BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1271

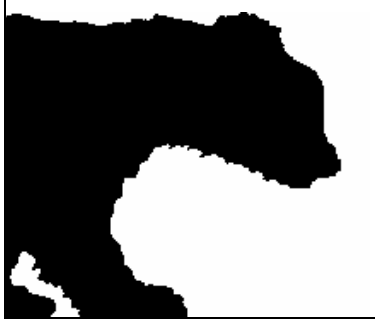
In the Matter of	)
PORTLAND GENERAL ELECTRIC,	)
Deferred Accounting Authorization for Expenses/Refunds Associated with SB 408.	)

OPENING BRIEF

OF THE

CITIZENS' UTILITY BOARD OF OREGON

April 27, 2007



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I. Introduction

In 2001, PGE embarked on an unregulated, speculative business venture and purchased a turbine and transformer for merchant purposes. The circumstances PGE foresaw at the time did not materialize and the Company abandoned the project, but finished building the turbine in order to resell it. Half a decade later, three legislative sessions later, and a stormy, public tax policy debate later, PGE is asking the Commission to ignore the law and treat the Company's loss as if we were still in the world that existed in 2001. Not only would granting PGE's request violate the law, it would subsidize the Company's shareholders by compensating them for part of this unregulated loss through the use of regulated customer tax payments that will not be paid to any government entity. This docket should not have been filed, but since PGE is asking the parties and the Commission to spend time on this issue, we request that the Commission uphold the law and deny PGE's application.

II. PGE Is Asking The Commission To Subvert The Law

SB 408 was passed to align taxes paid to units of government with taxes collected from customers in rates. PGE's application in this case is contrary to both the letter and the intent of the law.

A. SB 408 Recap

In examining the direction and intent of SB 408, we begin with the text of the law itself:

> (6) The automatic adjustment clause shall account for all taxes paid to units of government by the public utility that are properly attributed to the regulated operations of the utility, or by the affiliated group that are properly attributed to the regulated operations of the utility, and all taxes that are authorized to be collected though rates, so that ratepayers are not charged for more tax than:
>
> (a) The utility pays to units of government and that is properly attributed to the regulated operations of the utility; or
>
> (b) In the case of an affiliated group, the affiliated group pays to units of government and that is properly attributed to the regulated operations of the utility.

ORS 757.268(6); SB 408, Section 3(6).

ORS 757.268(6) directs the Commission to charge customers no more in taxes than what is paid to units of government and is properly attributed to the regulated operations of the utility. The Oregon Department of Justice describes the rationale for this direction in a letter to Lee Beyer, the Chair of the Commission:

> In a consolidated return, the holding company may offset taxable income generated by some subsidiaries, such as an Oregon utility, with losses or tax credits from other subsidiaries in computing the net taxable income of the consolidated group. Likewise, a utility that engages in both regulated and unregulated operations may offset taxable income and taxes generated by its regulated operations with losses or tax credits generated by unregulated operations.
>
> The amount of tax revenue actually received by governmental units from a regulated utility may be more, or less, than the amount estimated during ratemaking. Choices made by a regulated utility and its parent corporation may affect the extent to which actual experience diverges from projected tax liability. Oregon Laws 2005, chapter 845 … addresses the difference between what ***did*** happen and what was ***projected*** to happen with respect to taxes paid and taxes projected.

Department of Justice, Letter to Lee Beyer, December 27, 2005. Emphasis in original.

It is clear, therefore, that customers are to pay no more in taxes than their properly attributed share of the actual taxes paid to government entities. The law further caps the amount of taxes that can be properly attributed to a utility. Returning to the text of the law:

> (12) For purposes of this section, taxes paid that are properly attributed to the regulated operations of the public utility may not exceed the lesser of:
>
> (a) That portion of the total taxes paid that is incurred as a result of income generated by the regulated operations of the utility; or
>
> (b) The total amount of taxes paid to units of government by the utility or by the affiliated group, whichever applies.

ORS 757.268(12); SB 408, Section 3(12).

ORS 757.268(12) establishes an upper limit on the amount of taxes that may be properly attributed to a utility; this limit is the lesser of the utility's stand-alone tax liability or the actual taxes paid to government entities. Thus, the Commission may only properly attribute taxes to a regulated utility to the extent that the properly attributed amount is less than the lower of 12(a) or (b). The Oregon Department of Justice describes this limit in its letter to Chair Beyer:

> While the Commission may elect to attribute taxes by any mechanism which yields a result that is equal to or less than the subsection 3(12) limitation, the Commission may not attribute taxes in excess of the amounts calculated under subsection 3(12).

Department of Justice, Letter to Lee Beyer, December 27, 2005.

In summary, customers shall pay no more for taxes in rates than what is properly attributable to the regulated operations of the utility, and that amount shall be no greater than either the utility's calculated stand-alone tax liability or the total amount in taxes paid to government entities.

B. PGE's Request

As an unregulated venture, PGE purchased a turbine and transformer in 2001 hoping to make unregulated profits for its shareholders. PGE/200/Piro-Tamlyn/1. In June of 2001, PGE cancelled the project, but had the turbine built anyway in order to resell it. PGE/200/Piro-Tamlyn/2. Five years later, in July 2006, PGE sold the turbine and transformer, incurring a loss of $12.3 million. According to PGE, the loss on this equipment will decrease PGE's 2006 consolidated tax liability by $4.8 million, and this reduction will be captured by the SB 408 automatic adjustment clause.

In this case, PGE asks the Commission for permission to establish a deferred account to capture this $4.8 million tax reduction from the Company's consolidated tax liability, and reserve it for the benefit of shareholders. The Company makes this request despite its apparent understanding, indeed acknowledgement, that SB 408 requires this tax write-off to be captured by the automatic adjustment clause.

> Senate Bill 408 (SB 408) now requires that the tax effects of non-utility expenses and investments affect ratemaking if those tax effects lower the taxes that the utility otherwise would pay.

UM 1271 PGE/100/Dahlgren-Tinker/3.

What PGE is asking for here is extraordinary. While admitting that, under the law, customers are entitled to a refund of the amount of taxes that they overpaid, PGE argues that this refund is unfair and the Commission should violate the law and authorize the Company to establish a deferred account of $4.8 million in order to "neutralize the tax effect of the loss associated with the sale of the turbine." PGE/100/Dahlgren-Tinker/4.

PGE goes as far as to argue that "customers will incur no harm as a result" of this deferral, because rates "will not change." PGE 300/Dahlgren-Tinker/2. The law requires the Company to return $4.8 million to customers through rates. "Neutralizing" that refund by diverting it back to the shareholders through a deferred account clearly harms customers, as customers would not receive the rate reduction that they are entitled to under the law.

C. PGE Request Is Against The Law

As stated earlier, SB 408 dictates that customers shall pay no more for taxes in rates than what is properly attributable to the regulated operations of the utility, and that this amount shall be no greater than either the utility's calculated stand-alone tax liability or the total amount in taxes paid to government entities.

i. PGE Request Violates The Lesser-Of Provision In SB 408

In the Company's testimony, PGE describes how SB 408 functions in regard to PGE's unregulated loss on a speculative investment of a merchant turbine.

> For SB 408 purposes, this decrease in PGE's total consolidated tax liability will flow through the calculation of PGE's total taxes paid, and ultimately result in a rate credit to customers of approximately $4.8 million.

UM 1271 PGE/200/Piro-Tamlyn/4-5.

It is the entire Company's consolidated tax liability that has been reduced by $4.8 million, and the Company claims this entire reduction would flow through to customers, thereby applying the Section 3(12)(b) cap of SB 408 (ORS 757.268(12)). The amount of taxes properly attributed to the regulated utility can be no more than the consolidated company's actual tax payments, which were reduced (all other things being equal) by $4.8 million from what was forecast to be collected in rates.

ii. PGE Request Is Contrary To The Intent Of The Law

As it turns out, this very issue has been before the Commission once before. In AR 499, the rulemaking proceeding to implement SB 408, PGE proposed a deferral mechanism using "the example of a turbine not included in rates, and which was sold at a loss." OPUC Order No. 06-400 p. 10. The Commission decision in that case was clear and correct.

> [W]e believe that adoption of a deferral mechanism would be in opposition to the intent of the legislature, because it would effectively offset the automatic adjustment clause so that it did not "adjust" rates, as it was designed to do.

AR 499 OPUC Order No. 06-400 p. 12.

Though the Commission was addressing PGE's proposal for a standing deferral mechanism in AR 499, the specific example the Commission was responding to and the circumstances it was addressing are both relevant in this particular deferral application. Obviously, PGE's example in AR 499 was not purely hypothetical, as the Company had been holding this turbine and transformer since 2001. The hypothetical did not convince the Commission in AR 499, and the actuality should not convince the Commission here.

The circumstances of this case go to the heart of SB 408. PGE has, in an unregulated subsidiary, sustained a loss on a speculative investment of a merchant

turbine, and the result of this loss on the Company's consolidated tax filing is to lower the Company's actual tax payments to less than what the regulated utility's stand-alone tax liability would have been. So, not only is PGE requesting that the Commission allow the Company to use customer tax payments to partially compensate shareholders for the loss incurred in this unregulated, speculative investment, PGE is doing so in a circumstance where the SB 408 Section 3(12)(b) cap – which specifically addresses the egregious abuse of customer tax payment perpetrated by Enron – applies.

iii. SB 408 Has No Grandfathering Provision

SB 408 contains no grandfathering provision, and PGE is therefore subject to current law and current Commission policy.

PGE's primary argument is that, while the law requires a refund to customers, the Commission should circumvent the law in the interest of "fairness." PGE/100/Dahlgren-Tinker/4. PGE explains that, because SB 408 was not the law in 2001, when the Company purchased the turbine, it would be unfair to enforce the law now. As "PGE expected that neither gains nor losses associated with the turbine would affect PGE electric prices" in 2001, now, "in keeping with PGE's reasonable investment-backed expectations at the time the turbine was purchased," the utility should not be subject to current law. PGE/100/Dahlgren-Tinker/4.

There are several problems with this argument. The first is that the law has changed. The legislature has the authority to do that. In 2005, the legislature passed SB 408, which dictates that, beginning in 2006, the Commission shall ensure that taxes collected in rates are not higher than taxes paid to government entities. If PGE assumed the legislature would never change the law, the Company was doing so in the face of a

great deal of public debate about utility tax attribution, and, therefore, the reasonable possibility that the law would change. The turbine and transformer were an unregulated investment, and, as such, PGE shareholders took the risk that the assumptions and plans regarding the turbine were correct. Customers should not have to pay shareholders $4.8 million because the Company's assumption was incorrect.

Second, like the legislature, within its statutory authority, the Commission can change its policies and practices. In its reconsideration in UE 170, the Commission stated that it would have changed its tax policy and moved away from stand-alone tax attribution regardless of the passage of SB 408.

> We also affirm our earlier conclusion that, even in the absence of SB 408, we could, and would, have departed from our traditional practice of treating taxes on a stand-alone basis and considered the taxes to be paid to units of government in setting PacifiCorp's rates … We would have made such an adjustment to address wide-spread criticisms of the potential mismatch, resulting from the use of the stand-alone methodology, between monies collected from ratepayers to pay taxes and the actual amount of taxes paid to the taxing authorities.

UE 170 Reconsideration OPUC Order No. 06-379 p. 7.

If PGE purchased the turbine with the assumption that the Commission practice of stand-alone tax attribution would not change, then the Company was taking a risk, because the Commission has the right – and when required by law, the responsibility – to change its practices.[1]

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[1] On a more practical level, PGE had ample time to sell the turbine and transformer prior to either the Commission's change in policy or the legislature's change in law. PGE decided in June of 2001 to abandon the turbine project, but waited until July of 2006 to sell the turbine. During these 5 years, the issue of utility tax attribution was becoming increasingly public and controversial.

By early 2005, it was clear that changes in the way taxes are determined for inclusion in rates were actively being considered. Yet, PGE did not sell the turbine until July of 2006. Notwithstanding the legal and policy reasons for denying PGE's application in this case, on a practical level the Company could have sold the turbine and transformer before 2006 when SB 408 went into effect and avoided this docket entirely, but it did not.

D. PGE Request Would Result In Subsidization Of Shareholders By Customers

In testimony, PGE suggests that its proposed deferral would prevent the cross-subsidization of utility customers by shareholders. PGE/100/Dahlgren-Tinker/2. In fact, PGE's proposal would do just the opposite. If PGE's application for a deferred account is granted, then regulated customer tax payments, that were forecast to go to units of government, will instead go into shareholder pockets, thereby compensating them, in part, for the Company's loss in an unregulated business venture.

Under PGE's proposal, part of customer tax payments would not go to any government entity, but would instead subsidize PGE shareholders' poor turbine investment. In other words, PGE customers' money does not go to pay taxes, but to PGE shareholders, who would be recovering a portion of their unregulated loss through regulated customer tax payments.

PGE took a risk in a speculative, merchant turbine in order to make unregulated profits for shareholders. That risk materialized, and PGE incurred a $12.3 million loss. PGE is now asking the Commission to take $4.8 million of customer tax payments and use that revenue to offset the shareholders' loss, thereby reducing the loss by nearly 40%. This is a classic example of a subsidy, and customers should not be subsidizing the utility's unregulated activity.

Not only is the Company's proposed subsidy prohibited under SB 408 and current Oregon law, but it is also bad regulatory policy. PGE took a significant risk when it decided to become a wholesale electric generator in 2001, a time of tremendous uncertainty in the electricity market. PGE did not seek Commission approval for this speculative venture, and did not offer to share any of its unregulated profits, should the

investment be successful. Were the Commission to allow PGE to use customer tax payments (or customer refunds of tax over-payments) to offset 40% of the Company's loss, it would encourage utilities to engage in such risky, unregulated ventures.

Both customers and the economy depend upon reliable, affordable utility service; it is not in the public's best interest to encourage utilities to engage in risky adventures. Oregon has invested a great deal of time and effort in designing regulatory protections to safeguard regulated utilities from the unregulated activities of affiliated companies. This has been a large part of the effort of the Commission, Staff, and other parties during the utility acquisition proceedings under 757.511 that have come before the Commission in recent years. It makes little sense to protect customers from the risky, unregulated activities of its affiliates with one hand, while encouraging them to undertake risky, unregulated activity with the other.

E. PGE's Application Is Contrary To The Oregon Statute It Was Filed Under

Finally, not only does PGE's Application request subsidization of the Company's unregulated merchant business venture with customer tax payments, it also runs contrary to the Oregon Revised Statute upon which the Company's Application is based. PGE requests this deferral under ORS 757.259(2)(e). PGE Application p. 6. The part of the statute that PGE calls upon reads:

> (2) … the commission by order may authorize deferral of the following amounts for later incorporation in rates: …
>
> (e) … Identifiable utility expenses or revenues, the recovery or refund of which the commission finds should be deferred in order … to match appropriately the costs borne by and benefits received by ratepayers.

ORS 757.259(2)(e).

Customers did not buy the turbine and transformer in question. Had this unregulated investment played out as the Company envisioned, customers would have received no benefit from the equipment. Yet PGE's proposed deferral would require customers to compensate shareholders for part of their loss through so-called "tax payments," despite the fact that the payments in question would never be sent to any unit of government. Such a deferral would not appropriately match "costs borne by and benefits received by ratepayers." Customers did not benefit from this merchant turbine, and should not have to pay phantom tax costs to ease shareholders' loss. There cannot be any matching of costs and benefits and therefore reliance on ORS 757.259(2)(e) is misplaced.

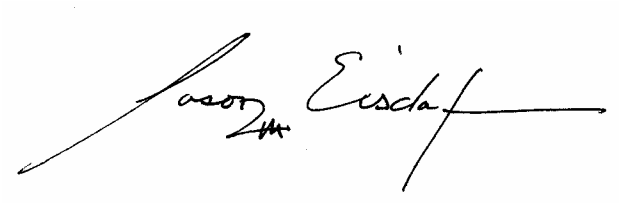
F. The Commission Does Not Have The Authority To Change The Law

PGE may not like ORS 757.268, and the Company may not agree with the policy concerns behind the law. However, PGE should not ask the Commission to "neutralize" the law. It is not within the Commission's scope of authority to change the law at PGE's request.

III. Conclusion

PGE's application in this case is blatantly contrary to existing law in ORS 757.268 and the Commission's Rules implementing it, and should be denied.

Respectfully Submitted,
April 27, 2007



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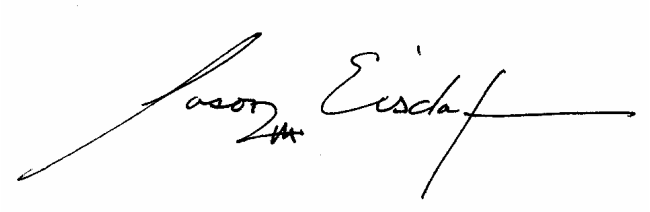
CERTIFICATE OF SERVICE

I hereby certify that on this 27th day of April, 2007, I served the foregoing Opening Brief of the Citizens' Utility Board of Oregon in docket UM 1271 upon each party listed below, by email and, where paper service is not waived, by U.S. mail, postage prepaid, and upon the Commission by email and by sending 2 copies by U.S. mail, postage prepaid, to the Commission's Salem offices.

Respectfully submitted,



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