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May 18, 2007

Via Electronic and U.S. Mail

Public Utility Commission
Attn: Filing Center
550 Capitol St. NE #215
P.O. Box 2148
Salem OR 97308-2148

Re: In the Matter of PORTLAND GENERAL ELECTRIC COMPANY Deferred Accounting Authorization for certain Expenses/Revenue Refunds Associated with SB 408 and the Sale of Certain Non-utility Assets
Docket No. UM 1271

Dear Filing Center:

Enclosed please find the original and six copies of the Reply Brief of the Industrial Customers of Northwest Utilities in the above-referenced matter.

Please return one file-stamped copy of the document in the postage-prepaid envelope provided. Thank you for your assistance.

Sincerely yours,

/s/ Ruth A. Miller
Ruth A. Miller

Enclosures
cc: Service List

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing Reply Brief of the Industrial Customers of Northwest Utilities upon the parties on the service list, shown below, by causing the same to be deposited in the U.S. Mail, postage-prepaid, to those parties which have not waived paper service, and by electronic mail to all parties.

Dated at Portland, Oregon, this 18th day of May, 2007.

/s/ Ruth A. Miller
Ruth A. Miller

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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1271

In the Matter of	)	
	)	
PORTLAND GENERAL ELECTRIC COMPANY	)	REPLY BRIEF OF THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES
	)	
Application for Deferred Accounting of Certain Revenue Refunds Associated with Senate Bill 408.	)	

I. INTRODUCTION

Portland General Electric Company's ("PGE" or the "Company") Opening Brief raises arguments that the legislature and the Public Utility Commission of Oregon ("OPUC") have already rejected. In addition, PGE raises numerous constitutional arguments that have no basis in law. PGE provides little to no legal analysis from which the OPUC can properly evaluate PGE's claims. It appears as though PGE may be positioning itself for an appeal by simply raising its constitutional arguments to the OPUC without the proper analysis one would expect from a legal document. Accordingly, there is no legal basis to grant PGE's request for a deferred account based on the earnings issues associated with SB 408.

The common theme in PGE's Opening Brief is that the benefits and burdens of the costs at issue in this case do not match if SB 408 and the OPUC's rules operate as the legislature intended and that the OPUC should apply pre-SB 408 policies. PGE, however, ignores the clear legislative mandate of SB 408 and completely fails to explain or even mention the OPUC's orders in AR 499. PGE's Opening Brief does not raise any issues that the parties to

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this docket and the OPUC have not heard and decided. As a result, PGE's application must be denied.

II. ARGUMENT

A. PGE's Claim That It Has Satisfied the Deferred Accounting Standards Ignores the Legislative Intent Behind SB 408 and the OPUC's Orders in AR 499

PGE asserts that it has met its burden of proof and persuasion in support of its application for a deferred account. PGE mistakenly concludes that the matching of benefits and burdens involves the allocation of a particular tax event to customers or the utility. SB 408, however, establishes that the proper matching of burdens and benefits in the context of income taxes occurs by matching "taxes collected" with "taxes paid." In addition, PGE fails to acknowledge the OPUC's rejection of the Company's proposed deferred accounting mechanism in AR 499. ICNU's Opening Brief explains in detail why PGE's application fails to meet the deferred accounting standards. ICNU Opening Brief at 7-10. PGE does not raise any new arguments in its Opening Brief regarding the deferred accounting standards that ICNU has not already addressed.

B. The Operation of SB 408 Does Not Violate State and Federal Law

PGE makes various arguments challenging the operation of SB 408 based on state and federal law. PGE's arguments consist solely of conclusory statements that misconstrue the applicable legal requirements and provide no evidence supporting the Company's claims.

1. The Operation of SB 408 Does Not Deprive PGE of Fair, Just, and Reasonable Rates

PGE argues that the operation of SB 408 in this case would deprive the Company of fair, just, and reasonable rates under Oregon law. PGE Opening Brief at 11-12. PGE states

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that the Company's actual rate of return will be further reduced below authorized levels if the Commission does not grant a deferral.

The only evidence that PGE provides to support its claim is the statement that the Company does "not expect the deferral of $4.8 million to produce regulated earnings in excess of PGE's authorized ROE for 2006," and the Company supports this conclusion by extrapolating from 2005 data. PGE/100, Dahlgren-Tinker/7. PGE provided no actual evidence of its year-end 2006 earnings, and the Company neglects to mention that its reported earnings for 2005 and 2006 likely were affected by the costs of replacement power for the Boardman outages, a portion of which the Company has now been authorized to record in a deferred account. In any event, rates are not unjust and unreasonable simply because PGE does not expect to earn "in excess" of its authorized ROE. Id. The legislature has already determined that the alignment of "taxes collected" and "taxes paid" will result in rates that are fair, just, and reasonable. ORS § 757.267(f).

2. The Operation of SB 408 Will Not Result in an Unconstitutional Taking

Once again, PGE raises the benefits and burdens theme and argues that because shareholders assumed the risk in purchasing the turbine, shareholders somehow have a constitutionally protected right to the tax benefit involved in this case that cannot be taken without just compensation. PGE Opening Brief at 12. PGE's argument suggests that the matching of benefits and burdens is a constitutional principle, but the Company is incorrect. This is simply a policy decision applied in some jurisdictions.

To successfully assert a takings claim, PGE would first have to identify some property interest of which SB 408 deprives the Company. Bodies of government are

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constitutionally prohibited from taking property without just compensation. U.S. Const. amend. V; Or. Const, Art. I, § 18. Property interests, however, are not created by the Constitution, but "are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law. . . ." Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 161 (1980) (internal quotation marks omitted). PGE's argument rests, therefore, on the premise that some source of law has created and given to shareholders a property interest to the tax benefit in this case.

PGE has not cited any source of law that grants shareholders such a property interest. To the contrary, SB 408 requires the opposite conclusion. In Fed. Power Comm'n v. United Gas Pipe Line Co., 386 U.S. 237 (1967), the United States Supreme Court rejected an argument that the tax benefits resulting from a consolidated tax filing belong solely to shareholders. In rejecting the argument that the tax savings from a consolidated filing should *never* be shared with the consolidated group, the Court stated:

> Rates fixed on this basis would give the [utility] and its stockholders not only the fair return to which they are entitled but also the full amount of an expense never in fact incurred. In such circumstances, the Commission could properly disallow the hypothetical tax expense and hold that rates based on such an unreal cost of service would not be just and reasonable.

Id. at 244. Moreover, SB 408 specifically undercuts PGE's argument that shareholders have a property interest to the tax benefit in this case. SB 408 requires that tax benefits from consolidated tax filings that reduce the amount of "taxes paid" be reflected in rates. ORS § 757.268(4). Thus, the tax benefits are prohibited from being the sole possession of shareholders.

The cases cited by PGE do not provide any support to the contrary. All three cases cited involve money or property in which the relevant laws create a property interest.

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Webb's Fabulous Pharmacies, 449 U.S. at 451 (money held for the ultimate benefit of creditors); Phillips v. Wash. Legal Found., 524 U.S. 156, 159 (1998) (client funds deposited in a trust account); GTE Northwest Inc. v. Pub. Util. Comm'n of Or., 321 Or. 458, 463 (1995) (physical invasion of private property). As discussed, however, the law does not grant shareholders a property interest in the tax benefit. PGE's taking claim therefore lacks an essential element and must be rejected.

3. There Has Been No Showing of Confiscatory Rates

Rates must allow utilities to "operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risk assumed . . . ." Fed. Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 605 (1944). A party challenging rates based on the premise that the rates set are confiscatory "carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences." Id. at 602. PGE's argument on confiscatory rates simply states the standard and, without any analysis, concludes that the operation of SB 408 is "inherently at odds with this constitutional standard." PGE Opening Brief at 14.

When challenging rates based on confiscation, the court looks at the overall effect of the rate order, not the methodology used to set rates and certainly not one small component of a utility's revenue requirement. Hope, 310 U.S. at 602. The United States Supreme Court has stated that "[t]he Constitution protects the utility from the *net effect of the rate order* on its property." Duquesne Light Co. v. Barasch, 488 U.S. 299, 314 (1989) (emphasis added). It is curious, therefore, that PGE bases its confiscatory rate argument on the method, i.e., matching benefits and burdens, and does not provide any argument or evidence regarding how the

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operation of SB 408 in this case will result in confiscatory rates. See, e.g., id. at 312 ("No argument has been made that these slightly reduced rates jeopardize the financial integrity of the companies, either by leaving them insufficient operating capital or by impeding their ability to raise future capital."). This argument suffers from the same evidentiary shortcomings as PGE's argument regarding just and reasonable rates. See supra, at 2-3. Without more, PGE has given the OPUC insufficient information with which to evaluate the Company's claim.

4. PGE's Reliance on Duquesne Light Is Misguided

Citing Duquesne Light, PGE argues that the operation of SB 408 will constitute an arbitrary and opportunistic change in regulation. PGE Opening Brief at 15. PGE cites, in isolation, one statement from Duquesne Light in which the Court stated that "a State's decision to arbitrarily switch back and forth between methodologies in a way which required investors to bear the risk of bad investments at some times while denying them the benefit of good investments at others would raise serious constitutional questions." Id. (quoting 488 U.S. at 315.) Seizing on this quote, PGE incorrectly concludes that the Commission is prohibited from applying SB 408.

PGE ignores the rest of the Court's analysis and ultimate decision in Duquesne Light. The issue in Duquesne Light was whether the Pennsylvania legislature acted unconstitutionally in requiring the Pennsylvania Utility Commission ("PUC") to apply a "used and useful" standard that the PUC never used before in setting rates. Duquesne Light, 488 U.S. at 313. In upholding the Pennsylvania legislature's actions, the Court stated that "[i]t cannot seriously be contended that the Constitution prevents state legislatures from giving specific instructions to their utility commissions." Id. Moreover, the Court reiterated the legal principle

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that the impact of the rate order, and not the methodology used to set rates, is the ultimate question to be answered by the court. Id. at 314.

5. PGE's Argument Regarding Impairment of Contract is Baseless

PGE maintains that the operation of SB 408 violates the Contract Clauses of the United States and Oregon Constitutions. PGE's argument is based on the "ring fencing" provisions imposed by the stipulation approving the merger between PGE and Enron. According to PGE, because the "ring fencing" provisions imposed conditions designed to insulate utility customers from the risks involved with unregulated activities, those provisions impliedly guaranteed shareholders the entire tax effect of the losses incurred by unregulated activities. PGE Opening Brief at 15-16. The "ring fencing" provisions provide no such guarantee.

The ultimate inquiry in a Contract Clause challenge is "whether the change in state law has operated as a substantial impairment of a contractual relationship." General Motors Corp. v. Romein, 503 U.S. 181, 186 (1992) (internal quotation marks omitted); see also, State v. Willingham, 206 Or. App. 156, 165 n.2 (2006) (impairment of contract occurs under the Oregon Constitution when "by operation of law, there is an elimination of an obligation under which performance is required"). That inquiry involves three parts: 1) whether there is a contractual relationship; 2) whether a change in law impairs that contractual relationship; and 3) whether the impairment is substantial. General Motors, 503 U.S. at 186. PGE's argument fails because there is no contractual agreement regarding income taxes and SB 408 does not impair PGE's obligations under the stipulation.

PGE specifically cites to three provisions of the stipulation, none of which have anything to do with allocating the tax effects of a consolidated tax filing. Re Enron Corp.,

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Docket No. UM 814, Order No. 97-196 at App. A, pp. 2-4, ¶¶ 7, 10, 14 (June 4, 1997).[1/] PGE must show that the parties reached agreement on these provisions with the tax issues involved with SB 408 in mind, or that SB 408 changed the legal enforceability of the stipulation. See, e.g., General Motors, 503 U.S. at 188-90. (change in workers' compensation laws did not impair employment agreements because the parties to the agreements did not manifest an intent to address workers' compensation, nor did the change in law affect the legal enforceability of the employment agreements). PGE has made no showing to that effect.

6. The Supremacy Clause Is Not Implicated by the Operation of SB 408

Without citation to any provision of the federal tax laws, PGE argues that those laws somehow guarantee that shareholders get to keep the tax benefit associated with the turbine sale. The United States Supreme Court has already squarely rejected such an argument, and PGE can point to no provision of the tax laws supporting such an argument.

In United Gas, the Court characterized the argument that regulated activities should never share in the tax benefits on a consolidated basis as "untenable." 386 U.S. at 243-44. After all, without the gains from regulated activities to offset, the losses from unregulated activities in the consolidated group are worthless. See City of Charlottesville v. FERC, 774 F.2d 1205, 1221 (D.C. Cir. 1985). SB 408 does not affect in any way PGE's ability to take advantage of the federal income tax laws, and PGE is free to file its income tax return on either a stand-alone basis or as part of a consolidated group. SB 408 does, however, prohibit the OPUC from authorizing PGE to collect in rates amounts for income taxes that are not paid to units of

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[1/] Those provisions required Enron to ensure, respectively, 1) that the allowed return on common equity and other costs of capital would not rise as a result of the merger; 2) that customers would be held harmless if the merger resulted in a higher revenue requirement; and 3) that Enron would not subsidize its activities by allocating or directly charging PGE for expenses not authorized by the Commission.

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government. The operation of SB 408 does not prevent PGE from using losses to offset gains in a consolidated tax filing, it affects what amount PGE is able to include in rates.

7. The Legislature Had a Legitimate State Purpose in Excluding Utilities with Less Than 50,000 Customers from the Operation of SB 408

SB 408 applies only to "[a] regulated investor-owned utility that provided electric or natural gas service to an average of 50,000 or more customers in Oregon in 2003." ORS § 757.268(13)(b)(A). PGE argues that SB 408 arbitrarily creates two classes of utilities subject to different tax treatments. Again, PGE states the law and makes conclusory statements with little to no support. A quick glance at the legislative history of SB 408 reveals the legislature's purpose in limiting SB 408 to utilities with more than 50,000 customers.

First, SB 408 addresses how utility rates are set, not how utilities pay income taxes. The premise of PGE's argument is fundamentally flawed, because SB 408 does not subject utilities to differing income tax treatment. Second, "[t]he law is well settled that 'the States have a very wide discretion in the laying of their taxes.'" Weissinger v. White, 733 F.2d 802, 805 (11th Cir. 1984) (quoting Allied Stores v. Bowers, 358 U.S. 522, 526 (1959)). As a result, state tax laws are subject to a "minimal level of scrutiny" when challenged on equal protection grounds, and will be upheld as long as the differing tax treatment "rests upon some ground of difference having a fair and substantial relation to the object of the legislation." Id. at 806 (internal quotation marks omitted). In Weissinger, the court upheld the State of Alabama's property tax, which applied different methods of calculating the tax for different types of property based on Alabama's special interest in preserving farm and timberland. Id. at 806-07.

Even if SB 408 is construed as a tax law, it satisfies the minimal level of scrutiny applied in the face of equal protection challenges. The line was drawn at investor-owned utilities

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with more than 50,000 customers in 2003 due to the cost of complying with SB 408. House State and Federal Affairs Committee, SB 408 Work Session, Tr. at 9, July 15, 2005 (Statement of Rep. Tom Butler). Due to the small size of an investor-owned utility that serves less than 50,000 customers, any tax adjustment would be outweighed by the cost to the utility of complying and the administrative burden placed on the Commission to oversee compliance. Id.

III. CONCLUSION

PGE's application for a deferred account is contrary to Oregon law and this Commission is without legal authority to authorize it. Not only does PGE's application fail to satisfy the OPUC's standards for a deferred account, but the legal and constitutional arguments raised in PGE's Opening Brief border on frivolous and are unsupported by any evidence or legal analysis whatsoever. As a result, PGE's application must be denied.

Dated this 18th day of May, 2007.

Respectfully submitted,

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