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September 10, 2009

VIA ELECTRONIC AND FIRST CLASS MAIL

Oregon Public Utilities Commission
Attn: Filing Center
550 Capitol Street NE, #215
P.O. Box 2148
Salem, OR 97308-2148

Re: AR 537 – In the Matter of Permanently Amending OAR 860-022-0041 to be Consistent with ORS 757.268

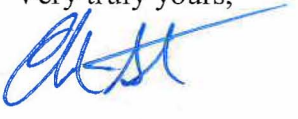
Joint Comments of the Citizens' Utility Board of Oregon, The Industrial Customers of Northwest Utilities and the Northwest Industrial Gas Users on Proposed Deletion of Subsection 10

Dear Filing Center:

Enclosed for filing in the above referenced docket is the original and one copy of Joint Comments of the Citizens' Utility Board of Oregon, The Industrial Customers of Northwest Utilities and the Northwest Industrial Gas Users on Proposed Deletion of Subsection 10.

Thank you for your assistance in this matter. Should you have any questions regarding this matter, please feel free to contact me.

Very truly yours,



Chad M. Stokes

CMS: ca
Enclosure(s)

cc: AR 537 Service List (via e-mail and via first class mail to parties not waiving paper service)

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JOINT COMMENTS OF THE CITIZENS' UTILITY BOARD OF OREGON, THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES AND THE NORTHWEST INDUSTRIAL GAS USERS ON PROPOSED DELETION OF SUBSECTION 10

Pursuant to the August 27, 2009 Ruling to extend the public comment deadline to allow written comments on the possible deletion of OAR 860-022-0041 (10), the Citizens' Utility Board of Oregon, the Industrial Customers of Northwest Utilities and the Northwest Industrial Gas Users (the "Joint Customers") submit these joint comments. As detailed below, the Joint Customers agree with the Oregon Public Utility Commission's ("Commission" or "OPUC") finding, as set forth in Order No. 09-135 at 1, that the prior version of 860-022-0041 (10) is in conflict with ORS 757.267 and ORS 757.268 ("SB 408"). The rule was incorrect in requiring that the earnings review use a historical applicable tax year when a utility made a confiscatory rate claim under ORS 756.040. While the prior version of subsection 10 was wrong, and while the Commission's new version of subsection 10 as proposed in AR 537 is better, the Joint Customers agree with the Commission's alternative proposal to delete subsection 10 in its entirety with no other change in OAR 860-022-0041.

The Joint Customers limit these Joint Comments to the issue posed by the Ruling of August 27, 2009 and reserve the right to brief all of the legal and constitutional issues[1] noted for resolution in the Ruling and Prehearing Conference Report issued September 2, 2009 in Docket No. UG 171(1).

I. The Prior Version of OAR 860-022-0041(10) Conflicts with SB 408.

Under Senate Bill 408--codified primarily at ORS 757.268--public utilities must true-up the amount paid to taxing authorities with the amount collected in rates for taxes. If the amount collected differs by $100,000 or more from the amount paid, then the utility must either refund to customers the amount in excess of taxes paid, or surcharge customers for the increased amount of taxes paid through the establishment of an

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[1] Two decisions from the United States Supreme Court address the basic constitutional principles applicable to the ratemaking process. These cases are *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) (*Hope*) and *Duquesne Light Co v. Barasch*, 488 U.S. 299 (1989) (*Duquesne*). These standards require the OPUC to establish rates that prospectively provide the utility with a reasonable opportunity to recover its prudent expenses and to earn a fair return on investment that serves customers. As we will address in the UG 171 (1) docket briefing schedule, the Constitution requires only that the total rate allowed is reasonable; it does not require or allow separate aspects of the rates to be examined piecemeal. Neither *Hope* nor *Duquesne* established any constitutional right with regard to the utility's actual revenues or earnings which the utilities' operations produce under such rates.

automatic adjustment clause ("AAC"). *See* ORS 757.268 (4). Under ORS 757.268 (9) and OAR 860-022-041 (9), any person may petition to terminate an AAC on the basis that it would result in a material adverse effect on customers. Such issues would arise in the context of SB 408 surcharges to customers, and while not the subject of OAR 860-022-041 (10), Joint Customers note that relief for customers from such a SB 408 surcharge would require the Commission's consideration of that surcharge's impact prospectively upon that utility's customers. A rate surcharge will obviously have its most material impact on customers during the period of time that it is on their bills.

If a utility claims that a SB 408 refund is confiscatory and violates ORS 756.040, then the Commission must review the confiscatory claim in the appropriate legal context, which is also prospective. But, even though the refund is based on taxes collected and paid in an historic period, the rate action to which the confiscatory claim is made is setting future rates. *See Pacific Northwest Bell Telephone Company v. Katz*, 841 P.2d 652 (Or. Ct. App. 1992).

In the original version of OAR 860-022-0041 (10), the Commission would have analyzed a confiscatory rate claim based upon the utility's actual earnings from its results of operations report for the time period in which the taxes were collected. This created a disconnect between the time period during which the Commission was ordering a utility to return money to its customers and the time period during which the utility shareholders were claiming confiscatory rates. Put another way, can an action that the Commission is requiring a utility to take next year, really violate the constitutional rights of the utility two years before the Commission even makes the decision? Upon consideration of Avista's application, and at the first point in time that the Commission considered this issue in Docket UG 171, the Commission appropriately recognized inconsistency of the rule with *Hope* and with the legislative intent of SB 408 in using historical tax year earnings. Such application subverted SB 408, and the Commission correctly rejected the original rule.

The Commission was correct. First, a historic analysis is not required by *Hope*. The *Hope* test is prospective – *i.e.*, are the rates – in total including the refund – in the period to be applied so low as to be confiscatory? Second, income taxes are derivative of earnings. When a utility whose rates include a tax component ("Tax Component A"), earns less net revenue due to the utility's performance than the revenue assumptions underlying Tax Component A, then that utility will pay less taxes than the revenues produced by Tax Component A. Under SB 408, that excess revenue collected "as taxes paid" is customer money to be returned as a refund. It is not a utility's slush fund to prop up its shareholders' earnings. Rather, the intent of SB 408 is to carve out income taxes from the regulatory paradigm of other utility expenses that are recovered in its charges to customers, but which may be higher or lower in actuality in a given year than the component that underlies the charges when the rates were set by the Commission.

Once rates are set by the Commission, the utility has an opportunity to earn a just and reasonable return. If a utility fails to manage its costs and ends up with a tax bill less than what it collected from its customers, then customers are entitled to a refund. Going

back and analyzing its earnings historically only props up the utility's poor performance with SB 408 refund monies. These funds are not a utility's with which to make itself whole because of the failure of its historic performance.

II. The Proposed Version of OAR 860-022-0041 (10), While Correct in Its Prospective Focus, Is Unnecessary.

While the proposed rule in AR 537 is better than the old rule, the Joint Customers have decided not to support the temporary rule becoming a permanent rule. This AR 537 rulemaking proposal is for a permanent rule change to OAR 860-022-0041 (10) implementing the change made by the Commission on a temporary basis in Docket No. AR 536 as follows:

> (10) At any time, after filing a tariff implementing an automatic adjustment clause a utility may file a claim that a rate adjustment under the automatic adjustment clause violates ORS 756.040 or other applicable law. In making a determination regarding a potential violation of 756.040, the Commission will examine the utility's projected earnings during the period the automatic adjustment clause would be in effect.

This proposal changes the time period used for the earnings review to evaluate the fair and reasonable standard from the applicable historical tax year in the prior version to the future period during which the AAC would be in effect. In other words, to evaluate any utility's claim that a refund of customer monies would violate ORS 756.040 and result in confiscatory rates, the Commission would conduct a prospective earnings review during the time that the refund would be provided to customers. *(i.e.*, June 1 to May 31).

This makes sense. The Commission sets rates. When it establishes a refund or surcharge as part of an AAC, that refund or surcharge is a rate element that is prospective -- that will show up on customers' bills after the Commission decision which authorizes it. To judge whether that refund is confiscatory, or whether a surcharge has a material adverse effect, requires that we look at the period of time when the rates paid by customers include the refund or surcharge. A rate cannot be confiscatory two years before it is in place. A rate cannot cause a material adverse effect on customers when that rate has yet to be charged to customers.

The Joint Customers do not believe the change set forth in the temporary rule goes far enough. No where in SB 408, the statues codifying it (ORS 757.267 and ORS 757.268), or in the rules implementing the codifying statutes, other than in subsection (10), is a confiscatory taking discussed. All references to confiscatory takings should be removed from the rules, and thus subsection (10) in both its original and temporary form should be deleted.

III. The Alternative Proposal for Deletion of Subsection 10 Is Preferable Because the Rules Implementing SB 408 Do Not Need to Address Confiscatory Claims.

Under the *Hope* standard, courts have held that it is the end result that must be fair; *i.e.*, the regulator must set rates to provide sufficient revenues to pay the reasonable expenses and capital costs of a utility overall. The issue is not a single element of rates, such as a SB 408 refund, but the level of rates, overall.

SB 408 does not include any provisions relating to confiscatory rates. It does allow suspension of the AAC in order to prevent a material harm to customers, but it includes no provision for suspending the AAC if shareholders feel the rates are confiscatory. This does not mean that confiscatory rates cannot be implicated by SB 408.

Constitutional protections exist, and the Commission must adhere to them, even though SB 408 made no reference to protecting the constitutional rights of a utility's shareholders. This is codified in ORS 756.040. But in the specific ratemaking statues, like SB 408, there is no mention of confiscatory rates. The statutes codifying SB 408 are no different than any other ratemaking statute that applies to the OPUC. Nowhere in the general ratemaking section (ORS 757.210 (1)), the AFOR section (ORS 757.210(2)), the deferral section (ORS 757.259) or in the Renewable Adjustment Clause (ORS 757.262) is there a reference to confiscatory rates. The rules associated with these sections of OPUC authority also are silent on confiscatory rates. This does not mean that the Commission can establish confiscatory rates through AFOR or other means, since constitutional protections exist independent of Commission authority.

It does suggest, however, that having a section of the SB 408 implementing rules establishing a procedure to examine a claim of confiscatory ratemaking is unnecessary. A utility is free to challenge a Commission rate order as confiscatory regardless of the particular statute that the Commission was acting under when it established the rate. Why the implementing rules for SB 408 raise a unique specter of confiscatory ratemaking when SB 408 and the rules governing other rate proceedings do not, is unclear.

If the Commission does feel the need to have rules to govern a proceeding which is opened to examine a utility's claim that its rates are confiscatory, then such rules should apply, not just to SB 408, but to any rate that is challenged as confiscatory. Such rules would be more appropriate under ORS 756.040. If the Commission wishes to design rules to govern a confiscatory taking under the *Hope* standard, than it should open a rulemaking under ORS 756.040.

Having been granted the opportunity to review this important question by the extension of the public comment period, the Joint Customers agree that deletion of OAR 860-022-0041 (10) is the best way for the Commission to proceed and to allow the Commission to be consistent with the constitutional issues that must be considered in the overall context of a confiscatory claim. Obviously, a rule cannot limit a party's constitutional rights, and the implementing rules for SB 408 need not address a constitutional claim. The Commission can revisit the appropriateness of a rule after the decision in Docket UG 171 (1).

Dated: September 10, 2009

Respectfully submitted,

Citizens' Utility Board

for Bob Jenks, Executive Director

Industrial Customers of Northwest Utilities

for Michael Early, Executive Director

Northwest Industrial Gas Users

for Paula Pyron, Executive Director