IN THE SUPREME COURT OF THE STATE OF OREGON

FRANK GEARHART; PATRICIA MORGAN; KAFOURY BROTHERS, INC.,
Petitioners,
Petitioners on Review,

and

UNIFORM REFORM PROJECT,
Petitioner,

v.

PUBLIC UTILITY COMMISSION OF OREGON and PORTLAND GENERAL ELECTRIC COMPANY,
Respondents,
Respondents on Review.

FRANK GEARHART; PATRICIA MORGAN; KAFOURY BROTHERS, INC.,
Petitioners
Petitioners on Review,

and

UNIFORM REFORM PROJECT,
Petitioner,

v.

PUBLIC UTILITY COMMISSION OF OREGON and PORTLAND GENERAL ELECTRIC COMPANY,
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Public Utility Commission of Oregon
08487, 09093

Court of Appeals
A140317
S061517 (Control)

January 2014

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AMICUS CURIAE BRIEF
OF THE EDISON ELECTRIC INSTITUTE

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I. Interest of Amicus

The Edison Electric Institute ("EEI") is the association of United States shareholder-owned electric companies. EEI's members include electricity generation, transmission, distribution, and service companies that operate in wholesale and retail markets throughout the country. They serve almost 99 percent of the ultimate customers in the shareholder-owned segment of the industry and nearly 70 percent of the electric utility ultimate customers in the nation, and they generate over 70 percent of the electricity generated by United States electric utilities. EEI represents the interests of the industry in general before state and federal courts, especially where issues of national importance are involved, as EEI believes there are in this case.

Virtually all of EEI's members are subject to regulation of their rates by state utility commissions performing functions similar to those of the Oregon Public Utility Commission ("OPUC"). Even states that allow for competition in the retail sales of electricity often continue to regulate rates for electricity supplies through provider-of-last-resort rules. For these reasons, the proper roles for state utility commissions in the approval of utility rates and for courts in reviewing ratemaking decisions are extremely important to EEI and its members.

In particular, as we note in our argument below, a ruling by this court not to affirm OPUC's ratemaking decision would alter the balance between the

commission and the courts in the rate regulation process and would increase the risk perceived by utility investors. At the end of the day, this would raise the cost of capital for utilities, which in turn would raise the rates of utility customers. That is why EEI supports affirmance here.

II. Summary of Issues to be Addressed

EEI addresses two issues in this amicus brief. The first concerns the proper role played by state utility commissions such as OPUC. Whether portrayed as a question of deference or separation of powers, utility commissions are charged with and specially suited to determining the proper balance between utility and consumer interests in setting rates. Indeed, those interests often coincide. If utilities do not get a fair return, their ability to provide reliable service to consumers is jeopardized, their cost of capital goes up, and customer rates are worse in the long run. Utility commissions are set up to provide an expert forum for making such determinations. Courts are experts at construing statutes and reviewing whether a commission has violated any law or acted arbitrarily and capriciously when setting rates. But they are not experts at setting those rates. If the dissent's view below is adopted by this court, however, the courts will effectively be dictating rates and taking over the role that the legislature has vested in OPUC. That result would be wrong as a matter of law and bad policy as well. It

would create unanticipated risks for investors, raising the costs of capital and harming consumers in the long run.

The second issue concerns when rates become confiscatory to the point of violating the takings clause of the U.S. Constitution. This is an important issue for EEI members because electric utilities are among the most capital intensive enterprises in our nation. They ultimately rely on retail rates approved by state commissions such as OPUC to recover their investments and to repay their lenders, enabling them to attract additional capital on reasonable terms. In a number of seminal Supreme Court decisions, the Court has specified that utilities are entitled to a return of their investments to ensure that the utilities can remain financially sound and to avoid an unconstitutional taking.

To put this issue in perspective, during the time period after the Trojan plant involved in this case was being built, the utility industry faced changes in circumstances beyond its control that led to the premature closure or outright abandonment of a number of projects costing billions of dollars. In the 1970's, based on growth in electricity demand in the preceding decades and predicted costs to build and operate generation facilities, utilities vastly expanded their investments in projects such as nuclear generating plants and plants to convert coal into synthetic gas. *See,* 2 Energy Information Admin., U.S. Dep't of Energy, "Projected Costs of Electricity from Nuclear and Coal-Fired Plants" 1, 41 n.9

(1982). These investments were fueled in large part by estimates of increased electricity usage in the coming decades that did not prove out in the long run. Because these kinds of projects had (and continue to have) lead times of eight to twelve years and occurred during a period of very high inflation, however, billions of dollars were by necessity committed based on prudent business projections. *See*, U.S. Dept. of Energy, "Impacts of Financial Constraints on the Electric Utility Industry," 38 (1982). An unusually high percentage of these projects were cancelled or abandoned, especially after the Three-Mile Island disaster delayed construction pending additional safety reviews and changes. *See*, Energy Information Administration, U.S. Dept. of Energy, "Nuclear Plant Cancellations; Causes, Costs, and Consequences," xviii, table § 2, xxi table § 4 (1982).

The broad importance of the issues EEI plans to address, and these background facts about the electric utility industry's investment in major capital facilities during the Trojan time frame, show why this case has attracted EEI attention. The Court of Appeals has already ruled on the question of what utilities may recover under Oregon law in connection with retired plants, determining that they are entitled to a return *of*, but not a return *on*, investments that were prudent when incurred, but, in the public interest, were retired before the investment is fully recovered in rates. *Utility Reform Project v. PUC*, 154 Or App 702, 713, 962 P2d 744 (1989), *rev. dismissed*, 335 Or 91, 53 P3d 822 (2002). This case asks the

separate question of what roles OPUC and the courts play in the rate-setting process where past rates are involved.

EEI strongly supports the positions of OPUC and PGE concerning why the Court of Appeals' majority decision to accept the decisions and reasoning of OPUC complies with Oregon's ratemaking statutory scheme. We believe that the Court of Appeals' decision is consistent with the sound public policy the Oregon legislature sought to achieve through its ratemaking laws, and that adopting the dissent's view would go against that sound public policy and likely violate constitutional proscriptions against confiscatory rates.

III. Argument

A. The Court Should Uphold the Majority's Decision as Consistent With Sound Ratemaking Principles and as Beneficial to Utilities and Consumers Alike.

Many states, including Oregon, bestow on electricity utilities exclusive rights to serve defined territories. These states substitute regulation for competition to further the public interest. If utilities competed in the same service areas, they would have to make duplicative outlays of the significant capital needed for infrastructure development. This would waste economic resources and compound harm to the environment. It would also raise consumers' rates by spreading those duplicative costs over the same number of ratepayers who would otherwise be paying for those costs only once. Minimizing waste of economic and

environmental resources and avoiding unnecessary rate increases are inarguably in the public interest.

Moreover, the capital-intensive nature of electric utility services, which involve the construction and maintenance of generation plants, substations, power lines, and poles to provide reliable service of this basic business and household necessity, requires regular visits to the long-term capital markets for projects costing in the hundreds of millions of dollars or more. Utilities' costs of capital depend on the capital markets' assessment of risk. When investors can depend on the predictability and stability in cash flows that result from a clear regulatory system for approving and publishing rate orders and a clear process for appealing such orders with defined roles for the commissions and the courts, capital costs are lower and consumers and utilities both benefit.

The Oregon legislature has provided just such a framework for ratemaking. As is true of every state in the Union, OPUC sets rates through public proceedings to ensure that customers receive safe, reliable services at reasonable rates, while utilities are provided with cost recovery (including a return on capital for used and useful facilities) through rates that are just and reasonable. The OPUC process provided in ORS Chapter 757 is far more open to input from all stakeholders than any court proceeding, which of necessity must impose narrower procedural and evidentiary restrictions than in a rate proceeding. OPUC rate cases

have more in common with legislative hearings than with trials, as the legislature has charged the agency with executing its statutory mandates. *See Valley & Siletz R. Co. v. Flagg*, 195 Or 683, 715, 247 P2d 639 (1952) (characterizing ratemaking as a legislative function). Once that full and fair process has addressed all utility rate issues raised by each stakeholder constituency, OPUC approves rates that are subject to deferential standards of review by the Oregon courts. Those rates are valid so long as OPUC correctly applied the law, there is substantial evidence in the record as a whole to support the rate order, and OPUC did not abuse its discretion. ORS 183.482(8). The issue in this case is whether the rates approved by OPUC are lawful. Rates are unlawful only when they are (1) unjust and unreasonable, ORS 756.040, (2) discriminatory, ORS 757.310(2), or (3) confiscatory, ORS 756.040. *Pacific Tel. & Tel. Co. v. Wallace*, 158 Or 210, 297, 75 P2d 942 (1938); *American Can v. Lobdell*, 55 Or App 451, 461-62, 638 P2d 1152, *rev. den.*, 293 Or 190, 648 P2d 851 (1982). Even when a reviewing court overturns a commission rate order on one of these grounds, the remedy is not for the court to set the rates itself but rather to remand to OPUC to remedy the error.

The legislature's distribution of authority between OPUC and the courts represents an undeniably sound policy choice. Commissions have ratemaking expertise. Courts do not. This court's decision in *Dreyer v. Portland General Electric Co.*, 341 OR 202, 285-87, 142 P3d 1010 (2006), to abate the

Marion County class action so that OPUC could exercise its primary jurisdiction to determine whether ratepayers had been injured and, if so, the extent of their injury, clearly recognized the distinction in the roles played by OPUC and the courts.

The dissent below purports to recognize that OPUC has the authority on remand to re-evaluate an entire rate structure when it makes an error that the Court of Appeals has corrected. 255 Or App at 107-08 (Schuman, J., dissenting). But the dissent then creates a distinction found nowhere in OPUC's governing statutes between "ordinary ratemaking" and what occurred on remand here. *Id.* What the dissent proposes would effectively turn the courts into ratemaking bodies, because it would impose on OPUC the duty to do nothing more than produce a mathematical calculation. There would be no real reason to remand. This would be single-issue ratemaking that fails to recognize how changing or removing one input affects others in the ratemaking process.

Regulated utilities across the country recognize that such a reallocation of roles between commissions and the courts would have a deleterious effect on utilities' costs of capital and eventually on consumer rates. The dissent's approach ignores OPUC's role in balancing the special relationship between utilities and consumers. While consumers would receive refunds in the short run, they would face greater harm in the long run. By shifting away from the roles the legislature has assigned to OPUC and the courts, the dissent would increase the

risk perceived by investors, who would in turn demand higher returns to compensate for that risk.

This is particularly harmful for the capital intensive electric industry. *See Missouri, ex rel. Southwestern Bell Telephone Co. v. Public Services Commission*, 262 US 276, 308 (1923) ("*Southwestern Bell*") (Brandeis, J., concurring) ("the community can get cheap service from private companies only through cheap capital"). A few additional basis points on bonds or loans with principal in the hundreds of millions of dollars for individual projects and in the billions of dollars across the nation can translate into significant additional costs for utilities, which in turn can translate into increased rates for consumers. *See* Roger A. Morin, *New Regulatory Finance*, 42-45 (2006). Indeed, it is accepted without controversy among regulatory finance experts that the perception of increased "regulatory risk"[1] raises both the cost of capital and corresponding rates and can have broader effects on the utility's region as a whole. As Professor Morin states, "Unreasonable rate treatment for any utility can not only raise the cost of capital and, hence, ratepayer burden, but may also have serious public policy implications and repercussions for the entire business or economic region." *Id.* at 44.

[1] "Regulatory risk" refers to the quality and consistency of regulations applied to a given regulated utility, including particularly the technique employed by the regulatory system to determine and review rates. *Id.* at 43.

B. **The Majority's Decision Also Is Consistent With Supreme Court Takings Precedent.**

The central ratemaking role of the utility commissions has produced a line of U.S. Supreme Court constitutional takings case law that dates back to the late 19th Century. In *Reagan v. Farmers' Loan and Trust Co.*, 154 US 362 (1894), the Court early on articulated the analogy between regulatory ratemaking and the government's exercise of eminent domain. The case involved an order by the Texas Railroad Commission to lower the rates being charged by a failing railroad. The Court said that there could be no doubt that, under the takings clause of the 5th Amendment as applied to the states through the 14th Amendment, Texas would have to pay the fair market value if it sought to acquire **title** to the roads themselves.[2] In turn, the Court concluded that there can equally be no doubt that the State must also pay fair market value when it takes the **use** of the roads for a public benefit. *Id.* at 410.

[2] The Fifth Amendment to the United States Constitution provides: "[N]or shall private property be taken for public use, without just compensation." The Oregon Constitution provides: "Private property shall not be taken for public use, nor the particular services of any man be demanded, without just compensation." Consistently, ORS 757.210(1) provides that rates approved by OPUC that are "fair, just and reasonable" meet the just compensation constitutional standard by balancing the interests of consumers and investors. *See* ORS 757.040(1). The Fifth Amendment's takings clause was recognized as being incorporated into the Fourteenth Amendment in *Chicago, B. & Q. Railroad v. Chicago*, 166 US 226, 238-239 (1897).

In subsequent rate cases, the Court went on to consider precisely what the government is taking when it regulates the value of a shareholder-owned utility. In the first landmark utility ratemaking case, *Smyth v. Ames*, 169 US 266, 547 (1898), the Court posited that a utility is entitled to a return on the value of that which it employs for the public convenience. However, in his concurring opinion in *Southwestern Bell* two decades later, Justice Brandeis criticized this thinking as "legally and economically unsound." Brandeis reasoned that it is not the specific property "but capital embarked in the enterprise" that the utilities' investors have devoted to public use. 262 US at 290. While Justice Brandeis' view did not rise to the level of a constitutional standard, it influenced state statutory schemes for how commissions set rates to provide a fair rate of return on investment.

For takings purposes, the Court turned away from looking at particular factors commissions used to set rates and instead focused on the ultimate effects of the final rate order. In two cases decided forty-five years apart, *Federal Power Commission v. Hope Natural Gas Co.*, 320 US 591 (1944) ("*Hope*") and *Duquesne Light Co. v. Barasch*, 488 US 299 (1989) ("*Duquesne*"), the Court established a substantive standard of constitutional review requiring that the total effect of the rate order must not be confiscatory, but instead must be "just and reasonable." *Hope*, 320 US at 603; *Duquesne*, 488 US at 310-12. Determining whether rates meet this standard requires a balancing of investor and consumer

interests. *Hope*, 320 US at 603. The *Hope* Court described that investor interest as an interest in receiving enough revenue for operating expenses, for capital costs, for service of debt and dividends on stock commensurate with returns on investments in other enterprises with corresponding risks, and for maintaining the financial integrity of the enterprise so as to maintain its credit and to attract capital. *Id*. If rates do not "afford sufficient compensation to the investor-owned utility, the State has taken the use of utility property without paying just compensation" and thereby has violated the Fifth and Fourteenth Amendments of the U.S. Constitution. *Duquesne*, 488 US at 308.

The *Hope* and *Duquesne* cases remain the starting point for a constitutional analysis for evaluating utility rates to determine whether rates are confiscatory. *Hope*, 320 US 591; *Duquesne*, 488 US 299. The *Hope* Court stated: "If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry … is at an end." *Hope*, 320 US at 602. The Court's emphasis was therefore on the effects of rates regardless of any "infirmities" in the methodology under which the rates were set. *Id*.; *see also Duquesne*, 488 US at 310 (reaffirming *Hope*). This court has cited the "manifest wisdom" of the *Hope* rule. *Valley & Siletz R. Co. v. Flagg*, 195 Or at 698-99 (railroad rate case).

On the investor side of the investor/consumer interest balance, the *Hope* Court stated that an investor in a utility "has a legitimate concern with the

financial integrity of the company." *Id*. at 603. The investor's return "should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." *Id*. (citing *Southwestern Bell*, 262 US at 291 (Brandeis, J., concurring)). "Rates which enable [a] company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risk assumed certainly cannot be condemned as invalid." *Id*. at 605. In simple terms, an investor-owned utility must be able to give a reasonable rate of return to its investors and to raise capital at a reasonable cost.

The *Duquesne* Court clarified that an otherwise reasonable rate is not subject to constitutional attack "by questioning the theoretical consistency of the method that produced it." 488 US at 314. "It is not the theory, but the impact of the rate order which counts." *Id*. (quoting *Hope*, 320 US at 602). The Court went on to state:

> "Errors to the detriment of one party may well be canceled out by countervailing errors or allowances in another part of the rate proceeding. The Constitution protects the utility from the net effect of the rate order on its property. Inconsistencies in one aspect of the methodology have no constitutional effect on the utility's property if they are compensated by countervailing factors in some other aspect."

Id.

As recognized by the Court of Appeals majority in this case, OPUC's discretion in its legislative function of setting rates is subject only to statutory and constitutional restraints. 255 Or App at 61. Rates are prohibited and unlawful if

the rates are confiscatory. *Id*.; *Pacific Tel.& Tel. Co. v. Wallace*, 158 Or 210, 297 (1938). Here, according to the Utility Reform Project ("URP") and PGE, the dissent's methodology would lead to PGE being ordered to pay $958,000,000-959,000,000 plus interest in refunds, well more than its combined 2010-2012 three-year net operating income. *See* URP Brief p. 2; PGE Brief p. 35, n. 15. Such an end-result would be confiscatory under any measure.

Furthermore, the dissent's recommended methodology has the potential to cripple an investor-owned utility, a result that is neither just nor reasonable under any standard. The dissent would have OPUC look at one factor in isolation, which would deprive PGE of the benefit of any "countervailing factors" that would otherwise have affected directly related aspects of OPUC's ratemaking had it calculated the rate without the legal error of including a return on the unamortized Trojan balance in the first instance. *Duquesne*, 488 US at 314. The dissent itself acknowledged that such "single issue ratemaking" is generally impermissible. 255 Or App at 108. Indeed, it is exactly contrary to *Hope* and *Duquesne*. That is because ratemaking decisions cannot be made in isolation due to the interdependent nature of individual rate elements. *See* 255 Or App at 81; *Duquesne*, 488 US at 314.

OPUC's decision to revisit its ratemaking approach on remand after the Court of Appeals had rejected the award of a return on the unamortized

investment was the proper way to implement its responsibilities. In comparison, the dissent's refusal to allow OPUC to apply its expert judgment would lead to a constitutionally invalid result. In short, on remand from this court, OPUC acted consistently with *Hope* and *Duquesne*. The dissent itself recognized that the *Dreyer* opinion suggested that OPUC could, on remand, determine any damages that resulted from its legal error by determining what fair and reasonable rates would be if the rate did not include Trojan. 255 Or App at 110. "Doing so, the [*Dreyer*] court assumed, would involve excluding the return on Trojan from PGE's revenue requirement for the relevant period, establishing hypothetical rates as a result of the reduced revenue requirement that would follow from that exclusion, and then evaluating the resulting rates for fairness and reasonableness." *Id*. This is exactly what OPUC did, as thoroughly explained by the Court of Appeals majority. 255 Or App at 81-82. If instead OPUC had engaged in single-issue ratemaking and simply subtracted the inappropriate factor from the 1995-2000 rates, the result would have been neither fair nor reasonable to PGE.

IV. Conclusion

The majority decision properly preserves the lines between OPUC and the courts and accords with the sound policy enacted by the legislature by which OPUC sets rates to balance the interests of utility investors and consumers. The dissent's view would distort those lines and impose rates that would harm

consumers in the long run and likely violate PGE's constitutional rights to just compensation. The decision below should be affirmed.

DATED this 24th day of January, 2014.

Respectfully Submitted,

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I certify that (1) this brief complies with the word-count limitation in ORAP 5.05(2)(b) and (2) the word-count of this brief (as described in ORAP 5.05(2)(a)) is 3,544 words.

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DATED this 24th day of January, 2014.

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I hereby certify that on the date set forth below, I directed the original ***AMICUS CURIAE*** **BRIEF OF THE EDISON ELECTRIC INSTITUTE** to be filed electronically with the Appellate Court Administrator, Appellate Records Section, through the eFile system and served said document electronically through the same eFile system on:

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