ORDER NO. 18 423

ENTERED OCT 29 2018

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.	ORDER

DISPOSITION: AUTHORITY DETERMINED TO DEFER CAPITAL COSTS

I. SUMMARY

We opened this investigation to clarify the scope of our legal authority to authorize deferred accounting under ORS 757.259(2)(e). New uncertainty had arisen about the scope of our authority under the statute, and we asked the parties to address the legal basis to allow the deferral of costs related to capital investments.

This proceeding focused on the meaning of the legislature's allowance for deferrals of "identifiable utility expenses and revenues" in ORS 757.259(2)(e). The parties presented two interpretations—one that would allow deferrals of all capital costs, and another that would permit deferrals of costs associated with the *return of* investment, but not costs associated with the *return on* capital.

Based on our review of the text and context of ORS 757.259(2)(e), as well as its legislative history, we disagree with both proposed interpretations. Instead, we interpret the statutory language consistent with accounting principles and, for reasons set forth below, conclude that ORS 757.259(2)(e) provides the Commission no authority to allow deferrals of any costs related to capital investments.

We acknowledge this conclusion is contrary to our past limited practice of allowing comprehensive deferrals, and will require certain adjustments to our regulatory practices. We direct our Staff to meet with the utilities and stakeholders to address the full implications of this decision, and to bring forth to us recommendations needed to implement this decision consistent with our legal authority and the public interest.

II. BACKGROUND

To provide a proper context for the summary of the parties' positions and our examination of the legal issues presented, we begin with a brief explanation of the Commission's ratemaking authority and the relevant regulatory principles that guide the use of that authority.

Ratemaking involves an exercise of Commission discretion to balance the interests of the utility investor and the customer. The fundamental and ultimate goal, as mandated by the legislature, is to set fair and reasonable rates that provide adequate revenue to recover the utility's operating expenses, as well as an opportunity to earn a return on capital investments.[1] Traditionally, we set rates for a future period based on a forecast of the utility's 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 absorbs higher than projected expenses and benefits from lower than projected expenses.

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 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.

ORS 757.259 creates a statutory exception to the rule against retroactive ratemaking, and authorizes this Commission to allow utilities the opportunity to recover identifiable expenses or revenues in future rates under certain circumstances. This statute permits a utility to capture and track identified expenses through the use of "deferred accounting" for possible recovery in a future rate proceeding. We have broad discretion to use deferred accounting to address utility expenses or revenues outside of the utility's general rate case proceeding, and have done so over the years to the benefit of both ratepayers and utilities.[2]

The issue presented before us is whether ORS 757.259 permits the deferral of costs related to capital investments. As more fully described below, the utilities argue that we may allow deferrals of any utility 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).

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[1] ORS 756.040(1).

[2] 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).

III. DISCUSSION

This investigation turns on the meaning of statutory language contained in ORS 757.259(2)(e), which 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. (*Emphasis added.*)

The question presented focuses on the meaning of the legislature's use of the highlighted term "expenses."

A. Positions of the Parties

1. Joint Utilities

The Oregon investor-owned energy utilities—Portland General Electric Company (PGE); PacifiCorp, dba Pacific Power; Idaho Power Company; Northwest Natural Gas Company, dba NW Natural; Avista Corporation, dba Avista Utilities; and Cascade Natural Gas Corporation (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 the dictionary defines "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 House Bill (HB) 2145 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 capital investments, and that Commissioner Davis confirmed that these accounts deferred recognition of the reasonable cost of capital for the company.

The Joint Utilities also highlight the fact that, throughout the legislative process that cumulated 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 stress 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.

2. *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. Staff contends that "revenues" is a term of art in utility ratemaking, and that we must therefore interpret it 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 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" (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, but not for costs associated with a *return on* utility investment.

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. Staff clarifies, however, 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."[3]

The Oregon Citizens' Utility Board (CUB) and the Alliance of Western Energy Consumers (AWEC) support Staff's arguments. They concur in Staff's view that we lack the legal authority to defer costs associated with the *return on* a utility's capital investment 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 return on investment and may have intended to expressly foreclose that option.

B. Resolution

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.[4] 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."[5] In this first-level analysis, we may also examine legislative history to help discern legislative intent.[6] If ambiguity (two or more plausible interpretations of the subject text) remains as to the legislature's intent after a textual

[3] Staff Opening Brief at 7 (Feb 16, 2018), citing *Whipple v. Howser,* 291 Or 475, 480 (1981).
[4] *See, e.g., State v. Johnson*, 339 Or 69, 81 n 7 (2005).
[5] *PGE v. Bureau of Labor and Industries*, 317 Or 606, 610 (1993).
[6] *State v. Gaines*, 346 Or 160, 171 (2009).

analysis and review of legislative history, we may undertake a second-level analysis and resort to general maxims of statutory construction.[7]

We agree with the parties that "expense" is an inexact statutory term as used in ORS 757.259(2)(e). The term expresses a complete legislative policy judgment, but is subject to competing interpretations. The legislature does not define the term in statute, and no court has interpreted its meaning.[8] From the statute's text, we are unable to discern how the legislature intended "expenses" to be defined.

We disagree, however, with both of the proposed definitions for "expenses" offered by all of the parties. The Joint Utilities are correct that courts often resort to a dictionary to define an undefined statutory term,[9] but overlook the fact that the dictionary offers many definitions for "expenses." The dictionary of choice in the Oregon Appellate Courts is *Webster's Third New Int'l Dictionary*, which provides many common uses for the term "expenses," some of which are more inclusive than the Joint Utilities' proposed broad interpretation to include any "cost." For example, the dictionary includes the accounting definition that "expense" means "an item of outlay incurred in the operation of a business enterprise allocable to and chargeable against revenue for a specific period."[10] Thus, even if we were to resort to a dictionary to define "expense," we would need to decide which of the many definitions to use—including those that are not synonymous with cost.

Similarly, we are not persuaded by Staff's proposal to define these terms by specific reference to the formula we have used to determine revenue requirement. As the Joint Utilities point out, the ratemaking formula was never addressed during HB 2145's legislative history. More importantly, 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." [11] 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" these definitions when it enacted ORS 757.259(2)(e).

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[7] *Id.* at 172.

[8] *See, e.g.*, *State v. McAnulty*, 356 Or 432, 441, (2014) (Prior judicial construction is always a first-level consideration.).

[9] *Pete's Mountain Homeowners v. Ore. Water Resources*, 236 Or App 507, 516-17 (2010) ("The usual source for determining the ordinary meaning of statutory terms is a dictionary of common usage.").

[10] *Webster's Third New Int'l Dictionary* (unabridged ed 2002) at 800.

[11] *Pacific Northwest Bell Tel. Co. v. Eachus*, 135 Or App 41, 56, 898 P2d 774 (1995), citing *Sabin*, 21 Or App at 224 (*emphasis added*).

Instead, we resolve this ambiguity by examining the statute's context, which includes other provisions of the statute,[12] as well as the statutory framework in which the legislation was enacted.[13] This context shows that the legislature used "expenses" as a term of art, and that it should be given its specialized meaning from the field of accounting.

The provisions of ORS 757.259 make clear that the statute should be interpreted consistent with accounting practices. Most noticeably, the statute permits the Commission to allow a utility to identify certain expenses and revenues through the use of "deferred accounting" for later consideration in a rate proceeding. In addition, the specific provision at issue here addresses "expenses," "revenues," and "deferred" amounts—terms of art in the practice of accounting where a deferral means a delay in recognition of an expense or revenue transaction. Simply put, ORS 757.259 addresses an exercise of accounting, and should be construed as such.

The statutory framework, of which ORS 757.259 is a part, also demonstrates the critical role accounting plays in utility regulation. As the Joint Utilities note, regulated utilities are required to comply with standard accounting practices as well as requirements imposed by state and federal regulators. Utilities must conform to Generally Accepted Accounting Principles, federal accounting standards, and Internal Revenue Service requirements. Under state law, regulated utilities must keep uniform accounts and records in a manner prescribed by this Commission,[14] and, for this purpose we have adopted the Uniform Systems of Accounts prescribed by the Federal Energy Regulatory Commission.[15] Standard and regulatory accounting requirements play a fundamental role to help inform and implement the regulatory processes of setting just and reasonable rates.

As defined by accounting principles, "expenses" are a specific type of cost. They are limited to "outflows or other using up of assets or incurrences of liabilities (or a combination of both) from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity's ongoing major or central operations."[16] As more precisely defined, "expenses" are a type of cost reflected on an income statement to reflect the "using up of assets or incurrence of liabilities" during the time period indicated in the income statement.[17]

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[12] *See, e.g., Lane County v. LCDC*, 325 Or 569, 578 (1997) ("[W]e do not look at one subsection of a statute in a vacuum; rather, we construe each part together with the other parts in an attempt to produce a harmonious whole."
[13] *See, e.g., State v. Ofodrinwa*, 353 Or 507, 512 (2013) ("The context for interpreting a statute's text includes * * * the statutory framework within which the law was enacted.").
[14] *See* ORS 757.120 (Accounts required); ORS 757.125 (Duty of utility to keep records and accounts); and ORS 757.135 (Closing accounts and filing balance sheet; rules; auditing records).
[15] OAR 860-027-0065.
[16] *See FASB Concepts No.6, Elements of Financial Statements—a replacement of FASB Concepts Statement No. 3* (incorporating an amendment of FASB Concepts Statement No. 2), (Issue Date 12/85), pages 6-1 and 6-2. (https://www.fasb.org/jsp/FASB/Page/PreCodSectionPage&cid=1176156317989)
[17] We note this definition is similar to the dictionary definition discussed above.

Costs directly associated with constructing an asset are not treated as expenses under required accounting practices. Rather, a utility records these costs in a general ledger account called Construction Work in Progress (CWIP). When the asset is placed in service, the utility converts these amounts to Plant in Service, and then may seek rate recovery of its investment by including it in rate base and depreciating the associated capital costs over time. Thus, only after the Commission has considered capital costs from a ratemaking standpoint and authorized them to be included in rate base, do they become chargeable to a particular period as they are depreciated.

With this clarification, we return to the statutory provision in question. ORS 757.259(2)(e) provides the Commission the authority to authorize deferrals of identifiable utility "expenses." Interpreting "expenses" as a term of art from the field of accounting, we find that the statutory provision authorizes the deferral of costs that would generally be expensed against a particular income reporting period, but not costs associated with constructing an asset that are recorded for later ratemaking consideration. Thus, we conclude that ORS 757.259(2)(e) provides the Commission no authority to allow deferrals of any costs related to capital investments.

We emphasize that this interpretation does not preclude a utility's ability to recover financing costs associated with a capital investment. Because a utility often finances construction projects with debt and common equity, CWIP includes an estimate of those costs of capital in Allowance of Funds Used During Construction (AFUDC). This AFUDC is calculated according to a formula provided in the Uniform System of Accounts established by FERC, and is a two-part allowance. It includes (1) an allowance for borrowed funds used during construction that includes the cost of short-term debt and long-term debt; and (2) an allowance for other funds that includes the cost of common equity and preferred stock. The AFUDC rate is multiplied by the level of CWIP and the resulting AFUDC is then added to CWIP and capitalized when the asset is placed in service. Thus, the use of AFUDC assures that the utility is adequately compensated for its financing costs—and given an opportunity to later earn a return on those costs—at a later date when the investments are eligible to be included in the rates charged to customers.

We also find that this interpretation is consistent with the purpose of ORS 757.259. Although the statute's legislative history includes statements where the terms "costs" and "expenses" were used interchangeably, and citations to the practice of allowing full revenue requirement deferrals, the Commission's purpose of seeking the passage of HB 2145 was to create a statutory exception to the rule against retroactive ratemaking—a rule that does not apply to the recovery of capital costs. Although the rule precludes the ability of a utility to recover any operating costs that were incurred in the past, a utility may—at any time—seek to include capital costs in rate base regardless of when those costs were incurred. The only ratemaking principle affecting the recovery of capital costs is regulatory lag. Thus, the Commission's efforts to create a statutory exception to the rule against retroactive ratemaking were directed at the recovery of costs that

would be expensed and ineligible for later rate recovery, and the operative language passed by the legislature reflects that intent.[18]

We acknowledge the significance of this decision. This conclusion is contrary to our past practice of allowing comprehensive deferrals. As Staff emphasizes, however, those decisions have been limited and were made as part of uncontested negotiated agreements among the presenting parties and implemented without an explicit examination of our legal authority. Now that we have carefully reviewed the scope of our authority to authorize deferred accounting, we conclude that those prior decisions were inconsistent with the purpose and scope of ORS 757.259(2)(e).

This decision also impacts the methodologies currently used by PGE and PacifiCorp under ORS 469A.120 for costs associated with the Renewable Portfolio Standards (RPS). This methodology utilizes full revenue requirement deferrals between the in-service date and the date the renewable resource is reflected in rates.[19] We share Staff's belief, however, that we can modify this methodology to include an automatic adjustment clause under ORS 757.210 to ensure the recovery of capital costs associated with RPS compliance as contemplated by the statute. Because the recovery of capital costs is not affected by the rule against retroactive ratemaking, there is no need for a deferral (even if it were permitted) to allow proper recovery of RPS related capital costs. We direct Staff to lead efforts to modify our methodologies to properly implement ORS 469A.120 consistent with our authority under ORS 757.259(2)(e).

Finally, this decision precludes our ability to consider future agreements like those in the past, in which all parties agreed it was in the public interest to allow full revenue-requirement deferrals. We encourage our Staff and stakeholders to explore, when necessary, alternative ratemaking tools to help minimize the regulatory lag for recovery of capital costs. This Commission has broad authority to set rates under a comprehensive and flexible regulatory scheme,[20] and we have many tools to help incent utility investments that further the interests of ratepayers and the public. In the past, we have helped mitigate regulatory lag by evaluating costs of a new investment prior to it being placed in service.[21] We can also explore the use of abbreviated rate proceedings to help implement agreements among the parties related to utility investments. We

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[18] 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." *Whipple v. Howser,* 291 Or at 480 (1981).

[19] *In re Investigation of Automatic Adjustment Clause Pursuant to SB 838*, Docket No. UM 1330, Order No. 07-572 at 3 (Dec 19, 2007).

[20] *See Multnomah County v. Davis,* 35 Or App 521, 525, (1978).

[21] *See, e.g., In re Portland General Electric Company*, Dockets UE 180/UE 181/UE 184, Order No. 07-015 (Jan 12, 2007) (Approving rates to go into effect once placed in service with provisions for additional cost review if project delayed.); *In re Avista Corporation, dba Avista Utilities*, Docket No. UG 325, Order No. 17-344 (Sep 13, 2017) (Allowing utility to include plant not-yet-in service as part of the proposed revenue requirement when justified.)

also have flexibility to consider adjustments to the AFUDC rate, if necessary, to ensure that utilities are properly compensated for financing costs associated with capital investments.

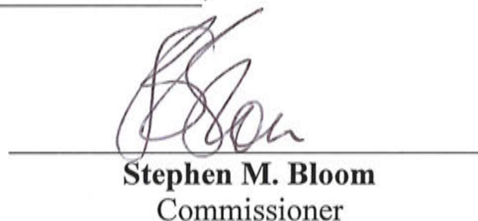
In summary, we recognize the departure this decision represents from our past instances of allowing comprehensive deferrals, and that our legal conclusion here requires some short term adjustments to our regulatory practices. We believe, however, that out decision provides a more certain foundation from which we may examine ways to adapt our regulatory tools to continue to ensure that utility rates and services are in the public interest.

IV. ORDER

IT IS SO ORDERED.

Made, entered, and effective OCT 29 2018.

Megan W. Decker
Chair



Stephen M. Bloom
Commissioner

Letha Tawney
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 Court of Appeals in compliance with ORS 183.480 through 183.484.