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VIA E-FILING & FIRST CLASS MAIL

Oregon Public Utility Commission
Attn: Filing Center
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Re: *UM 1271*

Attention Filing Center:

Enclosed for filing in the above-referenced docket are the original and five copies of Portland General Electric Company's Reply Brief. This document is being filed electronically per the Commission's eFiling policy to the electronic address PUC.FilingCenter@state.or.us, with copies being served on all parties on the service list via U.S. Mail. A photocopy of the PUC tracking information will be forwarded with the hard copy filing.

Very truly yours,

David F. White

DFW/ldh
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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 REPLY BRIEF**

I. INTRODUCTION

The deferred accounting application filed by Portland General Electric Company ("PGE") in this matter provides the Commission with an opportunity to account for the tax loss associated with the sale of the unregulated Turbine in a manner that is fair, consistent with Commission policy, and in line with the state and federal constitutions. Denial of this Application will deprive PGE of approximately $4.9 million of tax benefits arising from the sale of unregulated property. PGE therefore urges the Commission to grant the Application.

II. ARGUMENT

The reply briefs filed by the three Intervenors and Staff focus almost entirely on PGE's constitutional arguments, which the Intervenors and Staff roundly dismiss. However, PGE is hardly the first to raise constitutional concerns—most notably, the Department of Justice ("DOJ") and the Commission itself have raised some of the same concerns in connection with then-proposed legislation that the Legislature later enacted as SB 408. *See* Public Utility Commission memorandum, "Recommendation on treatment of utility income taxes," directed to Senators Ryan Deckert and Rick Metsger, dated March 22, 2005, at 3; 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. When the Utility Reform Project ("URP") attacked the DOJ's

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constitutional concerns in that context as inconsistent with "the current state of relevant law," which is essentially the same charge now leveled against PGE in this proceeding, the DOJ responded with a memorandum standing by its position and explaining why URP's position was not sound. *See* 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. Any suggestion that PGE is pulling constitutional arguments out of thin air is therefore misleading.

As for the more specific arguments in the Intervenors' and Staff's Opening and Reply Briefs, PGE will attempt to respond to them cohesively rather than addressing each brief separately.

1. One common theme in the Reply Briefs is their claim that benefit-burden alignment is no longer a Commission policy post-SB 408, and therefore irrelevant. However, the deferred accounting statute specifically allows the Commission to grant deferrals "to match appropriately the costs borne by and benefits received by ratepayers." ORS 757.259(2)(e). While the Commission may be reluctant as a general matter to grant deferrals related to consolidated tax losses going forward, it is appropriate to do so in this case given that PGE purchased the Turbine long before SB 408 was passed, and when PGE's investors reasonably expected to absorb or receive the tax burden or benefit arising from the Turbine investment. SB 408 did not amend, let alone nullify, ORS 757.259(2)(e) with respect to taxes. Although the Intervenors and Staff insist that the Commission should look only at SB 408, the reality is that all of PGE's arguments are based on either the deferred accounting statute or the state and federal constitutions, neither of which were amended or overridden by SB 408.

2. Another common theme in the Reply Briefs is that PGE's constitutional arguments are irrelevant in this proceeding because they are not ripe. It is true

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that the Commission's decision on the deferred accounting application will not, standing alone, have constitutional magnitude—as we mentioned in our Opening Brief, the Commission may address the Turbine sale in the context of the automatic adjustment clause implementing SB 408. However, there is no reason to view the Application in isolation. The deferred accounting process offers a legitimate means to avoid serious statutory and constitutional problems in the very near future. Without this deferral, there may be no way to prevent this tax benefit from being taken from PGE through SB 408. If PGE did not request this deferral, parties may later clam that the $4.9 million tax benefit cannot be excluded from SB 408 because PGE did not timely request a deferral to avoid this outcome. The constitutional aspects of the overall situation are relevant and should be considered by the Commission in this proceeding in making its decision.

3. Staff argues that granting the Application will not prevent PGE (or other utilities) from attacking SB 408 in the future in other situations. The Turbine tax loss is a unique situation because of the timing of the purchase and sale relative to the passage of SB 408. At the same time, it is certainly true that there may be future occasions that SB 408 is subject to constitutional or other legal challenges. That does not change the issue before the Commission today—whether to allow deferred accounting for the $4.9 million tax benefit from the Turbine sale as a practical solution to a serious problem currently before the Commission.

4. URP and the Industrial Customers of Northwest Utilities ("ICNU") assert in their Reply Briefs that a bevy of courts have already rejected the constitutional arguments PGE raises, including the U.S. Supreme Court. This is not true. The cases on which Intervenors rely did not involve constitutional challenges. In *Federal Power Commission v. United Gas Pipe Line Co.*, 386 US 237, 246 (1967), the only question was whether the agency had violated its statutory authority by adopting the flow-through method.

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City of Charlottesville v. FERC, 774 F2d 1205 (DC Cir 1985) involved an unsuccessful attack on the stand-alone method and therefore offered no opportunity for the D.C. Circuit to determine the constitutionality of the flow-through method.[1] There was no discussion of constitutionality in *BP West Coast Products, LLC v. FERC*, 374 F3d 1263 (DC Cir), where no one appears to have raised the issue. The same is true in the state cases URP cites.[2] Finally, URP's reliance on a passage from the legal encyclopedia Corpus Juris Secundum ("CJS") is misplaced because it is based on a handful of state cases, none of which involved constitutional challenges akin to PGE's. *See* C.J.S., Public Utilities, Taxes Paid by Utility, § 95 (cited in URP Reply Brief at 6-7). Indeed, reading CJS would give one the erroneous impression that the stand-alone method is legally impermissible, which is not the case. *See id.* In fact, most states use the traditional stand-alone method.

5. Staff and ICNU minimize the relevance of the U.S. Supreme Court's statement in *Duquesne Light Company v. Barasch* that "serious constitutional questions" arise when a state arbitrarily switches between methodologies such that investors bear the risk of bad investments but are denied the benefit of good investments. 488 US 299, 315 (1989). However, that is precisely the situation here, because SB 408 requires PGE's investors to bear the costs of unsuccessful unregulated activities but denies them the tax benefits of such activities, while protecting customers from ever paying for the tax liability associated with income from unregulated activities. The warning in *Duquesne* is clear, and the fact that SB 408 is the result of legislative action does not shield it from constitutional

[1] For further discussion of *Charlottesville* and *United Gas*, and why the Commission should instead rely on *Duquesne*, see the DOJ's memorandum titled "Reply to the Utility Reform Project's comments on tax treatment in utility ratemaking," *supra*.

[2] *See Greeley Gas Co. v. State Corp. Comm'n of State of Kansas*, 807 P3d 167 (Kan App 1991) (no discussion of constitutional issues); *City of Muncie v. Public Serv. Comm'n of Indiana*, 378 NE2d 896 (Ind App 1978) (same); *Central Power & Light Co. v. Public Utility Comm'n of Texas*, 36 SW3d 547 (Tex App 2000) (same); *In Re New Jersey Nat'l Gas Co.*, 1991 WL 501940, 128 PUR4th 199 (NJ Board of Reg. Comm'rs 1991) (same).

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review as ICNU suggests (ICNU Reply Brief at 6), nor does the fact that the legislation was heavily debated before adoption preclude such review (Staff's Reply Brief at 7). *Duquesne* announces a constitutional rule against which legislative and administrative decisions must be tested.

It is telling that no one has disputed the factual predicate of our *Duquesne* argument, namely that the operation of SB 408 inherently and opportunistically switches the treatment of taxes back and forth depending on whether the Turbine is sold for a loss or sold for a profit. Nor does anyone dispute the timing of the purchase and sale of the Turbine relative to the adoption of SB 408. Finally, no one disputes the substantial financial harm to PGE. Without deferred accounting, PGE will be deprived of $4.9 million of tax benefit arising from the Turbine sale.

6. With regard to SB 408's disparate treatment of utilities based on the number of customers they have, PGE disagrees with ICNU's assertion that there is a fair and substantial relationship between that classification and the purpose of the SB 408 legislation. The stated purpose of SB 408 is to align the taxes collected by public utilities with the taxes paid by utilities. ORS 757.267(1)(a). Indeed, the legislation goes so far as to state that rates must reflect actual taxes paid in order "to be considered fair, just and reasonable." ORS 757.267(1)(f). Given the stated purpose of SB 408, there is no rational basis to allow smaller utilities to charge customers more than actual taxes paid, regardless of the compliance costs of SB 408.

7. With respect to the Contract Clause issue, the nature of the obligations arising from a contract is a question of contract interpretation. The mere fact that taxes are not expressly referenced in the Enron contract cannot be considered determinative under the circumstances. The Commission would enforce the ring-fencing principle against Enron and PGE in any way consistent with the concept, not just specific requirements expressly stated

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in the contract. The same must be true of any reciprocal obligation of the Commission. PGE maintains that SB 408 substantially impairs a term of its contract with the Commission, thereby giving rise to a Contract Clause violation under the test stated in *General Motors Corporation v. Romein*, 503 US 181, 188-89 (1992).[3]

8. PGE is not ignoring the Commission's decision in AR 499 as ICNU asserts. On the contrary, our request for deferred accounting is expressly permitted by the Commission's final order. In AR 499, the Commission affirmed that it would continue to consider deferred accounting applications on a case-by-case basis. Order No. 06-400 at 11 (July 14, 2006). As such, Staff's suggestion that SB 408 forecloses any application of the deferred accounting statute (ORS 757.259) to tax gains or losses is inconsistent with the Commission's own recognition in AR 499 that SB 408 and ORS 757.259 are compatible. *See id.* It is also notable that the Commission's rejection of a general deferral mechanism in AR 499 was premised on the Commission's conclusion that SB 408's automatic adjustment clause for taxes was "certainly foreseeable" going forward because it was "set in statute." *Id.* That rationale does not apply to the Turbine situation.

9. ICNU criticizes PGE for failing to cite the federal statute regarding consolidation for federal tax purposes and the attendant benefits thereof. (ICNU Reply Brief at 8) PGE is unaware of any dispute about the nature or benefits of consolidated tax filings, but the relevant statutes are located at 26 USC §§ 1501 to 1563.

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[3] In *General Motors*, the Court concluded that a change in workers' compensation law did not impair certain employment contracts between the parties. 503 US at 187. The petitioners essentially argued that the workers' compensation law in existence when the contracts were entered was automatically incorporated into the contracts, even though the contracts made no reference to workers' compensation. *Id.* at 187-89. The contract at issue in this case is fundamentally different than the ones in *General Motors* because it specifically addresses and requires a separation between PGE's regulated and unregulated activities. The issue of taxation is implicit in that requirement, especially in the context that the Commission always calculated PGE's taxes on a stand-alone basis for purposes of ratemaking. In any event, whether there is an implied term binding on the Commission is a question of contract interpretation.

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10. The fact that there is little to no caselaw applying Oregon and federal constitutional principles to a situation such as this one is hardly surprising—SB 408 is a unique statute that has not been constitutionally tested or reconciled with the other Oregon utility statutes.

11. The other parties raise no new arguments under ORS 757.259 and the Commission's implementing policy. *See* PGE's Opening Brief at 3-10. Aside from PGE's constitutional arguments, the Commission should approve the Application under a straight-forward application of its deferred accounting policy.

III. CONCLUSION

In sum, there are serious statutory and constitutional questions implicated by SB 408, particularly as it applies to the Turbine and SB 408's deprivation of $4.9 million in tax benefits, and deferred accounting is an appropriate means of avoiding a thorny situation. PGE respectfully urges the Commission to grant the Application.

DATED this 8th day of June, 2007.

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CERTIFICATE OF SERVICE

I hereby certify that on this day I served the foregoing **PORTLAND GENERAL ELECTRIC COMPANY'S REPLY 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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