complex and burdensome proceeding. *See id.* at 12-13. ICNU also argues that the Commission should retain some flexibility while using Staff's matrix. *See* ICNU comments, 11 (Feb 18, 2005). CUB also endorses Staff's matrix, stating that the threshold impact should be high, to prevent deferred accounting from becoming "a tool for utilities to cherry-pick increased costs for recovery, while ignoring any decreased costs." CUB comments, 7 (Jan 18, 2005).

The utilities favor a more flexible approach. Idaho Power asserts that the elements in Staff's matrix are already implicitly considered in Commission evaluation of deferral account applications. *See* Idaho Power comments, 2-3 (Jan 14, 2005). Additionally, Idaho Power requests that the impact of an expense be considered in relation to the size of that utility. *See id.* at 3. PGE argues for a more flexible approach, stating that a materiality test that differs depending upon the type of risk should be used with caution because it has not been used consistently in the past. If a materiality test must be applied, PGE argues that it should be considered in context with how the risk was treated in the last rate case, the type of event giving rise to the application, and other factors. *See* PGE comments, 2-3, 12-16 (Jan 18, 2005). PacifiCorp concurs with an approach that analyzes each application on a case-by-case basis. *See* PacifiCorp comments, 2 (Jan 18, 2005).

Instead of the matrix, PacifiCorp proposes a different approach: the Commission should review the type of event that caused the deferral request and the magnitude of the event's effect on a case-by-case basis without a particular formula. *See id.* at 2. PacifiCorp agrees that "the Commission should consider the magnitude of the financial impact of the triggering event in reviewing a deferred accounting application," *see id.* at 7-8, but not in such a rigid format as Staff's matrix. PGE also supports this two-pronged approach, but asserts that a materiality test is not flexible enough to adequately evaluate deferral applications. *See* PGE comments, 13-14 (Jan 18, 2005).

NWIGU points out that "the types of risks and events that cause utilities to request deferred accounting are very different for gas and electric utilities." NWIGU comments, 1-2, (Jan 18, 2005). While it supports some changes to the use of deferred accounts, it generally supports Commission discretion in the use of deferred accounts for gas utilities. *See id*. NW Natural agrees that the Commission should retain its discretion and consider the differences between gas and electric utilities, noting that many of its deferred accounts benefit ratepayers. *See* NW Natural comments, 2 (Feb 18, 2005).

Conclusions

While the matrix sets forth the essential considerations used to evaluate a deferral application, we decline at this time to formally adopt the matrix itself for future use. We do find that the matrix is very illustrative of our policy in this matter. However, we instead employ those considerations in applying the two-prong approach set forth in Order No. 04-108, which provides more flexibility for the Commission to exercise its discretion. First, the Commission will examine the triggering event that led to the deferral application. The utility bears the burden of identifying the event and showing its significance. The Commission will look to whether the event was modeled in rates, and, if so, whether extenuating circumstances were involved that were not foreseeable during the rate case, or whether the event fell within a foreseen range of risk when rates were last set. If the event was not modeled, we will consider whether it was foreseeable as happening in the normal course of events, or not likely to have been capable of forecast. The Commission will examine whether or not the "risks are reasonably predictable and quantifiable." *See* Order No. 04-108 at 9.

Initially, the proper approach in analyzing an event is to examine the nature of the event, its impact on the utility, the treatment in ratemaking, and other factors used to evaluate whether a deferred account is appropriate. The next step is to examine the magnitude of the underlying event in terms of the potential harm. The type of event—modeled in rates or not, foreseeable or not—will affect the amount of harm that must be shown by the utility. If the event was modeled or foreseen, without extenuating circumstances, the magnitude of harm must be substantial to warrant the Commission's exercise of discretion in opening a deferred account. If the event was neither modeled nor foreseen, or if extenuating circumstances were not foreseen, then the magnitude of harm that would justify deferral likely would be lower.

III. Deferred Accounting Procedures

Positions of the Parties

Currently, OAR 860-027-0300 sets forth the requirements for deferral application and reauthorization application contents, notices, and reply comments, and provides for consideration at Commission public meetings. Most parties support the use of current procedures, as they can be adjusted to fit the requirements of a particular deferral application. *See* Staff comments, 4 (Feb 18, 2005); PacifiCorp comments, 10 (Jan 18, 2005). PacifiCorp suggests a time limit for a Commission decision, so a utility knows if it should pursue other remedies. *See id.* at 11.

Customer groups suggest additional content requirements for deferral applications. CUB argues that the application should clearly delineate how the application meets the statutory threshold, the event the deferral relates to, the defined deferral period, the anticipated financial magnitude, and a clear and supportable baseline from which the projected deferral balance is calculated. *See* CUB comments, 11 (Jan 18, 2005). ICNU proposes specific amendments to OAR 860-027-0300(3) to require that deferral applications contain certain information for evaluation by the Commission, including discussion of how the expense item subject to deferral was treated in the last rate case, what factors are contributing to the total estimated amount of the deferred account, and how a deferral under ORS 757.259(2)(e) meets the statutory requirements of that section. *See* ICNU comments, 16-17 (Feb 18, 2005). NWIGU made general suggestions that support ICNU's proposal. *See* NWIGU comments, 3 (Feb 18, 2005).

PGE proposes new procedures regarding evidence and a hearing, to be incorporated in OAR 860-027-0300. These procedures include a 20 day deadline for comments on the application and a 30 day deadline for a prehearing conference. Further, parties must indicate by the prehearing conference whether a hearing will be necessary and if more information is needed regarding the application. A supplemental application may be filed in response to a party's request, in which case parties may request a hearing within 15 days of that filing. For deferral applications without a hearing, all factual claims in the application and its supplement are deemed true for purposes of that docket. If a hearing is required, the Commission would issue a final order within 180 days of the last application or supplement filed. If no hearing is required, the order should be issued within 90 days of the last application or supplement filing date. *See* PGE comments, 20-21 (Jan 18, 2005). ICNU and NWIGU express concern that PGE's proposed schedule would be too expedited and burdensome on Staff and intervenors. *See* ICNU comments, 15-16 (Feb 18, 2005); NWIGU comments, 2 (Feb 18, 2005).

Conclusions

We decline to modify the requirements set forth in OAR 860-027-0300. The changes proposed by customer groups reflect frustration with deferral applications that are being perceived as too vague in their initial stages. We agree that utilities should set forth their reason for applying for deferral under ORS 757.259(2), especially as it relates to our discussion above, but that requirement is already in the rule. We will continue to closely review applications for compliance with the requirements in OAR 860-027-0300, and retain flexibility to adapt our procedures as necessary on a case-by-case basis.

IV. Alternatives to Deferred Accounts

Positions of the Parties

Customer groups express concern about the use of deferred accounting outside of general rate cases. Both CUB and ICNU argue that rate cases balance risks and rewards between utilities and ratepayers, while deferred accounting shifts that risk allocation to provide a safety net for utilities facing unexpected costs. *See* CUB comments, 2-3 (Jan 18, 2005); ICNU comments, 19 (Jan 18, 2005). The deferred accounting statute is neutral as to whether it applies to costs or revenues to be offset in a later rate proceeding. *See, e.g.*, ORS 757.259(2)(e) (applying deferred accounts to "[i]dentifiable utility expenses or revenues"). However, customer groups argue that in practice, use of deferrals favor utilities, because the "utilities' access to information will always put the utility on higher ground both in proposing and defending deferral applications." CUB comments, 4 (Jan 18, 2005); *see also* ICNU comments, 19 (Jan 18, 2005). For that reason, CUB discourages the use of cost or revenue recovery mechanisms in favor of more frequent rate cases which balance savings and other adjustments to rates that are reflected in an overall analysis of a utility's operations. *See id.* at 14. ICNU states that alternatives to deferred accounting should be evaluated on a case-by-case approach. *See* ICNU comments, 19 (Jan 18, 2005).

The utilities argue that the statute and applicable procedures are symmetrical in nature and should not be altered. *See* PacifiCorp comments, 12-13 (Jan 18, 2005). In support of their argument, the utilities point to deferral accounts that benefit ratepayers. *See* PacifiCorp comments, 13 (Jan 18, 2005); PGE comments, 2-3 (Feb 18, 2005). PacifiCorp suggests interim rate increases or power cost adjustment mechanisms (PCA) as possible alternatives to deferred accounting. *See* PacifiCorp comments, 11-12 (Jan 18, 2005). Idaho Power also supports a PCA, which it uses in Idaho. *See* Idaho Power comments, 6 (Jan 14, 2005). CUB strongly opposes this position, arguing that a PCA is another way to shift the traditional risk allocation between utilities and ratepayers. *See* CUB comments, 8 (Feb 18, 2005). PGE evaluates the use of deferred accounting in the context of the various ratemaking methods available to the Commission: General rate cases, single-issue rate cases, interim rate relief, on-going tariffs or mechanisms, and accounting orders. *See* PGE comments, 10-11 (Jan 18, 2005). PGE expresses its preference for deferred accounting because it can be used to provide incentives, or disincentives, for certain types of activity, operate quickly in the face of sudden non-recurring events, and facilitate rate-case settlements. *See id.*

Conclusions

As the parties point out, there are a number of regulatory mechanisms that provide avenues for recovery of excess utility costs or revenues. While deferred accounting appears to have been one of the more frequently used mechanisms due to its versatility and expediency, we agree with the customer groups that deferrals should be used sparingly. If deferral is being sought for recovery of costs caused by a recurring triggering event, a deferred account is most likely not the proper mechanism to be used. In exercising our discretion under ORS 757.259(2), we will consider whether there are other, more appropriate regulatory tools to address recovery of the identified costs or revenues. These include the many mechanisms identified by the parties, as well as a general rate proceeding.

Much of the controversy and uncertainty surrounding deferrals relates to excess power costs, the largest category of costs for which this Commission has granted deferred accounting. In denying PGE's request in docket UM 1071 for a deferral of excess power costs, we encouraged parties to present alternative mechanisms, such as a PCA, to address problems with hydro variability. *See* Order No. 04-108 at 10. There, we agreed with CUB and Staff that a properly structured PCA might be an appropriate way of permanently allocating risks and benefits of hydro variability between shareholders and ratepayers. *Id.* at 11. We maintain that belief, and broaden it to apply to other factors causing fluctuations in power costs. Consequently, we continue to encourage the parties to this docket and other interested persons to explore other regulatory mechanisms, such as a PCA, to address excess power costs. Indeed, a properly structured PCA could reduce the number of separate requests for deferred accounts.

V. Limitations on Deferrals

Positions of the Parties

Customer groups also urge limitations on deferrals. First, CUB argues that a cap on the amount to be deferred might be impractical depending on the circumstances, but should be considered with other limitations to prevent overuse of deferrals. *See* CUB comments, 15-16 (Jan 18, 2005). ICNU strongly supports a cap on the total amount that a utility can defer to no more than 6 percent of the utility's gross revenues for the previous calendar year, with an exception for deferrals for which a denial would harm public safety, welfare, or continuing electric service. *See* ICNU comments, 20 (Jan 18, 2005). Second, CUB further proposes additional reviews to ensure that only costs related to the discrete triggering event are included in the account. *See* CUB comments, 12-13 (Jan 18, 2005). ICNU agrees with CUB that deferrals should be limited to the cost causing factors identified in the original application, and if new costs arise, a new filing should be submitted seeking approval for their deferral. *See* ICNU comments, 15-16 (Jan 18, 2005). As an example, ICNU points to UM 995, in which PacifiCorp applied to recover excess net power costs, then added costs related to an outage at the Hunter 1 generating plant and below-normal hydro conditions. *See id.* Finally, CUB and ICNU also argue that costs eligible for deferred accounting should be extraordinary, unanticipated, and discrete, and that annual deferrals are inappropriate and should be resolved in a general rate case. *See* CUB comments, 18 (Jan 18, 2005); ICNU comments, 25-26 (Jan 18, 2005).

The utilities argue against the limitations proposed by customer groups. First, they argue that there is no statutory basis for a cap on deferral, and that the cap on amortization "has proved to be very effective in limiting the inclusion of deferred costs in customer rates." Idaho Power comments, 7 (Jan 14, 2005); *see also* NW Natural comments, 3 (Jan 18, 2005); PacifiCorp comments, 13 (Jan 18, 2005); PGE comments, 22 (Jan 18, 2005). Second, the utilities agree that costs should relate to the original application. *See* Idaho Power comments, 5 (Jan 14, 2005); NW Natural comments, 2-3 (Jan 18, 2005). However, they also argue that the Commission should not narrowly interpret the original application to exclude related amounts that should be deferred. *See* PacifiCorp comments, 9 (Jan 18, 2005); PGE comments, 17 (Jan 18, 2005). PacifiCorp warns, "An overly restrictive interpretation of the scope of an application may require utilities to file multiple applications on closely related issues to ensure they are not excluded." PacifiCorp comments, 9 (Jan 18, 2005); *see also* PGE comments, 6 (Feb 18, 2005) ("ICNU's requirement [applied to UM 995] would have simply resulted in three separate deferred accounting applications.") PGE urges the Commission to retain its discretion to examine each application on its own merits without additional limitations set in this docket. *See* PGE comments, 17 (Jan 18, 2005). Third, utilities argue that the Commission should use its discretion in granting deferred accounting applications, and not limit it to discrete items. *See* PGE comments, 24 (Jan 18, 2005) (arguing that past Commission-approved deferred costs have not always been "extraordinary, unanticipated, non-recurring and/or discrete"). Further, PacifiCorp and Idaho Power argue that the Commission should exercise its discretion by examining the nature and magnitude of the triggering event and its impact on the utility, and not be limited to events that are extraordinary, unanticipated, or nonrecurring. *See* PacifiCorp comments, 14 (Jan 18, 2005); Idaho Power comments, 3 (Jan 18, 2005).

Conclusions

We acknowledge the concerns of customer groups that deferred accounting should not be used too liberally, but retain our discretion as discussed above in considering whether a utility seeks to defer an excessive amount of costs, amounts not related to the original application, or amounts related to events that are anticipated and ordinary.

We reject the request for an overall cap on the amount of costs that a utility can defer in one year. The existing cap on the amortization of deferred amounts set forth in ORS 757.259(6)-(8) is sufficient to guard against overuse of deferrals.

VI. Interest Rates

Positions of the Parties

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. This practice, Staff observes, was based on the theory that as any dollar approved for recovery "is fungible and can be used for alternative purposes," every dollar should receive the same rate of return. Staff comments, 2 (Jan 18, 2005). Staff now challenges this theory, however, arguing that utility investments are distinguishable in terms of the risk of investment recovery. For example, Staff argues that deferrals "do not pose the same earnings and economic risks as do rate-based, long-lived assets." Staff further explains that recovery of deferred accounts—as opposed to recovery of other utility accounts—is "very likely through dollar for dollar recovery," particularly after the monies are approved for recovery by the Commission. *Id*. at 2-3. Consequently, Staff contends that the interest rate applied to deferred accounts should reflect a lower risk of recovery and, therefore, proposes altering the historical treatment of deferred accounts, as follows: Deferrals under ORS 757.259(2)(b) or (c) would receive a 1-year Treasury rate, set quarterly; all other deferred accounts would receive an average or blended rate of the 1-, 3-, and 5-year Treasury rates, recalculated each quarter. *Id. at 2.* Alternatively, Staff contends that the interest rate for a deferred account could be set against a "benchmark" such as a Treasury security, modified as appropriate. *Id*. at 3. NWIGU supports Staff's approach. *See* NWIGU comments, 4 (Jan 18, 2005).

ICNU agrees that the interest rate applied to a utility's deferred accounts should not be the same as the utility's cost of capital, but suggests that the utility's cost of short-term debt be used. *See* ICNU comments, 17 (Jan 18, 2005). In the alternative, ICNU supports Staff's proposal. *See* ICNU comments, 14 (Feb 18, 2005). CUB recommends that the interest rate applied to a deferred account reflect the time period, on a case-by-case basis, that recovery of the deferred amount is amortized over. For example, CUB notes that a balance amortized over a single year might accrue interest at the utility's short-term cost of debt. *See* CUB comments, 10 (Jan 18, 2005). CUB proposes that the Commission determine an appropriate interest rate for a deferred account during the amortization phase of the deferral process. *Id.* at 10-11; *see also* CUB comments, 6 (Feb 18, 2005).

All four utilities urge the Commission to not deviate from the historical practice of allowing a utility's deferred accounts to accrue interest at the utility's authorized rate of return. *See* Idaho Power comments, 3 (Jan 14, 2005); NW Natural Comments, 3 (Jan 18, 2005), PacifiCorp comments, 10 (Jan 18, 2005); PGE comments, 18 (Jan 18, 2005). Both PacifiCorp and PGE dispute the contention that any risks associated with deferred accounts, are relevant to determining a particularized rate of return that apply to such accounts. *Id*. PGE contends that insufficient evidence has been presented to conclude that there is different risk associated with the recovery of deferred accounts. As PGE points out, [t]here is no evidence in this docket or elsewhere regarding the relative risk of recovery of deferred accounts and how it compares with the risk of other utility investments." PGE comments, 18 (Jan 18, 2005). PGE also argues that there are substantial regulatory risks associated with deferred accounts such as prudence reviews and earning tests. PGE comments, 8 (Feb 22, 2005). In any case, PGE and PacifiCorp argue that it is inappropriate to consider the individual risk profiles of recovering specific accounts to establish individualized returns as investments are not financed discretely. *Id*. Rather, the utilities argue that it is appropriate to continue to establish one rate of return on all utility investments. As PacifiCorp states, "[d]eferred 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." PacifiCorp comments, 6 (Oct 7, 2004). PGE and PacifiCorp also observe that a lower return on deferred accounts would be asymmetric because investments with a higher risk of recovery do not receive a higher return. PacifiCorp comments, 10 (Jan 18, 2005). Finally, PGE, PacifiCorp and Idaho Power raise concerns about complexities associated with the process that would be used to establish a specific rate of return on deferred accounts and all utilities challenge the various processes proposed by Staff and the customer groups. PGE comments, 19 (Jan 18, 2005), Idaho comments, 6 (Jan 18, 2005); PacifiCorp comments, 10 (Jan 18, 2005). PGE particularly disagrees that a utility's short-term financing rate should be applied to deferred accounts, observing that amortization periods for deferred accounts may be longer than one year. PGE comments, 19 (Jan 18, 2005).

Conclusions

In setting rates, we seek to ensure that customers of public utilities receive adequate service at "fair and reasonable rates." ORS 756.040. We understand, therefore, that rates, while being fair and reasonable to customers, must also allow utilities to attract investment sufficient to provide adequate service to customers. We have previously commented that we believe rates do the latter when rates "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 (citations omitted).

In this proceeding, Staff and customer groups query whether allowing interest on deferred accounts at the rate of return authorized on all of the utility's investments, results in the utility earning more than is commensurate with the risk of recovery for those deferred accounts. The utilities counter that it is problematic to differentiate deferred accounts from other costs and revenues faced by utilities, arguing that the monies expended to serve customers, whether invested in power plants or used to cover excess power costs, are fungible and should earn one rate of return.

We agree with the utilities that the Commission currently does not examine, in a general rate case, the risk of recovery associated with individual utility accounts. We also agree that the Commission should not undertake this exercise as a general practice. The rate of return set in a general rate case for each utility shall continue to reflect an assessment of the overall level of financial risk faced by the utility with regard to forecasted costs and revenues. Moreover, we find that this assessed level of financial risk for a utility includes the effect of possible recovery of higher-than-expected costs through deferred accounting.

We discern, however, that there is a different risk of recovery of deferred amounts before and after amortization is approved. Before amortization has been authorized, recovery of a deferred account balance may be subject to a prudence review and earnings test. Once an amount is approved for amortization, the risk of recovery is lower. As Staff and the customers observe, the Commission normally authorizes any amortization of deferred accounts on a dollar for dollar basis. As a result, there is little risk that the authorized amount will not be collected by the utility (or returned to customers).

Discussion regarding the risks associated with deferred accounts focused on deferred accounts in general, however, and did not distinguish between the risks of recovery before and after amortization of a deferred account is authorized. We conclude that before changing the Commission's existing policy of applying an interest rate equal to the utility's authorized rate of return to deferred accounts, we need to hear comments on this distinction. Consequently, a second phase of this docket will be commenced in the near future to fully explore the question of whether a different rate of return should be applied to authorized deferred accounts during amortization If a party argues that a different rate of return should be applied to authorized deferred accounts during amortization, that party should also address how to determine what that rate should be and whether the rate may be calculated generally or should be done on a case-by-case basis. Parties will also be expected to address how any new policy 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.

ORDER

IT IS ORDERED that the guidelines set forth in this order shall apply to future and pending deferral account applications.

Made, entered, and effective OCT 05 2005.

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 to a court pursuant to applicable law.