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April 27, 2007

VIA E-FILING & FIRST CLASS MAIL

Oregon Public Utility Commission
Attn: Filing Center
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Salem, Oregon 97308-2148

Re: *UM 1271*

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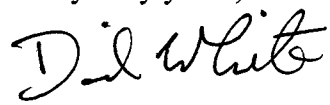

David F. White

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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1271

In the Matter of the Application of Portland General Electric Company for an Order Approving the Deferral of Certain Expenses/ Revenue Refunds Associated With SB 408	**PORTLAND GENERAL ELECTRIC COMPANY'S OPENING BRIEF**

I. INTRODUCTION

Portland General Electric Company's ("PGE") Deferred Accounting Application (the "Application") seeks to avoid an unlawful and potentially unconstitutional application of SB 408 to PGE's loss on the sale of an unregulated asset. Denial of this Application will deprive PGE of approximately $4.9 million of tax benefits arising from the loss on the sale of unregulated property.

PGE acquired the unregulated asset at issue, an LM 6000 Gas Turbine Generator (the "Turbine"),[1] in 2001, well before SB 408 was enacted. Customers never paid for the Turbine. Customers were never at risk for paying for the Turbine or any tax expense associated with the Turbine because the Commission sets rates based upon the operations of the stand-alone utility. However, SB 408 changed the rules of regulation in mid-course, interfering with PGE's reasonable investment-backed expectation that any tax benefits from the loss on the sale of unregulated assets would flow to the utility. SB 408 takes the tax benefit from PGE, which incurred the loss from the sale of the Turbine, and gives it to customers, who have been completely insulated from the burden of the Turbine investment. The Application gives the Commission the opportunity to avoid such a fundamentally unfair

[1] At the same time PGE acquired a transformer for use with the turbine. The purchase price of the transformer was a little over $400,000. PGE/200, Piro-Tamlyn/1. For convenience, in this Opening Brief we use the term "Turbine" to include both the LM 6000 turbine and the transformer, unless otherwise indicated. The tax benefits that are the subject of the Application include the tax benefits from the sale of the turbine and the transformer.

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outcome, one which would violate sound and well-established Commission precedent, as well as give rise to serious state and federal constitutional concerns.

Sections II through IV of this Opening Brief explain why the Commission should grant the Application under the deferred accounting statute and the Commission's policy implementing that statute. Section V addresses the state and federal constitutional problems that will arise if the Commission declines to apply deferred accounting treatment and implements an SB 408 adjustment based on the loss realized on the Turbine sale.

II. THE DEFERRED ACCOUNTING APPLICATION

In May 2001, PGE entered into a contract to pay $16.8 million to purchase the Turbine for a proposed Port of Morrow gas generating project. PGE/200, Piro-Tamlyn/1. Wholesale electricity prices were high at the time and justified the investment in a merchant (non-utility) plant. *Id.*/2. After wholesale power prices dropped, PGE decided not to proceed with construction of the Port of Morrow project, but PGE completed the acquisition of the Turbine. *Id.*

PGE transferred the Turbine purchase costs and other costs associated with the Turbine to Portland General Resource Group, Inc. ("PGRD"), a subsidiary of PGE created for the purpose of owning the Turbine.[2] *Id.* The costs associated with the Turbine were recorded in non-utility accounts and that treatment never changed. *Id.* PGE used shareholder equity, not debt, to acquire the Turbine. PGE/100, Dahlgren-Tinker/3.

In July 2006, PGRD sold the turbine for $6.1 million, suffering a $12 million tax loss. PGE/200, Piro-Tamlyn/4. At the same time, PGE sold the transformer, generating a combined tax loss of $12.3 million. This combined tax loss decreased PGE's consolidated 2006 income tax liability by approximately $4.9 million. *Id.* PGE's estimated federal and state tax payments reflect this $4.9 million reduction in tax liability. *Id.*

[2] PGE only transferred the turbine to PGRD. The transformer remained at PGE. PGE/200, Piro-Tamlyn/2.

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Under SB 408 and its implementing rules, the tax benefit from the loss on this unregulated sale will be passed through to customers. SB 408 compares "taxes paid" with "taxes collected" and refunds or surcharges customers for the difference. ORS 757.268(4). As the Commission has defined it, "taxes collected" is based upon the utility's actual revenue and certain ratios established in the utility's most recent rate case. OAR 860-22-0041(2)(q). "Taxes paid," on the other hand, is based upon actual tax payments to governmental entities. ORS 757.268(13)(f). By reducing PGE's taxable income, the loss on the Turbine sale reduces PGE's "taxes paid" for 2006 by $4.9 million, while leaving the "taxes collected" side of the equation unaffected. Under the Commission's current SB 408 rules, the result will be to deprive PGE of $4.9 million in cash and transfer this cash to customers. PGE/200, Piro-Tamlyn/4-5. None of the facts presented in PGE's testimony in support of the Application is contested. PGE/300, Dahlgren-Tinker/1-2.

PGE's Application seeks to realign the party responsible for absorbing the underlying financial loss with the party reaping the attendant tax benefit, consistent with the Commission's long-standing policy of matching benefits with burdens. PGE proposes two alternative accounting treatments: (a) deferral of the revenue refund of $4.9 million for the SB 408 related adjustment (the "Revenue Accounting Treatment"); or (b) deferral of the underlying tax effect from sale of the Turbine (the "Expense Accounting Treatment"). *Id.*/5.

III. THE APPLICATION SATISFIES THE STATUTORY REQUIREMENTS

The Commission considers deferred accounting applications in two phases. In the first phase, the Commission determines whether the application satisfies the legal requirements of the statute. In the second phase, the Commission exercises its discretion to determine whether granting the application is consistent with its deferred accounting policy. UM 1147, Order No. 05-1070 at 5-7 (Oct. 5, 2005); UM 1234, Order No. 07-049 at 8 (Feb. 12, 2007). PGE has met the applicant's burden of persuasion and production in support

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of both phases of the Commission's review.

A. THE APPLICATION IS AUTHORIZED BY STATUTE

PGE filed the Application under subsection 2(e) of ORS 757.259, which permits the deferral of "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."

The Application meets the initial threshold test: it concerns an identifiable utility expense or revenue item. The proposed Revenue Accounting Treatment defers the refund revenue associated with SB 408, directly addressing a "utility revenue or expense item." PGE/200, Piro-Tamlyn/5. Similarly, the alternative Expense Accounting Treatment concerns an eligible utility expense or revenue item. By reducing taxable income, the loss on the Turbine sale lowers the utility's tax paid, resulting in an SB 408 credit for customers. The Application seeks the deferral of this tax expense so the tax benefits associated with the loss on the sale are returned to the entity that bore the risk of loss. *See* UE 170/UM 1229, Order No. 06-379 at 1 (July 10, 2006) (granting deferred accounting treatment for tax expense adjustment).

Subsection 2(e)[3] applies an alternative test to "identifiable expenses or revenues." An application passes the test if it *either* minimizes the frequency of rate changes *or* matches those that benefit with those that bear the costs, but it need not satisfy both prongs of the test. UM 1234, Order No. 07-049 at 9; UM 1147, Order No. 05-1070 at 5; UM 995, Order No. 01-085 at 12 (Jan. 9, 2001).

The Application serves to match benefits with burdens, satisfying the latter prong. PGE acquired the Turbine with retained earnings, consistently maintaining the cost of

[3] ORS 757.259(2)(e).

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the investment in non-utility accounts. PGE/100, Dahlgren-Tinker/3. PGE never sought to include the Turbine cost in rates, and the Turbine never was included in rates. Moreover, the Commission set rates in UE 115 on a stand-alone utility basis, meaning that expenses or revenues from non-utility accounts were never included in rates, nor were the tax consequences of such revenues or expenses assumed in rates. PGE/100, Dahlgren-Tinker/3. In short, customers did not pay for the Turbine, customers bore no risk associated with PGE's investment in the Turbine, and customers were at no risk of paying any tax expense from the Turbine sale. PGE is the party who bore those costs and was exposed to those risks. Granting the deferral now is the only equitable and fair means to ensure that the party who incurred the cost is matched with the party who receives the benefit.

IV. THE COMMISSION SHOULD APPROVE THE APPLICATION UNDER THE FACTORS IT GENERALLY CONSIDERS

In the second phase, the Commission exercises its discretion to consider whether or not to grant deferred accounting treatment. No bright-line rules govern the Commission's review given the broad terms of the Legislature's grant of authority. UM 1147, Order No. 05-1070 at 11-12. The Commission considers a variety of factors, including "the nature of the event, its impact on the utility, the treatment in ratemaking, and other factors used to evaluate whether a deferred account is appropriate." *Id.* at 7. The Commission has used deferred accounting in a broad range of circumstances to address difficult to forecast events, implement legislative mandates or rate-making mechanisms, and to encourage and foster Commission regulatory policies. *Id.* at 2. PGE's Application should be approved both because it (1) would further important Commission policies and (2) reflects a "scenario event" with a material financial impact on PGE. We review each of these bases in turn.

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A. THE DEFERRAL FURTHERS IMPORTANT COMMISSION POLICIES

It has been the Commission's long-standing position that its decisions should align benefits and burdens. If customers bear the burden of a particular utility action, then customers should reap the benefits. Conversely, if customers do not bear the burden, then they should not share in any benefit that may later arise. *In re PacifiCorp*, UP 168, Order No. 00-112 (Feb. 29, 2000) (concluding that profits from the sale of utility property should follow the party that bears the risk of loss from the sale).

The Commission establishes rates on a stand-alone basis, assuming the expenses, investments and other revenues of the utility while excluding those same items for unregulated affiliates or divisions of the utility. Under the benefits and burdens test, customers should not receive the tax benefits for unregulated expenses given that they have not paid for those expenses. *City of Charlottsville v. FERC*, 774 F2d 1205, 1217 (DC Cir 1985) (tax deductions are attributable to the utility's jurisdictional activities if "the customers of a regulated entity contributed to the expenses which created the loss deductions"). Ultimately, this principle serves to protect customers by insulating utility operations from non-utility activities and ensuring that customers do not pay the bill for unregulated activities:

> For ratemaking purposes, the Commission set PGE's rates to reflect the costs of the company's regulated operations. That is, in a rate proceeding, PGE's rates are set based on its own revenues and costs in a rate case for a given test year. If PGE rates were set in a manner that captures some of [the parent company's] tax losses, PGE rates would also have needed to reflect the expense that created the tax savings, and customers would be worse off * * *. Staff counsel advised that it would be difficult for the OPUC to justify picking and choosing which of [the parent company's] revenues and expenses, including tax savings, to include for purposes of setting Oregon customers' rates."

UM 1074, Order No. 03-214, App. A at 2 (adopting and incorporating by reference Staff's recommendation).

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This matching of benefits and burdens comports with a stand-alone approach:

> The only approach that is consistent with standard ratemaking principles that prohibit cross-subsidization between utility and non-utility activities is to put the regulated operations on a stand-alone basis and to assign the full tax burden to the taxable gain source and a tax benefit to the tax loss source. The basic theory is that the regulated costs should not be affected by the results from nonregulated operations. * * * Under this principle, there is a well-reasoned, and widely recognized, postulate that taxes follow the events they give rise to. Thus, if ratepayers are held responsible for costs, they are entitled to the tax benefits associated with the costs. If ratepayers do not bear the costs, they are not entitled to the tax benefits associated with the costs.

OPUC Staff white paper prepared for the Oregon Legislative Assembly, at 7, Attachment B, (Feb. 1, 2005) (quoting Accounting for Public Utilities, §§ 7.08, 17.04).

In 2001, these regulatory principles were in place and PGE abided by them in purchasing the Turbine. PGE maintained unregulated accounts separate from utility accounts, ensuring that customers were protected from non-utility investments and expenses. These non-utility accounts had no impact on PGE's revenue requirement and were not included in PGE's regular results of operation reported to the Commission. PGE/100, Dahlgren-Tinker/2-3. The utility statutes prohibited PGE from issuing debt for non-utility purposes, and similarly forbade PGE from extending credit to an affiliate without Commission approval. ORS 757.415; ORS 757.495(5). At all times relevant to this Application, Commission statutes, rules and orders banned cross-subsidization of utility and non-utility activities. ORS 757.646 (prohibiting "cross subsidization between competitive operations and regulated operations"); UM 814, Order No. 97-196 (June 4, 1997), Appendix A (barring cross-subsidization and holding customers harmless from any rate impact from merger).

PGE expressly relied upon the Commission's rules and principles when it acquired the Turbine. PGE used retained earnings to purchase the Turbine, classifying the

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Turbine as a non-utility expense. PGE/100, Dahlgren-Tinker/4. PGE expected that "neither gains nor losses associated with the Turbine would affect PGE electric prices." *Id.* Moreover, the Commission recently observed that PGE may proceed with this deferred accounting application, acknowledging that deferred accounting applications in this area would be reviewed on a case-by-case basis, consistent with the Commission's general deferred accounting policy, and that the Commission will "consider the tax effects when evaluating issues in other dockets." AR 499, Order No. 06-400 at 9-12 (July 14, 2006).

In this case, the tax impacts of SB 408 will arbitrarily misalign tax benefits and burdens in a manner inconsistent with the regulatory framework in place when PGE acquired the Turbine and in violation of bedrock cost-of-service principles. The deferral statute gives the Commission the opportunity and authority to avoid such an outcome that violates long-standing Commission policy and practice. The Commission regularly approves deferred accounting orders that further Commission policies and directives. *See, e.g.*, UM 1256/UM 1257/UM 1258, Order No. 06-483 (Aug. 22, 2006)(approving deferred accounting for expenses that furthered Commission goal of establishing a regional transmission organization). The Commission precedents under the deferred accounting statute, and its stand-alone approach to rate setting, all indicate the Commission should take this opportunity and grant the Application.

B. ALTERNATIVELY, THE COMMISSION SHOULD APPROVE THE APPLICATION BASED UPON THE NATURE OF THE EVENT AND ITS FINANCIAL IMPACT

Alternatively, the Commission may grant the deferral based upon the nature of the event and the magnitude of the financial harm. Order No. 05-1070 at 7. As to the nature of the event, the Commission considers two important factors: whether the event was (1) included in test-year assumptions used to set rates, and (2) reasonably foreseeable as occurring in the ordinary course of events. *Id.* If the event was neither modeled in rates nor

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reasonably foreseeable in the ordinary course of events, then it is deemed a "scenario" event and "the magnitude of harm that would justify deferral likely would be lower." *Id.* The Commission has characterized the degree of financial harm required for events that were modeled or foreseen as "substantial." Events that were neither modeled in rates nor foreseen need only have a "material impact" to justify deferred accounting. *Id.*

The tax adjustment that is the subject of the Application was neither modeled in rates nor reasonably foreseeable. It is undisputed that the Turbine investment, its sale at a loss, and the attendant tax consequence were never modeled in rates. PGE/100, Dahlgren-Tinker/3. Moreover, given the regulatory compact at the time it acquired the Turbine, PGE could not have reasonably foreseen that a tax deduction from the loss on the Turbine sale would be taken from the utility and given to customers who had not funded the purchase. In fact, PGE relied on just the opposite assumption, namely, that the Commission establishes utility rates on a stand-alone basis and ignores the costs and tax effects of non-utility accounts. *Id.*/4. PGE's investment-backed expectation was eminently reasonable in light of the Commission's long-standing policy of setting rates on a stand-alone basis and its repeated affirmation of that position in multiple Commission proceedings. *See, e.g., In re Oregon Exchange Carriers Ass'n*, Order No. 93-325, 1993 WL 117620 at *5 (March 12, 1993) (the Commission's policy is to "calculate tax liability on a stand-alone basis"); Order No. 03-214, App. A at 2 (ratemaking on a stand-alone basis is "consistent with long-standing OPUC policy" which "protects utility customers, competitors, and the public generally"); OAR 860-027-0048 (requiring stand-alone reporting for rate-making treatment of taxes).

In a recent deferral accounting docket (UM 1234), the Commission considered whether the event at issue was within the reasonable range of outcomes considered in setting rates. Order No. 07-049 at 10. There is no evidence to suggest that the risk of an SB 408 adjustment was ever considered in setting PGE's rates during the time

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PGRD owned the Turbine. The Commission set PGE's return on equity for the period relevant to the Application in 2001 (UE 115), well before SB 408 became law. PGE/100, Dahlgren-Tinker/7. In short, the tax adjustment is a scenario event requiring only a material impact on the utility to warrant deferred accounting treatment.

The financial impact of the tax adjustment is material to PGE. The Commission has never articulated a precise quantitative measure for a "substantial" or "material" impact. Nevertheless, the Commission has authorized a variety of deferred accounting applications for scenario events with an economic impact of well less than the amount at issue here, $4.9 million. *See* UM 1285, Order No. 07-145 (April 13, 2007) (granting deferred accounting treatment for expense of Independent Evaluator expected to be $670,000). For example, last year the Commission granted deferred accounting treatment to PGE, PacifiCorp and Idaho Power for funding the start-up costs of Grid West. In those dockets, the Commission relied upon the fact that the costs were "not recognized in rates," granting deferred accounting treatment for as little as $1.2 million. *See* UM 1256/UM 1257/UM 1258, Order No. 06-483 (authorizing deferral for PGE of $1.3 million, for Idaho Power of $1.2 million and for PacifiCorp of $2.3 million) (Staff public meeting memoranda for May 10, 2006 public meeting). Most recently, in UE 170, the Commission authorized deferred accounting treatment for approximately $3.6 million for a tax expense adjustment. Order No. 06-379 at 1. Under these precedents, and under any reasonable interpretation of a "material" financial impact, the $4.9 million tax adjustment at issue in this docket is more than sufficient to merit deferred accounting treatment. The Commission should grant PGE's Application based either upon a finding that it (1) furthers important Commission policies or (2) reflects a scenario event with a material impact on PGE.

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V. CONSTITUTIONAL/LEGAL ARGUMENTS

Granting PGE's request for a deferral appears to be the only means for the Commission to comply with all applicable legal and rate-making principles, including, but not limited to, SB 408. Conversely, denial of the Application will likely lead to a situation in fall 2007 in which the Commission is forced to choose between (1) applying SB 408 in isolation and giving customers a $4.9 million windfall for tax year 2006 at the expense of PGE's shareholders who actually bore the risk of the Turbine investment , or (2) refusing to make the adjustment dictated by SB 408 because doing so would violate applicable Oregon statutes and state and federal constitutional principles. The deferral mechanism provides an opportunity to avoid this difficult situation and harmonize all applicable legal principles.

A. THE COMMISSION MUST COMPLY WITH OVERARCHING OREGON STATUTES

Under Oregon law, the Commission is required to set fair, just and reasonable rates for the regulated services PGE provides, and to balance the interests of utility investors and consumers. *See* ORS 756.040(1); ORS 757.210(1); letter from Department of Justice to OPUC, dated December 27, 2005, at 16 (stating that SB 408 adjustments must result in rates that satisfy the "fair and reasonable" requirement of ORS 756.040(1)). In order to be fair and reasonable under Oregon law, a rate must provide adequate revenue for operating expenses and capital costs, plus a return to shareholders that is "(a) [c]ommensurate with the return on investments in other enterprises having corresponding risks; and (b) [s]ufficient to ensure confidence in the financial integrity of the utility, allowing the utility to maintain its credit and attract capital." ORS 756.040(1).

The relevant rates PGE charged its customers in 2006 were set before SB 408 was ever contemplated. PGE's actual rate of return for 2006 is already expected to be less than PGE's authorized rate of return. PGE/100, Dahlgren-Tinker/7. Rejecting the deferral request related to the Turbine, and ordering PGE to transfer the entire financial benefit

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associated therewith to customers, would result in an even lower actual rate of return for 2006, below a fair, just and reasonable rate. Such a result would contravene Oregon law and should be avoided by application of the deferral mechanism.

B. THE COMMISSION MUST SATISFY FEDERAL AND STATE CONSTITUTIONAL REQUIREMENTS

The issues underlying the deferral request also give rise to several serious federal and state constitutional questions.

1. UNCONSTITUTIONAL TAKING BASED UPON SEIZURE OF PGE PROPERTY WITHOUT JUST COMPENSATION

Both the United States Constitution and the Oregon Constitution prohibit the taking of property without just compensation. *See* United States Constitution, Amendment V, XIV; Oregon Constitution, Art. I, § 18. Shielding PGE's customers from the costs and risks of the Turbine investment, but giving them the full tax benefit from the loss on the Turbine sale, would violate the "benefits follows burden" principle and result in an unconstitutional taking.

As the Department of Justice has recognized, "[t]ax benefits from consolidation can be included in the utility's rates only to the extent customers are responsible for the deductible expenses that produced the benefits. The tax effect of losses in one of the parent's other operations could not be included in setting the utility's rates if customers don't have to pay any of the costs that contributed to the losses." Department of Justice memorandum, "Recommendation on treatment of utility income taxes," directed to Senators Ryan Deckert and Rick Metsger, dated March 22, 2005, at 3; *see also* Department of Justice memorandum, "Legality of setting utility rates based upon the tax liability of its parent," directed to Commissioners Baum, Beyer and Savage, dated February 18, 2005, at 1 ("Taking into account the 'benefits and burdens' of its policy means the benefits of consolidated tax savings are given to ratepayers (by reducing the utility's tax allowance) if

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the customers bore the burden of paying the deductible expenses that generated the savings. If the Commission matches the benefits and burdens in some rational manner, I conclude that the Commission's choice would meet legal requirements."); Department of Justice memorandum, "Reply to the Utility Reform Project's comments on tax treatment in utility ratemaking," directed to Commissioners Baum, Beyer and Savage, dated March 22, 2005, at 4 ("it is clear that regulators have discretion to use different methods of calculating tax allowances, but it is also true that whichever method is chosen it should be applied in a way that matches benefits and burdens") (emphasis in original).

The courts have also recognized the importance of matching benefits to burdens in utility ratemaking. *See Washington Utils. & Transp. Comm'n v. PacifiCorp*, 2006 WL 1517095 *50 (Wash UTC) ("If the risks and costs of activities at the parent-level are borne exclusively by shareholders—because customers are insulated from them by [a] ring fence—then it is fair and appropriate for the shareholders, and not the customers, to receive the benefits that result from those activities."); *Iowa Elec. Light & Power Co.*, 135 Pub Util Rep 4th (PUR) 522, 527 (Iowa Utils Bd 1992) ("The affiliates' financial losses which create the tax savings exist only because of the investment and expenses borne by stockholders. It is clear the losses which created the tax savings belong to the affiliates.").

PGE shareholders who assumed the risk that the Turbine might not be financially successful did so with the understanding that, if that investment ultimately did result in a loss, then the actual cost to shareholders would be mitigated by benefits available under federal tax law. PGE/100, Dahlgren-Tinker/3-4. These tax benefits equate to $4.9 million in cash. That is $4.9 million of cash that PGE and its shareholders are entitled to as the ones who bore the cost and risk of the investment.

If the Commission seizes the $4.9 million from PGE's shareholders during the SB 408 implementation process in fall 2007 and transfers it to the public, then PGE's

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property will have been taken by the State without just compensation. *See Phillips v. Washington Legal Found.*, 524 US 156, 160 (1998) (money and interest from fund of money can be protected under the Takings Clause); *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 US 155, 164-65 (1980) (constitutional prohibition against taking property without just compensation applies to monetary interest from identifiable fund of money); *GTE Northwest, Inc. v. Public Util. Comm'n of Oregon*, 321 Or 458, 900 P2d 495, 164 PUR 4th 392 (1995) (en banc) (PUC rules requiring co-location of competitors' equipment on property owned by utility constituted an unconstitutional taking).

2. CONFISCATION

In addition to the general prohibition against the taking of property without just compensation, the courts have developed a specific application to rates set for, and imposed on, public utilities. Adjusting PGE's rates downward to reflect the tax benefits of the loss on the sale of the Turbine, but not the costs of the Turbine, may also result in a confiscatory rate, which is another form of unconstitutional taking. "If a rate does not afford sufficient compensation, the State has taken the use of utility property without paying just compensation and so violated the Fifth and Fourteenth Amendments." *Duquesne Light Co. v. Barasch*, 488 US 299, 308 (1989).

The rates the Commission implements must enable PGE "to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed." *FPC v. Hope Natural Gas Co.*, 320 US 591, 602 (1944) (emphasis added). A rate reduction that leaves the financial risks of an investment with shareholders but does not allow shareholders to enjoy the financial benefits ultimately flowing from the investment is inherently at odds with this constitutional standard.

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3. ARBITRARY AND OPPORTUNISTIC CHANGES IN REGULATION

If necessary and appropriate steps such as the requested deferral are not taken, SB 408 will also amount to an arbitrary and opportunistic change in regulation. As the Supreme Court explained in *Duquesne Light*, "a State's decision to arbitrarily switch back and forth between methodologies in a way which require[s] 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 concerns." 488 US at 315. In other words, regulation must be appropriately symmetrical. *See* March 22, 2005 Department of Justice memorandum to Senators Deckert and Metsger, *supra*, at 3 ("If the Commission includes the effects of consolidation in utility rates when they produce a benefit, it cannot omit those effects when they happen to increase customer rates.").

In this case, absent a deferral and corresponding rate adjustment to reflect the costs and risks associated with the Turbine investment, the application of SB 408, in particular section 12 (ORS 757.268(12)), would force the Commission to arbitrarily switch back and forth in how it apportions tax effects. PGE/200, Piro-Tamlyn/2-4. Tax effects that proved beneficial at a consolidated level would go entirely to the public, while tax effects that proved detrimental at a consolidated level would be borne entirely by PGE and its shareholders. *Id*. PGE made the Turbine investment before SB 408 existed, resulting in an unexpected disruption in the benefit-burden relationship which, absent appropriate action by the Commission, will give rise to an arbitrary impact on shareholders and a windfall to customers.

4. IMPAIRMENT OF CONTRACT

Appropriating the tax benefits of unregulated activities for customers while insulating customers from any investment cost or risk would also violate the Contract Clauses of the federal and Oregon constitutions. *See* United States Constitution, Art. I , § 10;

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Oregon Constitution, Art. I, § 21. At the time of the Enron-PGE merger, the parties to the proceeding entered a stipulation, which the Commission adopted and incorporated into its order approving the merger transaction. *See* UM 814, Order No. 97-196, Stipulation, App. A. The Stipulation imposed on PGE and Enron "ring fencing" conditions that shielded customers from the costs and risks of unregulated activities and ensured that customers were not worse off due to PGE's affiliation with Enron. *See id*. at 3-4 ¶¶ 7, 10, 14.

A necessary corollary of that contractual obligation was that PGE and Enron would retain the rewards and benefits of unregulated activities and that the State would not pick and choose certain benefits from unregulated activities to give to customers while insulating customers from the underlying risk of such activities. Application of SB 408 without the requested deferral would substantially impair that contractual agreement. *See Rui One Corp. v. City of Berkeley*, 371 F3d 1137, 1147 (9th Cir 2004) (discussing standard for Contract Clause violations under the federal constitution); *Strunk v. Public Employees Ret. Bd.*, 338 Or 145, 170, 108 P3d 1058 (2005) (discussing standard for Contract Clause violations under the Oregon Constitution).

5. FEDERAL PREEMPTION

Appropriation of the federal tax benefit associated with the Turbine by the State of Oregon would also violate the Supremacy Clause of the federal constitution. Federal law preempts state law when application of state law "would disturb, interfere with, or seriously compromise the purposes of the federal statutory scheme. In other words, an application of state law that would frustrate the purpose of a federal statutory scheme is preempted." *City of Morgan City v. South Louisiana Elec. Coop. Assoc.*, 31 F3d 319, 322 (5th Cir 1994). Preemption occurs even if the state law does not directly conflict with federal law such that compliance with both would be impossible. *See id*. The question is whether the state law disturbs, interferes with, or seriously compromises the federal law.

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That is the case here. Pursuant to federal tax law, PGE is entitled to use its PGRD losses (and its losses from the sale of the transformer) to offset PGE income and thereby significantly reduce the actual financial impact of those losses on the company and its shareholders. This is an affirmative benefit that Congress has provided to companies that file consolidated federal tax returns. Absent the requested deferral, the operation of SB 408 will deprive PGE and its shareholders of that federal tax benefit. It will force PGE and its shareholders to bear the entire loss related to the Turbine, essentially nullifying the federal tax benefits to which it is entitled.

6. DISPARATE TAX TREATMENT

Finally, SB 408 violates the uniformity of taxation clauses of the Oregon Constitution (Article I, section 32, and Article IX, section 1); the Privileges and Immunities Clause of the Oregon Constitution (Article I, section 20); and the Equal Protection Clause of the United States Constitution. SB 408 arbitrarily differentiates utilities into two classes—those with an average of 50,000 or more customers in 2003 and those with an average of fewer than 50,000 customers in 2003—and subjects those classes to different tax treatments. *See* ORS 757.268(13) (defining a “public utility” or “utility” as 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").

There is no rational basis for the Oregon Legislature to create such classifications. *See Knapp v. City of Jacksonville,* 342 Or 268, 276, 151 P3d 143 (2007) (A classification is rationally based "if it rests upon genuine differences" and those differences bear a "reasonable relationship to the legislative purpose."). The class of utilities with 50,000 or more customers and the class of utilities with fewer than 50,000 customers are not genuinely different in any way that bears a reasonable relationship to the legislative purpose. The exclusion from SB 408 of utilities with fewer than 50,000 customers is arbitrary,

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undermining the constitutionality of the statute as a whole.

VI. CONCLUSION

Public utility ratemaking is a complex process governed by an interconnected body of law. SB 408 does not supersede other legal principles and cannot be applied in isolation. Rather, the Commission must do its best to harmonize all applicable legal principles. Given the specific circumstances surrounding the Turbine investment, granting PGE's deferral request is the best, if not only, means to avoid a conflict between SB 408, other Oregon statutes, and the state and federal constitutions.

DATED this 27th day of April, 2007.

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CERTIFICATE OF SERVICE

I hereby certify that on this day I served the foregoing **PORTLAND GENERAL ELECTRIC COMPANY'S OPENING BRIEF** by mailing a copy thereof in a sealed, first-class postage prepaid envelope, addressed to each party listed below and depositing in the U.S. mail at Portland, Oregon.

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