BEFORE THE PUBLIC UTILITY COMMISSION OF OREGON

AR 499

In the Matter of the Adoption of Permanent Rules Implementing SB 408 Relating to Utility Taxes	)))	City of Portland's Response Comments

The City of Portland ("the City") submits the following response comments regarding the July 25, 2006 Proposed Rules and the various counter proposals originating at the August 8, 2006 workshop.

The City has three primary interests at this stage in these proceedings. First, the City is interested in ensuring that SB 408 (codified as ORS 757.267-ORS 757.268) is implemented to accomplish its goal of balancing the utility taxes paid by utility customers within rates established by the Commission and the appropriate tax burden to be borne by the utility's parent entity. Second, the City seeks to assure that nothing within the rules implementing SB 408 in any way reduces the taxes paid to local jurisdictions or modifies the rules by which those taxes are collected. Third, the City is attempting to participate in the rule making process and other PUC dockets to support the full implementation of SB 408. Finally, the City responds to the Joint Comments circulated earlier today and filed by Staff.

1. <u>Implementation of SB 408</u>

SB 408 was intended to provide for the allocation of tax liability among a group of assets held by a parent entity. The idea, in its simplest terms, was that no ratepayer would be obligated to pay more than its proportionate share of the overall tax liability of the parent entity. The enactment of SB 408 represented a change from past practices by which utilities became a revenue source to satisfy the tax liabilities of their parent corporations, or fed cash to the parent corporation offset by paper losses from other affiliated entities.[1] Under the old paradigm, the sister companies would only make contributions to pay the parent's tax liabilities if the funds received from the utility did not cover the parent's total amount due.

In drafting SB 408, the Oregon Legislature saw utter unfairness of the old approach. Ratepayers were charged too much. The system created incentives for corporate raiders to acquire utilities to gain access to this revenue stream. While it has been called an Enron problem, the problem was not unique to Enron. The old approach provided the incentive to the Texas Pacific Group, among others, to attempt to buy PGE.[2] In light of the efforts by Mid American to defeat the bill or limit its effect, it is still an apparent interest of investors seeking to increase the actual rate of return.

The utilities have argued that the old approach was a result of state regulation – that the obligation to collect taxes on a stand alone basis while allowing a parent to file on a consolidated basis required such a result. However

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[1] "An examination of regulatory filings by the New York Times show[ed] that companies with electric utilities in at least 26 states have pocketed money intended for income taxes, and that utilities can legally do so in 21 more states." David Cay Johnston, "Many Utilities Collect for Taxes They Never Pay", *New York Times* (March 15, 2006). "[T]hrough aggressive accounting, Enron was collecting tax refunds [instead of paying taxes] which meant that the $90 million [sent to Enron by PGE] was an extra corporate profit . . . " Steven Church, "Utilities avoid taxes, but public pays", *Delaware News Journal* (April 9, 2006) http://www.delawareonline.com/apps/pbcs.dll/article?AID=/20060409/NEWS/604090349/1006/rss Copies of these articles are attached.

[2] "If Texas Pacific had acquired Portland General Electric, whose profits are virtually guaranteed and which had $92 million a year of taxes embedded in the bills customers pay, it could have used the losses from its other customers to offset the utility's profit and keep the money paid by customers ostensibly for taxes . . . Texas Pacific Group expected annual returns greater than 33 percent, three times the expected rate of return for a utility" David Cay Johnston, *supra*.

the rules allowing the filing on a consolidated basis have no requirement for prudent and practical tax planning, do they address how the utility establishes what the appropriate stand alone tax is, nor do they address how ways in which a parent can manipulate profits and losses of the various entities owned by the parent to shift liability to the utility customers. The fact that this regulation does not address those critical issues does not give license to the parent to take whatever action it chooses, cloaked in some sort of regulatory protection.

The utilities also argue that this is how businesses work. That argument is without merit. As stated by a key proponent of SB 408, Dave Hamilton[3], "In the non utility world, if we had five companies and three had losses and two were profit making, we would take the losses against the profitable companies so each company had lower taxes." This is what the drafters of SB 408 expected – a fair allocation that reflects the shared liabilities and benefits resulting from utility ownership by an affiliated group.

There has been extensive discussion related to placing a cap on the three factor attribution equal to 100% of the utility losses during and following the August 8, 2006 workshop. Staff correctly sees that the changes proposed by the utilities represent an improper limitation on the three factor attribution approach. What the approach suggested by the utilities does is to reestablish the "old approach" described above. If the other members of the group have no liability or the group has no liability, the utility would still be required to pay all of the stand alone liability. In other words, this approach would effectively gut SB 408 and would specifically allow the "Enron Problem" to continue unabated.

[3] Dave Hamilton, VP Commercial Property Management, Norris & Stevens.

SB 408 and its allocation of losses is not a violation of normalization rules. The rules allow an allocation of deferred taxes as well. ORS 757.268(8) allows the Commission to adjust rates (implicitly including income taxes under SB 408) "to insure compliance with the normalization requirement of federal tax law." While subsection (13) (f) requires an adjustment for deferred taxes related to Oregon regulated operations of the utility, the affiliated group may also have deferred taxes for other, non-Oregon regulated entities. Additional adjustments are necessary to avoid triggering a normalization violation but these adjustments are not difficult and the information necessary to make the adjustments is readily available in FERC filings or can be calculable using tax returns. The normalization rules apply *only* to public utility property. Therefore, for any other property, the parent can use accelerated depreciation in its tax filing and that benefit can be passed to ratepayers under SB 408.

A few additional comments are in order. SB 408 requires an annual "truing up" of taxes collected in rates of the utility and taxes actually paid to governments by the utility[4] by an automatic adjustment clause. The entire scheme of truing up of taxes paid to those included in rates at the effective tax rate used in the rate making process has the potential of creating incentives to game the system. This can be accomplished by creating more taxable income in one year (though tax planning, purchase or sale of assets, or by planning when resources come on line) in order to prevent a potential refund to ratepayers, while rolling the corresponding deduction into a subsequent year. In the past the

[4] Note that the drafters did not seem to believe that paying "taxes" over to a parent corporation was the same as paying taxes to a governmental entity.

taxes were treated like other costs – any additional savings in taxes meant additional revenue to the utility. SB 408 changed that to make the tax savings a pass though to customers and not a source of income to the utility.

In order to make this work as envisioned, the Commission must require a change in the tax accounting methods of the utility's rate making calculation. Unless this occurs, rate payers will be double charged for deferred income taxes. To avoid this double charging, the deferred taxes should be refunded to ratepayers over the reversal periods of the specific temporary differences that caused the deferred taxes. If this does not occur, the deferred taxes *currently payable* cause an increase in taxes while the temporary differences creating the deferred taxes reverse. ORS 757.268(8) (b) relating to adjustments due to normalization requirements does not address this.

This is because the normalization rules do not prohibit overcharging ratepayers for taxes. They only prohibit passing on benefits of acceleration immediately to rate payers. The July 14, 2006 Order also did not address this because under OAR 860-022-0041(n)(C) "[t]axes paid while being adjusted for 'deferred taxes' " is not adjusted for deferred tax credits related to operations of the utility. A fair way to account for these pre-SB 408 deferred taxes and avoid double charging ratepayers is to refund the deferred tax credits to ratepayers over the reversal period of the specific temporary differences that created the deferred taxes.

2. Local Taxes.

Local taxes are inherently different from state and federal taxes. They are collected from customers though an amount that is separately stated on customers bills, as provided in the Commission's administrative rules. See, OAR 860-022-0040(1) and OAR 860-022-0045. The Commission used cannot set, modify, or amend the total amount of taxes due to the taxing jurisdiction. Under SB 408, the customers are not to pay more than their "properly attributed" share. If the methodology selected provides for an allocation between the customers and the parent, the local authorities must receive all that they are entitled to. If there is a short fall in the amount paid by the utility, the remaining balance of the taxes due will be paid by the parent entity.

The City disagrees with the Staff's opening comments of using a 100% gross income factor. This represents a presumption which may or may not necessarily coincide with actual apportionment factors employed at the local level. Rather, the utility should be required to provide the attribution numbers actually applied in the tax year in question.

The City otherwise agrees with the Commission that all jurisdictions should use an apportionment method. However, in light of the differences between local taxes and state and federal taxes, the apportionment method will need to be a one factor (sales) formula. The easiest way to address the local tax issues would be to require that the state unitary group (not simply the utility) be designated the tax payer with the allocation being based upon sales only.

A balancing account looks like an attractive solution. However, it would require a great deal more care and additional modifications to assure that the local authority received all it was entitled to and that customers on the whole receive all benefits that they are entitled to from being owned as part of an affiliated group. It would likely require the local taxing authorities to change their rules to allow the utility to file separately from other members of the unitary group and the Commission has no authority to require that. Unless the utility was required to pay separately from other members of the unitary group (and those members also paying separately) the local jurisdiction would not receive the full measure of which it is entitled. It would also require the regulated utility operations to file a separate local tax return regardless of the local utility's inclusion in any consolidated or unitary group for federal or state purposes – and then only amounts of the local tax paid directly by the regulated utility operations to the local jurisdiction would count for the purposes of charging that tax to rate payers. While seemingly attractive, the difficulties outweigh the possible benefits and this approach may result in an increase in taxes paid by customers that is not warranted.

Under any approach the result must be for the local taxing authority will receive all tax revenues to which it is entitled and that customers pay no more than they are required to under the local tax rules.

3. Participation by the City in this and other PUC Proceedings.

The City has made a commitment to its residents and businesses that it will work to insure that rates are no more than necessary to cover allowed costs and to recover a fair rate of return on investment. The City belives that as a monopoly, utilities are entitled to no more than the authorized rate of return without additional funds or "found" tax revenue. Unlike the competitive world where no profit is guaranteed, the utilities get an authorized rate of return in exchange for safe and reliable service at fair and reasonable rates. Rates cannot be considered fair and reasonable if they include a secret fund or found tax revenue that doubles or triples the allowed rate of return.

Implicit in the term "fair and reasonable" is an obligation for practical and prudent tax planning to minimize the tax burden imposed upon rate payers in rates. The Commission should make this an explicit rule as well.

The City is encouraged by the Commission's July 17th Order. With the modifications indicated above, the City supports the Staff's July 25th Proposed Rules. The City pledges to work with the Commission, the Staff, interested parties, and the utilities to see that the intent of SB 408 is met.

4. Joint Comments of Utilities and Staff.

The City notes that several of the utilities have joined together with Staff in filing joint comments today that include proposed new rules. The City has not had the opportunity to fully review and digest this latest proposal. The City of Portland has generally reviewed the "joint comments" as circulated today via email. As circulated, Portland cannot support the proposal.

Upon first review, the proposal should more properly be called the Utilities' Rules since it would have the apparent effect of taking many, if not all, of the benefits of SB 408 away from the customers. The proposed rules improperly attempt to limit the impact of the bill rather than support its implementation. In addition, the proposal does not address the issues raised by the customer groups and the City and implicitly authorizes procedures that are not consistent with the intent of SB 408.

Two areas of the joint comments are of particular interest of the City. The first is the elimination of use of the unitary group. This would be inconsistent with normally applicable tax regulations. Specifically, the City disagrees with the statement that: "the participants believe the Commission has discretion under the law to begin with all taxes paid by the affiliated group in Oregon, then remove the taxes paid by entities other than the unitary group that includes the utility, prior to applying the three-factor formula." The Commission has no such authority under SB 408.

The second area of interest to the City is that the MCBIT is improperly described as calculated "based upon Multnomah County gross income." In fact, as separately noted by Dan Meek, MCBIT is calculated based on the entity's net Oregon income, apportioned to Multnomah County by means of relative gross income. The local jurisdiction sets the rules on how the MCBIT or other local tax is calculated. The Commission has no authority to modify this local determination. The proposed manipulation would be inconsistent with local jurisdictional rules and is not a proper method for allocating credit for payment of MCBIT among affiliates who do business in Multnomah County.

The comments illustrate a purported disconnect in PacifiCorp's rates as justification of making a change. The change is not necessary when the correct numbers are utilized. The Oregon tax included in PacifiCorp rates ought to be at 6.6% not 4.7%. This difference is important because the true-up due ratepayers begins with the Oregon tax included in rates. Because the Oregon tax on the utility is deductible for federal purposes it need only be reimbursed to the utility at the exact amount (6.6%) in order to be neutral in computing the after tax return of the utility. If the PacifiCorp example is viewed this correct way, the Oregon tax included in rates is 13.875 and the Oregon allocated tax is also 13.875 so the system will have worked perfectly.

While the City appreciates the effort that has gone into the joint comments, it believes that the changes would be highly injurious to ratepayers and are not in keeping with the intent of SB 408. The City encourages the Commission to not be mislead by these efforts and to hold fast to the decisions inherent in its July 17, 2006 Order.

Dated this 14 day of August, 2006.

Respectfully submitted,

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Many Utilities Collect for Taxes They Never Pay

By DAVID CAY JOHNSTON

Many electric utility companies across the nation are collecting billions of dollars from their customers for corporate income taxes, then keeping the money rather than sending it to the government.

The practice is legal in most states. The companies say it is smart business.

But some representatives of utility customers say that the practice, which involves using losses from other subsidiaries to reduce taxes owed, is not fair. They say that money that utilities are required to collect for federal and state taxes — typically a nickel on each dollar paid for electricity — should go for just that, or not be included in electric bills.

Otherwise, they argue, these legal monopolies make more than they are authorized to, and other taxpayers have to make up the difference in higher taxes or reduced services.

An examination of regulatory filings by The New York Times shows that companies with electric utilities in at least 26 states have pocketed money intended for income taxes, and that utilities can legally do so in 21 more states.

Because they are legal monopolies, utilities must charge rates set by state regulators. These cover all costs — from buying fuel, to building new power plants, to a virtually guaranteed profit and paying the taxes on that profit.

Normally, customer payments for those taxes eventually find their way to federal and state governments. That is usually the case for independent utilities like Consolidated Edison, which serves the New York area, and American Electric Power, which operates in 11 states from Kentucky to Oklahoma.

But in recent years many utilities have expanded into unregulated businesses, like energy trading and aircraft leasing, while others have been acquired by companies that own other businesses. When those other businesses lose money or create artificial losses through tax planning, those losses can be used to offset income earned by the utilities.

As a result, the parent companies owe less in taxes than their electric customers paid. Sometimes these companies owe nothing, or receive large tax refunds. By not remitting the taxes, the parent companies effectively have more money to invest in their operations or pay to shareholders in dividends.

The ability to intercept tax payments is not limited to electric utilities. Natural gas, water and telephone utilities can use the same techniques. The potential tax benefits are much smaller for gas and water utilities, however. And most telephone companies are no longer regulated as monopolies and their rates no longer include income taxes. (The taxes and fees that phone companies add to monthly bills are not corporate income taxes.)

Among the electric utilities whose customer tax payments are not reaching tax coffers is Pepco, serving four states and the District of Columbia. Pepco collected nearly $546 million from customers to cover its income tax bill for the years 2002 through 2004. Yet the parent Pepco Holdings did not pay income taxes during those years; indeed, it received $435 million in tax refunds.

Pepco says the beneficiaries of those refunds were not the company's shareholders, but utility customers. A vice president, Anthony J. Kamerick, said that without the ability to use taxes embedded in monthly electric bills to help finance its unregulated investments, including new power plants, electric customers would pay higher rates.

Customers paid Xcel Energy, a big utility in 10 Midwest and Western states, at least $723 million to cover taxes from 2002 to 2004. But the money did not go to the government; in fact, the company received cash refunds of $351.4 million.

A spokesman, Ed Legge, said the refunds resulted from a failed energy trading business. "Utility customers did not bear the risk of that business, and they should not benefit either," he said.

Also expressing the utilities' view, Paul L. Joskow, an economist at the Massachusetts Institute of Technology, said, "For the customer, the result is the same." If the utility were a stand-alone company and filed its own tax return, he added, the customer would pay the same for power.

But critics argue that when utilities collect taxes the government never receives, customers do lose.

The Minnesota attorney general, Mike Hatch, said, "Essentially, the utility ratepayers pay the tax twice, once through the utility bill and again through the lost revenue to government that means either higher taxes for them or less government services." Mr. Hatch is trying to require that any taxes included in Xcel bills be paid to the government. Xcel opposes this.

The critics say that while many profitable businesses use losses to minimize their tax bills, utilities are unique because their taxes are built into the bills that customers pay.

Critics also say utility companies are enriched beyond the limits set by law if they pocket the tax money. "Utilities are entitled to a just and reasonable return," said Myer Shark, a 93-year-old lawyer who sued unsuccessfully to recover $300 million in taxes paid by Minnesota customers of Xcel. "But when they keep the taxes, they are earning an unjust and unreasonable rate of return."

Enron was a pioneer in turning taxes into profit. Since 1997 the company, now in bankruptcy, has collected nearly $900 million from customers of a utility it acquired, Portland General Electric, to cover income taxes. But none of that money reached the federal government from Enron, and only a quirk in the law forced Portland G.E. to pay about $800,000 in income taxes, of which $20 went to the state of Oregon.

Enron could keep the tax money because it created 881 subsidiaries in the Cayman Islands, Bermuda and other tax havens, tax shelters that on paper generated losses for the parent.

The tax benefits are one reason Wall Street these days likes electric utilities, long seen as unexciting investments. Warren E. Buffett, Henry R. Kravis and David Bonderman are among investors drawn to utilities in recent years in hopes of earning returns through parent companies that can be several times those typically approved by state regulators for the utilities themselves.

For decades utilities have been able to delay paying the government the taxes collected from customers; the delayed taxes are known as phantom taxes. But the more recent issue involves taxes the government will never receive because tax rules have not caught up with changes in the ownership structure of utilities.

Three decades ago, said James T. Selecky, a utility-rate consultant to the Minnesota attorney general, "we had true utility companies with very few or minor other operations," so the taxes eventually flowed to the government. But that is no longer true.

Only a few states have mechanisms to prevent pocketing such money. West Virginia and Oregon require that taxes be paid to the government, although the Oregon law, enacted last year, is under attack by utilities there.

In Pennsylvania, the state Supreme Court ruled in 1985 that "fictitious" expenses, such as taxes government never receives, cannot be included in utility rates.

The prospect that a utility could charge for taxes that the government would never receive became a major issue in Oregon when David Bonderman's Texas Pacific Group tried to buy Portland General Electric in 2004.

Texas Pacific specializes in revamping financially troubled companies like Burger King and the clothier J. Crew. Such companies typically have tax losses, but little or no profit to make use of them. If Texas Pacific had acquired Portland General Electric, whose profits are virtually guaranteed and which had $92 million a year of taxes embedded in the bills customers pay, it could have used the losses from its other companies to offset the utility's profit and keep the money paid by customers ostensibly for taxes.

Texas Pacific persuaded Oregon utility regulators to keep most records of the purchase proceedings secret.

When these documents became public, they showed that Texas Pacific expected annual returns greater than 33 percent, three times the expected rate of return for a utility. That revelation generated public and official criticism. The state Public Utility Commission unanimously rejected the Portland purchase a year ago.

In the wake of the controversy, the Oregon Legislature passed a law requiring that taxes on electric bills be turned over to the government and rates adjusted each year to accurately reflect what customers paid and governments collected.

MidAmerican Electric, an Iowa utility holding company controlled by Mr. Buffett, and PacifiCorp, a Scottish-owned electric utility, have been lobbying in Oregon for repeal of the law.

The National Federation of Independent Business's Oregon chapter, with 12,000 members, favors the law. J. L. Wilson, its executive director, said it helped prevent a practice that "just bumps up electric rates."

One way to make sure customers do not pay for taxes that governments never receive would be to require each utility to file its own tax return. That way, taxes would be paid to the government, not to a parent company.

Another solution has been advanced for three decades by Robert Batinovich, a California businessman who promoted innovative approaches to regulation when he was chairman of the California Public Utilities Commission in the 1970's. Mr. Batinovich, now chairman of Glenborough Realty Trust in San Mateo, Calif., suggested exempting regulated monopolies from the corporate income tax. "It's just a disguised consumption tax, just another way to take from the little guy," he said.

But he said that if governments wanted to raise money from regulated utilities, it would be easier just to add a tax, similar to a sales tax, to monthly bills and require that all that money be turned over.

delawareonline The News Journal

Utilities avoid taxes, but public pays

Delmarva Power's customers helped company pocket $75.2 million

BY STEVEN CHURCH
THE NEWS JOURNAL
04/09/2006

STORYCHAT: Read Comments

Since Delmarva Power merged with a Washington utility four years ago, state regulators have allowed the company to collect $75.2 million from Delaware customers to pay its income tax obligations.

Instead of sending that money to the federal and state governments, however, Delmarva's parent company, Pepco Holdings Inc., pocketed the cash. Turns out, Pepco Holdings Inc. hasn't needed ratepayer money to cover its income tax bills since merging with Delmarva.

Using common corporate tax strategies, the company has collected $391 million more in federal and state income tax refunds than it has paid over the past four years.

INCOME TAX GAINS

Since at least 2002, Delmarva Power has collected $64.42 a year, on average, from each of its 292,000 Delaware customers to pay its income tax bill. Little, if any, of that money has gone to tax collectors.

Over the past four years, Pepco Holdings Inc., Delmarva's parent company, received $391 million more in income tax refunds than it paid out.

Pepco Holdings disputes the notion that it is intentionally boosting profits by taking advantage of federal tax laws and state utility regulations.

"We pay our taxes," said Joseph M. Rigby, Pepco's chief financial officer. "We pay them when they are due."

Delmarva isn't the only utility in Delaware that turns taxes into profits. Artesian Water Co. collected money to pay income taxes, even though its parent company, Artesian Resources Inc., has not paid any the past two years.

Regulated utilities are treated differently than most businesses. Public officials must approve a utility's profit margin and any expenses, including income taxes, the company charges consumers through electricity or water rates.

If the company later finds a way to cut its tax bill through legal deductions, as Pepco Holdings and Artesian did, it is entitled to keep the excess cash, as long as it does not exceed its regulated profit margin.

Consumer advocates say electric bills, set to rise 59 percent May 1 for Delmarva residential customers, could be lower if regulators forced utilities to charge customers just for income taxes that are actually paid.

"It appears as though this whole tax system is designed for the convenience and benefit of the utility and not for the ratepayers," said Tyson Slocum, director of energy programs for the Washington, D.C., consumer activist group Public Citizen.

Any effort to change the formula used to include taxes in utility rates is met with protest from the companies.

When the Delaware Public Service Commission tried to clamp down on Artesian last year, the company got the General Assembly to change the law covering utility rates, expanding the utility's ability to collect income taxes from ratepayers.

Delmarva collects income tax from the part of their customers' bills that remains regulated by the Public Service Commission. Under the state's 1999 deregulation law, Delmarva continues to hold a monopoly on the poles, wires and other equipment that deliver electricity to most of Delaware.

The actual power used by customers, which represents about 60 percent of the cost of a residential bill, is unregulated and is not affected by the income tax issue. But increases in the cost to generate that power are behind the May 1 price spike.

Delmarva is asking for a separate, smaller rate hike on the regulated side to cover increases in the cost of delivering power. Among the expenses that have gone up: income taxes.

No outrage

On May 1, residential customers will see their bills jump by an average of 59 percent, while large, commercial and industrial users will see their bills climb 100 percent. In response, lawmakers and Gov. Ruth Ann Minner have proposed everything from phasing in the in- creases, to reregulating part of the electric industry.

Only one public figure, however, Delaware Public Advocate Arthur Padmore, has complained about the way utilities charge ratepayers for taxes.

"Whatever they pay, that's what the ratepayers should be responsible for," said Padmore, who is charged with protecting the interests of consumers. "And not a penny more."

So far, his arguments have been ignored.

Public Service Commission officials said they have no plans to challenge Delmarva's tax-collection approach. The Delaware House of Representative's Energy Committee did not invite Padmore to testify when it held a hearing about electricity rates that included a discussion of income taxes. Instead, after testimony from the commission and Delmarva, it took no action on the tax issue.

Nearly all of Pepco's tax gains came from deferring payments through the common business practice of accelerated depreciation, Pepco's treasurer, Tony Kamerick, said. When those deferrals run out, the company will need the money it collected to catch up on its tax bills, said Kamerick.

Don't count on that ever happening, consumer groups say. When deferred taxes come due, utilities could find something else to defer, or write off losses from their unregulated side, or find some other way to lower their obligations, said Robert McIntyre, director of the Washington, D.C., advocacy group Citizens for Tax Justice.

Pepco was at the top of Citizens' list of large corporations that received tax refunds from 2001 through 2003 even though they turned a profit.

A consultant for the Public Service Commission agreed Pepco might be able to avoid paying deferred taxes indefinitely. Tax laws change and new deferrals can offset expiring ones, said David Peterson, with Chesapeake Regulatory Consultants, based in Dunkirk, Md.

"There is a possibility that they won't pay them back, or that they will pay them back at a different rate than they collected them," Peterson said.

Long practice, new twist

For decades, utilities have collected more than they needed to cover their income tax bills. Regulators allowed the practice because the actual tax bills of traditional utilities were based mainly on deferred taxes that would eventually be paid.

Taxpayer advocates complained about the practice, but regulators and tax officials sided with the utilities.

Deregulation changed that tax model by encouraging utilities to get into riskier, unregulated businesses. Those businesses offered new ways to cut a utilities' income tax burden. Sometimes the unregulated businesses lost money and sometimes accounting strategies created paper losses that lowered the taxes they owed.

"Under deregulation, it becomes much easier for these utility companies to claim that this is what our estimated taxes are and we need to recoup these costs," said Slocum, with Public Citizen. "And then they engage in all kinds of tax liability schemes that wind up reducing what they actually owe."

Residents are not surprised that Delmarva is allowed to include its income tax bills in electric rates, but are incensed that the company sometimes collects more than it actually needs.

"That's totally unfair," Helen Geimeier of Wilmington said. "It's contributing to their stockholders."

The only thing consumers can do is rely on public officials to protect them, Sam Stein of Claymont said.

"I have to, because I can't keep up with that by myself," he said.

The Oregon model

One of Oregon's biggest utilities was owned by Enron, the Texas energy-trading company that collapsed during a massive accounting scandal. Every year the utility collected about $90 million from its customers and shipped the money to Enron, which was supposed to use the cash to pay taxes, said Judy Johnson, manager for rates and tariffs with the Oregon Public Utility Commission.

But through aggressive accounting, Enron was collecting tax refunds instead, which meant the $90 million was an extra corporate profit, provided by Oregon electric customers. Consumer groups pushed state lawmakers to change the rules last year, Johnson said.

Today, Oregon regulators automatically adjust rates every year to keep a better balance between actual taxes paid and what utilities collect from consumers, Johnson said.

Utilities can no longer use some tax tools, like offsetting profits from regulated businesses with losses from unregulated ones, Johnson said. Utilities still can use deferred taxes to lower their tax bills, which generally benefits consumers.

The law has been popular with consumer groups, but not utilities.

"In my view, that is theft," said Kamerick, with Pepco Holdings, which does not do business in Oregon. Ratepayers should not get any benefit from tax shelters that have nothing to do with their utility, he said.

Consumer advocates counter that that those tax shelters have become so complicated under deregulation that utilities can argue that few, if any, of them apply to ratepayers.

Kamerick said Pepco's tax refunds were based mostly on deferred taxes. He could not say how much was tied to losses by Pepco's unregulated energy trading businesses.

How taxes get into rates

At the heart of the issue are the complicated rules designed to let utilities charge ratepayers for every legitimate expense they expect to incur, including income taxes. As part of a proposed rate hike, utilities submit a list of expenses and regulators review them, challenging some and accepting others.

Delmarva officials estimate how much the company will need to pay its income tax bills, and the Public Service Commission, within limits set by state law, either approves the number or rejects it. Income taxes are included in a customer's electric rate and are not broken out on the bill. The taxes and other fees listed on customers' bills are levied directly on consumers by state and local governments and have nothing to do with the company's income taxes.

If Delmarva's income tax estimates turn out to be high, the company is free to keep the extra money so long as it doesn't collect more than its overall, regulated profit margin, which is about 9 percent.

Commission officials say Delmarva has not exceeded the margin, so there is nothing they can do.

But they can adjust how much the company collects in the future, because Delmarva is going through a rate case on its regulated power-delivery services. Based on what Delmarva has filed with regulators in that case, the company would need $19.5 million to cover future income tax bills, said Andrea Crane, a consultant hired by Padmore, the state's public advocate. That's up from the $18.8 built into the current rates.

So far, commission experts have not challenged the figure.

Actual taxes

Pepco Holdings has paid income taxes once in the last four years, when it had a bill of $44.1 million on net income of $371.2 million -- an actual tax rate of about 12 percent. Pepco Holdings files a consolidated return that includes all of its subsidiaries, including Delmarva.

According to Citizens for Tax Justice, the actual tax rate for the utility industry in recent years averaged about 14 percent.

Kamerick said ratepayers benefit from Delmarva's tax maneuvers, since so much of the tax savings are related to investments in the company's electric grid. Without those tax benefits, there would be much less incentive for the company to pay for new power poles, transformers and other basic electric equipment, he said.

Peterson, the Public Service Commission consultant, said there was no reason to suspect that the overpayments were unfair to Delmarva's customers.

But that could change, he said. If the commission requires Delmarva to calculate its tax expenses based on Pepco's actual tax rate, ratepayers could save money in the future.

Slocum, with Public Citizen, said if the price of a utility's product is inflated by unrealistic tax estimates, ratepayers can't really do anything about it.

"It's not like folks in Delaware can say 'This is an unfair practice. I'm going to get my electricity from someplace else.' "

Contact Steven Church at 324-2786 or schurch@delawareonline.com.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have served the City of Portland's Response Comments on Interim Order in Docket AR 499, upon the Commission via hard copy US Mail and to the parties listed below by sending a copy via electronic mail.

JIM ANDERSON JD ANDERSON ASSOCIATES 910 SAHALEE CT SE SALEM OR 97306	GARY BAUER NORTHWEST NATURAL 220 NW 2ND AVE PORTLAND OR 97209
LAURA BEANE PACIFICORP 825 MULTNOMAH STE 2000 PORTLAND OR 97232	SCOTT BOLTON PACIFICORP 825 NE MULTNOMAH PORTLAND OR 97232
JULIE BRANDIS ASSOCIATED OREGON INDUSTRIES 1149 COURT ST NE SALEM OR 97301-4030	LOWREY R BROWN CITIZENS' UTILITY BOARD OF OREGON 610 SW BROADWAY - STE 308 PORTLAND OR 97205
ED BUSCH PUBLIC UTILITY COMMISSION OF OREGON PO BOX 2148 SALEM OR 97308-2148	REP TOM BUTLER H-289 STATE CAPITOL SALEM OR 97310
RANDALL DAHLGREN PORTLAND GENERAL ELECTRIC 121 SW SALMON ST. 1WTC 0702 PORTLAND OR 97204	MELINDA J DAVISON DAVISON VAN CLEVE PC 333 SW TAYLOR - STE 400 PORTLAND OR 97204
JIM DEASON ATTORNEY AT LAW 521 SW CLAY ST STE 107 PORTLAND OR 97201-5407	MICHAEL EARLY INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES 333 SW TAYLOR STE 400 PORTLAND OR 97204
JASON EISDORFER CITIZENS' UTILITY BOARD OF OREGON 610 SW BROADWAY STE 308 PORTLAND OR 97205	STEVE EVANS MIDAMERICAN ENGERY HOLDINGS COMPANY 666 GRAND AVE DES MOINES IA 50303
EDWARD A FINKLEA CABLE HUSTON BENEDICT HAAGENSEN & LLOYD LLP 1001 SW 5TH - STE 2000 PORTLAND OR 97204	ANN L FISHER AF LEGAL & CONSULTING SERVICES 2005 SW 71ST AVE PORTLAND OR 97225-3705
ANDREA FOGUE LEAGUE OF OREGON CITIES PO BOX 928 SALEM OR 97308	KELLY FRANCONE ENERGY STRATEGIES 215 SOUTH STATE ST - STE 200 SALT LAKE CITY UT 84111

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GREGG KANTOR NORTHWEST NATURAL 220 NW SECOND PORTLAND OR 97209	MARGARET D KIRKPATRICK NORTHWEST NATURAL 220 NW 2ND AVE PORTLAND OR 97209
ELISA M LARSON NORTHWEST NATURAL 220 NW 2ND AVE PORTLAND OR 97209	PAMELA G LESH PORTLAND GENERAL ELECTRIC 121 SW SALMON ST 1 WTC 1703 PORTLAND OR 97204
KEN LEWIS PO BOX 29140 PORTLAND OR 97296	RAUL MADARANG PORTLAND GENERAL ELECTRIC 121 SW SALMON ST PORTLAND OR 97204
LARRY O MARTIN PACIFIC POWER & LIGHT 825 NE MULTNOMAH STE 800 PORTLAND OR 97232	DENNIS J MAURER DEPARTMENT OF REVENUE
KATHERINE A MCDOWELL MCDOWELL & ASSOCIATES PC 520 SW SIXTH AVE - SUITE 830 PORTLAND OR 97204	DANIEL W MEEK ATTORNEY AT LAW 10949 SW 4TH AVE PORTLAND OR 97219
SENATOR RICK METSGER STATE CAPITOL 900 COURT ST NE S-307 SALEM OR 97301	ALEX MILLER NORTHWEST NATURAL GAS COMPANY 220 NW SECOND AVE PORTLAND OR 97209-3991
JAN MITCHELL PACIFIC POWER & LIGHT 825 NE MULTNOMAH - STE 2000 PORTLAND OR 97232	MARK NELSON PUBLIC AFFAIRS COUNSEL PO BOX 12945 SALEM OR 97309
RICHARD PEACH PACIFICORP 825 NE MULTNOMAH PORTLAND OR 97232	MATTHEW W PERKINS DAVISON VAN CLEVE PC 333 SW TAYLOR - STE 400 PORTLAND OR 97204

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DAVE ROBERTSON PORTLAND GENERAL ELECTRIC 121 SW SALMON ST PORTLAND OR 97204	AUSEY H ROBNETT III PAINE HAMBLEN COFFIN BROOKE & MILLER PO BOX E COEUR D'ALENE ID 83816-0328
INARA K SCOTT PORTLAND GENERAL ELECTRIC 121 SW SALMON ST PORTLAND OR 97204	BOB TAMLYN PORTLAND GENERAL ELECTRIC 121 SW SALMON ST PORTLAND OR 97204
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