BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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| WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,<br><br>Complainant,<br><br>v.<br><br>PACIFICORP d/b/a PACIFIC POWER & LIGHT COMPANY<br><br>Respondent. | ) | DOCKET NO. UE-991832 |
| In re the Petition of<br><br>PACIFICORP d/b/a PACIFIC POWER & LIGHT COMPANY<br><br>For an Accounting Order Authorizing Deferral of Excess Net Power Costs. | ) | DOCKET NO. UE-020417 |

**INITIAL BRIEF OF STAFF REGARDING LEGAL AUTHORITY OF COMMISSION TO AUTHORIZE RETROACTIVE DEFERRED ACCOUNTING**

## I. INTRODUCTION

*1* On April 5, 2002, PacifiCorp d/b/a Pacific Power & Light Company ("PacifiCorp" or "the Company") filed with the Commission in Docket No. UE-020417 a petition ("Petition") for an order authorizing deferral of excess net power costs the Company claims would be incurred to serve its Washington customers. The Company proposes that the power cost deferrals commence June 1, 2002 and continue until the earlier of May 31, 2003 or the time the Commission approves a power cost adjustment

mechanism for PacifiCorp's Washington customers, or some other form of limited rate relief. Petition at 1 and 15, ¶ 29. However, PacifiCorp made no proposal regarding the recovery through rates of any deferred power costs. Any such proposal would be the subject of a future filing with the Commission. Petition at 12, ¶ 23. The Company may even propose in that later proceeding less than full recovery of any deferred power costs in recognition of the restrictions imposed by the current Rate Plan.[1] Petition at 12-13, ¶ 24.

*2* The Petition did not come before the Commission at an open meeting. Instead, a prehearing conference was convened on August 6, 2002. Issues discussed at the prehearing conference included whether the Commission lawfully can authorize PacifiCorp to defer power costs incurred by the Company prior to a Commission order authorizing deferred accounting.

*3* Staff concludes that any Commission order authorizing deferred accounting for PacifiCorp should also establish a specific methodology for recovery of prudent and reasonable deferred costs incurred *after* the order is issued.[2] Any order which omits a specific recovery method may be challenged as unlawful retroactive ratemaking. An accounting order that allows PacifiCorp to defer costs incurred *before* the effective date of the order, however, would not survive a retroactive ratemaking challenge.

*4* This initial brief is devoted exclusively to these conclusions.

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[1] The Commission approved the Rate Plan on August 9, 2000. *WUTC v. PacifiCorp d/b/a Pacific Power & Light Co.*, Third Supp. Order Approving and Adopting Settlement, Docket No. UE-991832 (2000). The Rate Plan restricts the Company's ability to increase general rates to 3 % in 2001, 3% in 2002 and 1% in 2003. No other increases are allowed through 2005 unless the Company meets the "PNB" standards for interim rate relief and is seeking such relief in Utah and Oregon. *Id.* at Appendix B, pp. 2-3 and 11.

By Commission order issued July 12, 2002, the Petition in Docket No. UE-020417 was consolidated with the general rate proceeding in Docket No. UE-991832.

## I. ARGUMENT

### A. General Principles of Retroactive Ratemaking: A Deferred Accounting Order Must Establish a Specific Rate Recovery Method for Costs Incurred After the Order is Issued

*5* The prohibition against retroactive ratemaking has not been addressed directly by the Commission in the specific context of a request for deferred accounting. However, it is a valid principle that has been adopted by this Commission, Washington courts, and other commissions and courts from across the country. The Circuit Court of Appeals for the District of Columbia stated the principle as follows:

> The retroactive ratemaking doctrine prohibits the Commission from authorizing or requiring a utility to adjust current rates to make up for past errors in projections. If a utility includes an estimate of certain costs in its rates and subsequently finds out that the estimate was too low, it cannot adjust *future* rates to "recoup the losses."

(Emphasis in original.) *Town of Norwood v. FERC,* 53 F.3d 377, 381 (D.C. Cir. 1995), citing, *City of Piqua v. FERC,* 610 F.2d 950, 954 (D.C. Cir. 1979).

*6* This Commission has adopted a similar viewpoint regarding the prohibition against retroactive ratemaking. It recently held that adjusting current rates to make up for past deficiencies is prohibited as retroactive ratemaking. Critical to the Commission's rationale were the requirements that ratepayers receive notice of charges prior to taking service and have the opportunity to participate in the proceeding that establishes such charges:

> The Commission determines that it is legally barred from granting PSE's petition to amend the accounting order in Docket No. UE-010410 under the doctrine of retroactive ratemaking. "The retroactive ratemaking doctrine prohibits the Commission from authorizing or requiring a utility to adjust current rates to make up

[2] At the prehearing conference, Staff indicated that the establishment of a specific cost recovery methodology is a relevant issue in this proceeding. (Tr. 50: 7-10.) That issue will be addressed in the written testimony to be filed in the case by all parties.

> for past errors in projections." *Town of Norwood, Mass. v. FERC*, 53 F.3d 377, 381 (D.C. Cir. 1995). With few exceptions (not applicable here) under RCW 80.28.020 the Commission is charged with setting rates on a *prospective* basis. Under RCW 80.28.050, every electrical company is required to file with the Commission tariffs showing the rates charged for service. Under RCW 80.28.080, no electrical company is permitted to charge a rate for service that deviates from its tariffed rate. Here, PSE proposes to reach back in time to alter the tariffed CIC rate.
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> > Retroactive rate making involves surcharges or refunds applied to rates which had been previously paid, constituting an additional charge applied after the service was provided or consumed. *The evil in retroactive rate making as thus understood is that the consumer has no opportunity prior to receiving or consuming the service to learn what the rate is or to participate in a proceeding by which the rate is set.* The Commission agrees that retroactive rate making, as thus understood, is extremely poor public policy and is illegal under the statutes of Washington State as a rate applied to a service *without prior notice and review.*
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> *WUTC v. U S West Communications, Inc.*, Docket No. UT-970010 Second Supp. Order at 10 (Nov. 7, 1997).

(Emphasis added.) *In re the Application of Puget Sound Energy*, Docket No. UE-010410, Order Denying Petition to Amend Accounting Order at ¶ 7 (November 9, 2001).[3] Predictability for ratepayers of the cost to receive service before service is

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[3] See also *In re Puget Sound Power & Light Co.*, Cause No. U-79-73, where the Commission considered a proposal to track power costs for two months, and then to reflect those costs in rates at the end of the two month period. That is, the utility proposed to recover in the future the actual cost of power incurred in the immediate past. The Commission concluded that the proposal was unlawful retroactive ratemaking. The Commission stated:

> The Washington Legislature has mandated the ratemaking process under the provisions contained in Title 80 RCW. RCW 80.28.020 requires the Commission to fix the rates to be observed. RCW 80.28.050 requires that electric rates be reflected in schedules filed with the Commission. RCW 80.28.080 requires that electrical companies charge only the rates "specified in its schedule". Thus, a plan that would make the total charge for the kilowatt hours sold during a given billing period something other than that specified in the company's schedules in effect at the time of sale – and unascertainable at the time of sale – is clearly prohibited."

Order at 3.

The company argued that all of the billings would be prospective, and based on the tariff then in effect. The Commission rejected this argument: "The plan proposed by the company clearly results in retroactive rates prohibited under the regulatory scheme framed by our legislature." *Id.* at 4. The

rendered is the essential goal of the rule against retroactive ratemaking. *Public Util. Comm'n of California v. FERC,* 988 F.2d 154, 163 (D.C. Cir. 1993).

*7* Retroactive ratemaking has also been addressed by the courts in this state on two occasions. In *Hearde v. City of Seattle,* 26 Wn. App. 219, 611 P.2d 1375 (1980), a city ordinance imposed a drought surcharge on electric rates. The court invalidated the ordinance to the extent the surcharge applied to customer usage that occurred before the ordinance became effective. The obligation to pay was fixed by the rates prescribed in the prior ordinance, and those rates could not be altered unless through the exercise of police power to protect a vital interest of the people. The existence of a severe drought did not qualify under the police power exception.

*8* In *State ex rel. Standard Oil Co. v. Department of Public Works,* 185 Wash. 235, 53 P.2d 318 (1936), the Commission found the existing rates of a utility to be excessive. However, the Commission did not have the authority to provide relief prior to the date a complaint for reparations was filed. The Court reasoned that to grant such relief would give "retroactive force" to the new rate, which was unlawful. *Id.* at 239.

*9* Admittedly, these cases involve perhaps the clearest forms of prohibited retroactive ratemaking: recovery through rates of costs incurred in past periods and changes to the effect of a rate contained in a published tariff. The retroactive nature of deferred accounting, however, has been addressed in the context of purchased gas adjustment (PGA) tariffs and power cost adjustment (PCA) tariffs since such tariffs often require the "true-up" of costs that have been deferred for later collection. PGAs and PCAs have been upheld against a challenge of retroactive ratemaking because the tariffs

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company, however, was not left without a remedy. The Commission considered the filing in the context of interim relief to account for immediately foreseeable excess power costs.

themselves prescribe a fixed mathematical formula that looks to past costs only to set prospective rates. The rates that result from the true-up of deferred costs, thus, is mandatory under tariffs already on file and in effect with the commission. *City of Norfolk v. Virginia Electric & Power Co.*, 90 S.E.2d 140, 148 (Va. 1955) (". . . the resulting rates under the escalator clause are as firmly fixed as if they were stated in terms of money."); *Colorado Energy Advocacy Office v. Public Serv. Co. of Colo.,* 704 P.2d 298, 305 (Colo. 1985); *People's Counsel v. Public Serv. Comm'n.,* 472 A.2d 860, 866-67 (D.C. 1984); *East Tenn. Natural Gas Co. v. FERC,* 631 F.2d 794, 800 (D.C. Cir. 1980) ("[The rule against retroactive ratemaking] does not prohibit the Commission from ordering a company to honor its tariff when the tariff itself calls for the adjustment.")

*10* This Commission has adopted a similar rationale. In *Utilities & Transportation Comm'n v. Puget Sound Power & Light Co.,* Cause No. U-81-41, the Commission approved an "Energy Cost Adjustment Clause", or ECAC. The tariff specifically included a formula designed to allow the company to recover its actual level of power supply costs. The proposal included a "true-up" of power costs deferred under the tariff.

*11* The Commission described unlawful retroactive ratemaking as: "surcharges or . . . refunds applied to rates which had previously been paid, constituting an additional charge applied after the service was provided or consumed." Second Supp. Order at 17. In the Commission's view, the proposed ECAC did not run afoul of the doctrine because:

> . . . the true-up involves a rate which was to be applied only prospectively and after hearing. A cost adjustment clause is prospective and not retroactive. It authorizes a fixed mathematical formula and is valid against a charge of retroactivity.

*Id.* at 18, citing *United Gas Corp., v. Mississippi Public Serv. Comm'n*, 127 So.2d 404 (Miss. 1961).

*12* Requests for accounting orders from the Commission authorizing a utility to defer certain costs, but without any tariff or other mechanism indicating that rates will collect the deferred costs, present a more dangerous issue of unlawful retroactive ratemaking. This is the scenario presented to the Commission by PacifiCorp's Petition. The issue is exacerbated even more because the Petition requests deferred accounting for costs incurred before a Commission order authorizing deferred accounting.

*13* Staff recognizes that, generally, when a commission authorizes deferred accounting, there may not be the potential for retroactive ratemaking, but rather a shift in the timing of the collection of the expense from future ratepayers. Goldman, *The Process of Ratemaking*, page 322 (1998). However, the utility must first seek permission from the commission to defer costs, and such permission is given prospectively. Commissions will not approve retroactive deferral of costs. *Id.*, citing, *In re Puget Sound Power & Light Co.*, 147 PUR 4th 80, 119 (Wash. 1993) (company ordered to immediately cease creating deferred accounts established without Commission approval); *In re Michigan Consol. Gas Co.*, 147 PUR 4th 1, 69 (Mich. 1993) (company authorized to defer only costs that exceeded amounts the company deferred previously without commission approval). See also *In re Pacific Power & Light Co.*, Cause No. U-82-12 and U-82-35, Fourth Supp. Order (1983); *In re Southern California Edison Co.*, 64 PUR 4th 452 (Cal. 1984) (commission refused to authorize inclusion in rate base of investment-related costs incurred after in-service date of generating plant but before accounting mechanism had been established to accrue those costs).

*14* Moreover, unlike a PGA or PCA, deferred accounting orders are not themselves tariffs and no other tariff is effective to indicate that rates will be set in the future to collect the costs that are deferred. Therefore, to assist against a retroactive ratemaking challenge, deferred accounting orders should establish a specific method for rate recovery of the deferred costs that are found by the Commission in a later proceeding to be reasonable and prudent. Establishment of a specific rate recovery method indicates *the Commission's* intent to create a regulatory asset which, in a rate case, would be amortized through rates as a current expense.[4] The critical interests of ratepayer notice and opportunity to review are also better protected.

### B. It is Unlawful Retroactive Ratemaking to Authorize Deferred Accounting For Costs Incurred Prior to a Commission Order

*15* Applying these principles to the Petition demonstrates that the power costs the Company requests to defer can only be costs that are incurred *after* the effective date of a Commission order authorizing deferred accounting and establishing a specific method for future collection of any such deferred costs that are determined in a rate case to be proper for recovery in rates. Allowing PacifiCorp to defer costs incurred *prior* to issuance of a Commission order constitutes unlawful retroactive ratemaking since it would allow PacifiCorp to defer costs incurred at a time when no tariff or other specific cost recovery method exists that contemplates recovery of such deferred costs from ratepayers.

[4] Similar treatment has been upheld for plant abandonment costs which are considered a current property loss and amortized through rates. *POWER v. Utilities & Transportation Comm'n*, 104 Wn.2d 798, 711 P.2d 319 (1985).

In fact, if anything, the current Rate Plan ensured ratepayers that, absent interim relief, they would not be held responsible for additional past, present or future costs through 2005 other than as allowed expressly by the Rate Plan.[5]

*16* The Commission may consider Staff's position to be inconsistent with a recent Commission order that allowed Avista Corporation to defer power costs incurred before the order was issued. *Petition of Avista Corporation,* Docket No. UE-000972, Order Approving Establishment of a Deferral Mechanism to Track Power Cost Expenses (August 9, 2000). The period for retroactive deferrals allowed for Avista, however, was only one month (July 1, 2000 to August 9, 2002). In contrast, if authorized, the period of retroactive deferrals for PacifiCorp likely will stretch over many months.

*17* Moreover, whether Avista's proposal constituted unlawful retroactive ratemaking was never presented to the Commission. The Commission simply did not decide that issue one way or another, and no party ever challenged the decision on retroactive ratemaking grounds.[6]

*18* Finally, the Commission may consider deferral of costs incurred prior to a Commission order permissible because recovery of such costs would occur prospectively

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[5] The Third Supplemental Order in Docket No. UE-991832 does allow the Company to submit petitions for accounting orders for the treatment of revenues, investments or expenditures during the Rate Plan period. *Id.* at Appendix B, p. 7. Whether this provision encompasses accounting petitions to defer "extraordinary" power costs is a question of interpretation that may be examined in the evidentiary phase of this case.

Furthermore, the provision allowing accounting petitions during the Rate Plan is silent on ratemaking implications. It does not authorize a tariff filing to collect any deferred costs. It provides no notice to ratepayers, and no entitlement to the Company, regarding the collection in rates of costs the Company seeks to defer. Such notice is achieved only by Commission order with respect to prospective costs.

[6] The Commission later modified the order in Docket No. UE-000972 to allow Avista to alter the power cost deferral mechanism. *Petition of Avista Corporation, supra,* Order Granting Request to Modify Power Cost Deferral Mechanism (January 24, 2001). The modification was granted, however, only upon condition that Avista file a specifc proposal that would address several cost recovery issues including prudency of the deferred costs, the appropriateness of recovery of the deferred costs, cost of capital offsets, and mitigation. *Id.* at 2-3. This is consistent with the Staff position rendered in the current proceeding.

under tariffs in effect at the time. Staff submits, however, that such reasoning virtually obliterates the doctrine of retroactive ratemaking and, thus, should be rejected. If recovery of a past cost is permissible so long as it is recovered from customers in future rates, then only the revision of a prior bill based on a later-approved tariff would constitute retroactive ratemaking. It would be difficult to defend such a conclusion under current law.

## III. CONCLUSION

*20* For the reasons set forth above, the Commission should issue an order declaring that it does not have legal authority to allow PacifiCorp to defer excess net power costs incurred prior to any order that authorizes deferred accounting and that establishes a method for deferred cost recovery. We request that such order be issued prior to the filing of written testimony which is set to commence October 18, 2002 since the Commission's ruling on this issue will help to frame the evidence the parties wish to present.

DATED This 28th day of August, 2002.

Respectfully submitted,

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