BEFORE THE PUBLIC UTILITY COMMISSION OF OREGON

UM 1224

UTILITY REFORM PROJECT and KEN LEWIS, **Application for Deferred Accounting,** **(UM 1224)**	**OPENING BRIEF OF UTILITY REFORM PROJECT AND KEN LEWIS** **April 14, 2008**

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The only substantive issues remaining in this docket is how much money PGE should be required to return to ratepayers due to its overcollecting of income taxes during the deferral period, October 5, 2005, through December 31, 2005, and when that amount should be returned.

The Oregon Public Utility Commission (OPUC) has already decided that this overcollection of income taxes warrants deferral under ORS 757.259. While ORS 757.259 provides the mechanism for deferral and later amortization, it is ORS 757.267 and ORS 757.268 that provide the substantive legal basis for requiring PGE to (1) quantify its income tax overcollection for the last few months of 2005 and (2) return that income tax overcollection to ratepayers, so that the rates charged by PGE are not unjust and unreasonable. ORS 757.267 (1)(f).

The specific remaining substantive questions are:

1. How much was PGE's income tax overcollection during the deferral period?

2. What interest rate should be applied to the income tax overcollection?

3. Should less than all of the deferred income tax overcollection be returned to PGE ratepayers?

4. When should ratepayers receive back in rates the deferred income tax overcollection?

I. POTENTIAL ISSUES OF PROCEDURE.

At the April 2, 2008, hearing, counsel for URP raised three procedural questions (by means of a handout and oral discussion).[1] The administrative law judge directed

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1. Below the questions, as stated in the handout, are presented in quotation marks.

that these questions be addressed in the briefs. No party objected to proceeding with the evidentiary hearing, and all appeared to assume that the subject of this proceeding was to determine the amortization of the amount ordered deferred by OPUC Order No. 07-351.

> **"1. Is this a ratemaking proceeding?**
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> OPUC Order No. 07-351 (p. 8) states: Ratemaking treatment of these deferred revenues is reserved for a ratemaking proceeding."

It is the position of Utility Reform Project (URP) and Ken Lewis [hereinafter "URP"] that this phase of UM 1224 is a ratemaking proceeding.

> **"2. Is this a proceeding under ORS 757.210 to change rates?**
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> ORS 757.259(5) states:
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> > (5) Unless subject to an automatic adjustment clause under ORS 757.210(1), amounts described in this section shall be allowed in rates only to the extent authorized by the commission in a proceeding under ORS 757.210 to change rates and upon review of the utility's earnings at the time of application to amortize the deferral. The commission may require that amortization of deferred amounts be subject to refund. The commission's final determination on the amount of deferrals allowable in the rates of the utility is subject to a finding by the commission that the amount was prudently incurred by the utility."

The revenues at issue in this case are not "subject to an automatic adjustment clause under ORS 757.210(1)." The automatic adjustment clause provisions of SB 408 apply to amounts that are collected and paid for income taxes for the period commencing with January 1, 2006, and not before. Thus, it would appear that amortization of the deferred amount "shall be allowed in rates only to the extent

authorized by the commission in a proceeding under ORS 757.210 to change rates and upon review of the utility's earnings at the time of application to amortize the deferral."

While we would prefer to resolve the issue of the amortization of the deferred amount in this proceeding, the above statute appears to require that amortization into rates be allowed only in a ORS 757.210 proceeding. It does not appear that UM 1224 is such a proceeding. Perhaps PGE's filing of its testimony on November 30, 2007, could be considered to be a filing under ORS 757.210, except that its filing did not state or establish a new rate or schedule of rates, as PGE contends that none of the deferred revenue should be returned to ratepayers.

"3. Is this a proceeding to handle a request for amortization of a deferred account under OAR 860-027-0300(9)?"

OAR 860-027-0300(9) states:

> Amortization: Amortization in rates of a deferred amount shall only be allowed in a proceeding, whether initiated by the energy or large telecommunications utility or another party. The Commission may authorize amortization of such amounts only for utility expenses or revenues for which the Commission previously has authorized deferred accounting. Upon request for amortization of a deferred account, the energy or large telecommunications utility shall provide the Commission with its financial results for a 12-month period or for multiple 12-month periods to allow the Commission to perform an earnings review. The period selected for the earnings review will encompass all or part of the period during which the deferral took place or must be reasonably representative of the deferral period. Unless authorized by the Commission to do otherwise:
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> > (a) An energy utility shall request that amortizations of deferred accounts commence no later than one year from the date that deferrals cease for that particular account; and

> (b) In the case of ongoing balancing accounts, the energy utility shall request amortization at least annually, unless amortization of the balancing account is then in effect; or
>
> (c) A large telecommunications utility shall request amortization of deferred accounts as soon as practical after the deferrals cease but no later than in its next rate proceeding.

This rule contemplates that there exists a "request for amortization of a deferred account." We are not aware that such a request has expressly been made in this docket. Obviously, no such request could be made, until the Commission ordered PGE to defer the amounts sought in the UM 1224 Application for Deferred Accounting. That was done in OPUC Order No. 07-351 on August 14, 2007. The ALJ's Memorandum and Ruling (January 29, 2008) correctly notes that URP requested the prehearing conference.[2] The request noted that "UM 1224 has no schedule beyond the filing of testimony by PGE on November 30, 2007," and that "I want to establish a

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2. That request was conveyed to the ALJ and parties by email from Daniel Meek on January 11, 2008, stating:

> Dear ALJ Kirkpatrick:
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> I was under the impression that the schedule for UM 1224 was supposed to be the same as for UE 178, so that both would produce final orders at the same time. But I am now told that such is not the case and that UM 1224 has no schedule beyond the filing of testimony by PGE on November 30, 2007.
>
> I want to establish a schedule for completing UM 1224. That would include, as in UE 178, a staff report regarding the PGE filing (pertaining to the difference between income taxes charged to ratepayers v. income taxes paid by the utility for the deferral period, which is October 5, 2005, through December 31, 2005). Then would come intervenor testimony, PGE rebuttal, etc.
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> For PGE, David White is available for a PHC on January 15, 17 and 18. For Staff, David Hatton is available on January 18, 23, 24 in the PM, 25, 28 in the PM, and 31. I am available on January 17 pm, 18 pm, 21, 23 pm, and 24 pm. So it appears the first date that is good for everyone is January 18 in the afternoon.
>
> I request that you schedule a PHC at the earliest available time. Thank you.

schedule for completing UM 1224." URP's request to complete UM 1224 can be considered a "request for amortization" of the deferred account established by OPUC Order No. 07-351.

II. HOW MUCH WAS PGE'S INCOME TAX OVERCOLLECTION DURING THE DEFERRAL PERIOD?

URP agrees with Staff that the proper amount to be considered for deferral is $26.5 million, plus appropriate interest.

A. THE PGE ALTERNATE METHODS ARE NOT CONSISTENT WITH THE COMMISSION'S ADOPTED AR 499 METHODOLOGY.

PGE offers numerous other ways to calculate its income tax overcollection during the deferral period. But none of those methods is consistent with the methodology adopted by the Commission in AR 499 (rulemaking) or in any of its other subsequent orders implementing SB 408. The substantive law that requires PGE to return its income tax overcollections to ratepayers is, in all of these cases, SB 408. There is nothing in ORS 757.259 that requires this, as that statute merely outlines procedures and does not grant either ratepayers or the utility any entitlement to deferred amounts. Thus, since the same substantive law applies, there would appear to be no reason to change the methodology for this docket. Further, the Commission already intimated in OPUC Order No. 07-351 that the AR 499 methodology would apply (directing PGE to use the OAR 860-022-0041 method).

B. THE PGE ALTERNATE METHODS DO NOT ACCURATELY TRACK OR MODEL THE AMOUNTS CHARGED TO RATEPAYERS FOR INCOME TAXES.

In addition, PGE's methods do not accurately track or model the amounts charged to ratepayers for income taxes. In essence, PGE argues that the amount of income taxes charged to ratepayers should be deemed equal to PGE' hypothetical income tax liability as a stand-alone utility. Thus, if PGE were to earn half of its authorized rate of return, it would calculate an income tax liability roughly half of the amount assumed in the rate case. Conversely, if PGE were to earn double its authorized rate of return, it would calculate an income tax liability roughly double of the amount assumed in the rate case.

But such wild fluctuations in income taxes charged to ratepayers do not happen. The "income taxes" paid by ratepayers are embedded in the per-unit rates. If the utility sells more units than projected in the rate case, then indeed ratepayers pay more to the utility for income taxes. If the utility sells fewer units than projected in the rate case, then indeed ratepayers pay less to the utility for income taxes than projected in the rate case. As confirmed by Staff witness Carla Owings during cross-examination (TR 48), the actual amounts charged to ratepayers for income taxes vary with the utility's gross income, not its net income.

> Q. Now would the amount of income taxes charged to ratepayers vary according to the utility's actual net income?
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> A. It would vary according to the utility's actual gross income, and not its net income.

The PGE methods produce wildly erroneous results by assuming that the charges to ratepayers for income taxes vary with the utility's net income, which is simply wrong.

C. PGE PROPOSES TO USE ITS ALTERNATE METHODS INCONSISTENTLY--ONLY WHEN IT RESULTS IN BENEFIT TO PGE SHAREHOLDERS AND HARMS RATEPAYERS--IN VIOLATION OF ITS OWN STATED GOAL OF SYMMETRY IN REGULATION.

Further, upon cross-examination it was established that PGE would not agree to applying its new method to its own SB 408 filing for 2007. In 2007, PGE earned far more than in 2006. Exhibit URP-200. Until PGE files its 2007 Annual Results of Operations Report to the OPUC, we cannot confirm that PGE earned in 2007 more than its authorized rate of return, although that appears very likely. Under the assumption that PGE earned more than its authorized rate of return in 2007, applying PGE's new method would find that ratepayers actually paid far more for income taxes than projected in the rate case and far more than the AR 499 methodology would calculate.

The PGE witnesses declined to agree to apply its new method to its 2007 filings under SB 408. Consequently, it appears that PGE believes that its new method should apply only when it allows PGE to keep more money and not when it allows ratepayers to keep more money. Thus, while PGE argues for avoiding the alleged "double whammy" in this docket, PGE is perfectly fine with benefitting from the same "double whammy" pertaining to its 2007 income tax undercollection. This is a prime example of the "asymmetry" that the PGE witnesses claimed should be avoided in ratemaking.

> Q. So then will PGE be proposing to forgo its expected $16 million surcharge for 2007 if the Company during 2007 earned more than its authorized rate of return?
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> A. (Mr. Hager) I am not aware of any discussions about that question.

Q. Wouldn't that be a symmetrical treatment to what you're proposing in this docket?
A. (Mr. Hager) No, I don't think so.
Q. Can you explain why not?
A. (Mr. Hager) Again, I think what is in this docket is under 757.259, the deferral. What we are talking about in 2007, I believe, is different.
Q. Well, let's talk about general rate making principles. That's where you're asserting that symmetry is a desirable feature in general, aren't you?
A. (Mr. Hager) I did not say that. Asymmetry in the treatment of the tax effects is something we should avoid. I agree with that in general.
Q. Okay. So in general, this asymmetry is to be avoided. Is your position in this docket then asymmetrical with the assertion that you can surcharge ratepayers $16 million for 2007?
A. (Mr. Hager) You'll have to repeat that question for me, Mr. Meek. I'm sorry.
Q. Well, is it symmetrical for PGE not to return to ratepayers the deferred amount for 2005 while charging ratepayers for the deferred amount in 2007, assuming the Company has already earned more than its authorized rate of return in 2007?
A. (Mr. Hager) Well, again, I think what's

happening is in the first case in terms of the credit that falls under a different --
Q. Well, let's just talk about general rate making principles here.
A. (Mr. Hager) Then you would have to state your question in very general terms.
Q. I believe I did.
A. (Mr. Hager) Repeat it for me again. I missed it.
Q. Well, is it symmetrical to say that the Company should not return to ratepayers over -- let's just use a shorthand tax -- over collections during a deferral period if a Company did not earn its authorized rate of return during the deferral period while at the same time charging ratepayers for the Company's tax undercollections even if the Company earned more than its authorized rate of return during the deferral period?

* * *

Q. So what you're proposing for 2007 is an instance which tends not to happen, in your words?

A. (Mr. Hager) It is an instance of asymmetry.

TR, pp. 27-29, 31.

III. WHAT INTEREST RATE SHOULD BE APPLIED TO THE INCOME TAX OVERCOLLECTION?

The $26.5 million in income tax overcollection from ratepayers did not all occur on December 31, 2005. The overcollection occurred ratably over the 88-day deferral period. Thus, interest on the deferred amount should commence as of the midpoint of that period, which is November 17, 2005.

To be consistent with the Commission's other rulings implementing SB 408, the rate of interest should be PGE's authorized rate of return for all periods since November 17, 2005. Since the deferred amount is to be amortized over a period of months, the interest on the declining balance should continue to accrue during the amortization period.

IV. SHOULD LESS THAN ALL OF THE DEFERRED INCOME TAX OVERCOLLECTION BE RETURNED TO PGE RATEPAYERS?

SB 408 requires the Commission to return all of PGE's income tax overcollections in this docket to ratepayers, with interest as noted above.

The OPUC decisions to establish the deferred account and its earlier decisions reducing rates for PacifiCorp, effective in October 2005, reflect the Commission's legal determination that SB 408 applies to utility rates as of its effective date, September 2, 2005, provided that the amounts at issue have been properly deferred.

PGE and Staff here argue that PGE should not be required to return any of the deferred amount, simply because PGE earned less than its authorized rate of return during the deferral period (and during a 12-month period that included the deferral

period). Such a conclusion would violate both SB 408 and the rule against retroactive ratemaking. The source of the utility's obligation not to charge ratepayers more for income taxes than the utility (or its parent) actually pays to government is not ORS 757.259. The source of that obligation is SB 408, mostly codified at ORS 757.267 and ORS 757.268. Whether SB 408 applies to utility rates prior to January 1, 2006, has already been decided by the Commission in OPUC Order No. 07-351 and OPUC Order No. 06-379.

PGE and Staff now argue that the properly deferred amount (which we and Staff say is $26.5 million, plus interest) should be offset by the amount that PGE allegedly did not earn its authorized rate of return during a 12-month period that includes the deferral period. This clearly violates the rule against retroactive ratemaking, which the OPUC has expressly followed for at least 20 years. It was set out in an opinion letter from the Attorney General to then-Commissioner, Charles Davis, who defined retroactive ratemaking as:

> "the setting of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match expenses plus rate-of-return with the rate actually established." ***State ex rel Util. Consumers Council v. P.S.C.***, 585 SW2d 41, 59 (Mo 1979) (hereafter ***Consumers Council***)* * * .

Another court stated the rule slightly differently:

> "Technically, retroactive rate making occurs when an additional charge is made for past use of utility service, or the utility is required to refund revenues collected, pursuant to then lawfully established rates, for such past use." * * *

> "* * * Prospective rate making to recover unexpected past expense, or to refund expected past expense which did not materialize, is as improper as is retroactive rate making."
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> ***State ex rel Utilities Com'n. v. Edmisten***, 291 NC 451, 232 SE2d 184, 194-95 (1977).

Or Opinion of the Attorney General OP-6076 (*Davis*), 1987 WL 278316 (March 18, 1987). This rule necessarily precludes applying past profits or losses in future rates. Here, PGE seeks to recoup past losses, which is clearly prohibited by the rule against retroactive ratemaking.

As the Commission noted in OPUC Order No. 02-227 (pp. 8-9):

> The filed rate doctrine is a companion to the rule against retroactive ratemaking, and these two concepts are cornerstones of Oregon regulatory law. Then Commissioner Charles Davis explained the connection between the filed rate doctrine and the rule against retroactive ratemaking as follows:
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> > There is a rule of law that utility rates may not be made retroactively in absence of express statutory authority. . . . From the customer's viewpoint, the principle underlying the prohibition against retroactive ratemaking is that the customer should know what a utility service costs him at the time he takes it. The posted tariff on the day of service represents a contract between the customer and the utility. The customer should not expect to pay more and the utility should not expect to get less.
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> Testimony of Commissioner Charles Davis on HB 2145, March 21, 1987, at 3.
>
> Under the filed rate doctrine and the rule against retroactive ratemaking, the Commission's ratemaking function must be prospective unless the Legislature authorizes that it be otherwise. The Oregon Attorney General Opinion No. 6076, March 18, 1987, 1987 WL 278316, at 5, notes that where the rule against retroactive ratemaking does not implicate constitutional concerns, the Legislature may authorize the Commission to act retroactively. The Oregon Legislature has authorized retroactive ratemaking in two cases: ORS 757.215(4) and (5) (permitting refunds for

interim and nonsuspended rates) and ORS 757.259 (permitting deferred accounting orders).

Note that neither of these exceptions apply to the PGE proposal. The PGE income tax overcollection was properly deferred, pursuant to URP request under ORS 757.259. But PGE's absence of profits during the deferral period was never deferred pursuant to any statute. PGE filed no request to defer for future collection its alleged revenue shortfall. A legally deferred amount cannot be offset against an amount that was not legally deferred (and probably never could be).

PGE also misstates the applicable "earnings test." The applicable statute, ORS 757.259(5), states (emphasis added):

> (5) Unless subject to an automatic adjustment clause under ORS 757.210 (1), amounts described in this section shall be allowed in rates only to the extent authorized by the commission in a proceeding under ORS 757.210 to change rates **and upon review of the utility's earnings at the time of application to amortize the deferral**. The commission may require that amortization of deferred amounts be subject to refund. The commission's final determination on the amount of deferrals allowable in the rates of the utility is subject to a finding by the commission that the amount was prudently incurred by the utility.

The only earnings test that the statute allows is the "review of the utility's earnings at the time of application to amortize the deferral." The phrase "at the time of the application to amortize the deferral" clearly modifies the phrase "utility's earnings." Thus, the only allowable earnings review in this proceeding would be a review of PGE's earnings "at the time of the application to amortize the deferral."[3] As noted

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3. To the extent OAR 860-027-0300(9) contemplates some other type of earnings review, it is unlawful and beyond the OPUC's authority.

earlier in this brief, that time was when URP requested a prehearing conference to complete this UM 1224 proceeding, which occurred on January 11, 2008.

Further, PGE's obligation to return the income tax overcollection to ratepayers stems from ORS 757.267, ORS 757.268, and ORS 757.210, which forbids any "rate or schedule of rates that is not fair, just and reasonable." ORS 757.259 then provides the procedural mechanism for returning the funds to ratepayers, without violation the rule against retroactive ratemaking. Conversely, PGE has no right to recover from ratepayers additional amounts, merely because it claims to have earned less than its authorized rate of return during parts of all of 2005 and 2006. There is no statute akin to ORS 757.267(f) stating that utility rates should reflect past failures to earn any particular level of profit "to be considered fair, just and reasonable."

V. WHEN SHOULD RATEPAYERS RECEIVE BACK IN RATES THE DEFERRED INCOME TAX OVERCOLLECTION?

The deferred income tax overcollection should be returned to ratepayers as soon as practical. URP suggests a 1-year amortization to commence at the same time as the amortization authorized in UE 178.

Note that PGE is suggesting a "never amortization," claiming that its lack of sufficient earnings during the deferral period somehow justifies never returning the deferred income tax overcollection to ratepayers. We see neither legal nor rational justification for this "amortization never" scheme, which would leave on PGE's

ratemaking books an amount owed to ratepayers that is never paid.

Dated: April 14, 2008

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I filed served for foregoing OPENING BRIEF OF UTILITY REFORM PROJECT AND KEN LEWIS by email to the list below and by depositing a true copy in the U.S. Mail, first class postage prepaid, a true and correct copy upon the addresses below.

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