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VIA ELECTRONIC FILING

PUC Filing Center
Public Utility Commission of Oregon
PO Box 2148
Salem, OR 97308-2148

Re: Docket AR 499

Enclosed for filing in the above-referenced matter is PacifiCorp's Opening Comments on Straw Proposals. A copy of this filing has been served on all parties to this proceeding as indicated on the attached certificate of service.

Very truly yours,

Sarah J. Adams Lien

SJL:knp
Enclosures
cc: Service List

BEFORE THE PUBLIC UTILITY COMMISSION OF OREGON

AR 499

In the Matter of the Adoption of Permanent Rules to Implement SB 408, Relating to Matching Utility Taxes Paid with Taxes Collected	**PACIFICORP'S OPENING COMMENTS ON STRAW PROPOSALS**

I. INTRODUCTION

In construing the major terms of SB 408 in this rulemaking, most notably the phrase "properly attributed," the Commission faces a decision that is unparalleled in recent memory in terms of its potential financial impact on Oregon regulated utilities. While the Attorney General's opinion made clear that the Commission had the responsibility to construe this term, it also provided a critical guidepost for the Commission: allocation of unregulated tax benefits to the utility is not required by SB 408 except when the consolidated group's tax liability is less than the utility's individual tax liability. Op Atty Gen at 17 (Dec 27, 2005).

The question presented here is whether the Commission should allocate additional unregulated tax benefits to the utility beyond those required by SB 408.

The answer to this question necessitates a review of the key policies and principles implicated. PacifiCorp submits that these policies uniformly militate against allocation of unregulated tax benefits to the utility. Indeed, as discussed below, it is difficult to identify any regulatory, tax, accounting or legal policy that justifies the selective and asymmetrical appropriation of unregulated tax benefits presented in the Straw Proposals of the Industrial Customers of Northwest Utilities ("ICNU"), Northwest Industrial Gas Users ("NWIGU") and Citizens' Utility Board of Oregon ("CUB").

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II. ARGUMENT

A. In Defining "Properly Attributed," the Commission Should Consider the Five Key Policies and Principles Implicated: Fairness and Rationality, Authenticity, Consistency, Practicality and Sustainability.

In addition to clarifying that loss allocation is not required by SB 408, the opinion of the Attorney General provides guidance to the Commission on how it should define "properly attributed" in SB 408. First, the Attorney General concluded that the term was a delegative term because the word "properly" implicated concepts of fairness and reasonableness traditionally left up to an agency to define. Op Atty Gen at 7-9 (Dec. 27, 2005).

Second, the opinion outlined two specific boundaries on the Commission's authority. First, the Commission must construe the phrase "properly attributed" in accordance with the general policy of SB 408, which is to "more closely align taxes collected by a regulated utility from its ratepayers with taxes received by units of government." *Id.* at 11, 2. Second, the definition of "properly attributed" must produce rates that are fair, just and reasonable. *Id.* at 2.

Working off these overarching concepts, PacifiCorp submits that the Commission should screen and select a definition of properly attributed using the following five key regulatory policies and principles: Fairness and Rationality, Authenticity, Consistency, Practicality and Sustainability.

1. Fairness and Rationality.

A bedrock principle of regulation and accounting, and one that benefits customers as often as utilities, is the matching principle. The Commission's February 2005 White Paper, *Treatment of Income Taxes In Utility Ratemaking* ("Commission White Paper") noted that:

> "Under this principle, there is a well-reasoned, and widely recognized postulate that taxes follow the events they give rise to. Thus, if ratepayers are held responsible for costs, they are entitled to the tax benefits associated with the costs. If

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> ratepayers do not bear the costs, they are not entitled to the tax benefits associated with the costs."

Commission White Paper at 7 (quoting *Accounting for Public Utilities* (LexisNexis 2003)). The Commission White Paper also noted that utility tax approaches that violate this matching principle "would be considered poor regulatory policy." *Id.* at 12.

SB 408 did not render the matching principle obsolete in Oregon. Instead, the legislative delegation of what taxes are "proper" to attribute to the utility allows for continued adherence to this principle in the new SB 408 "actual taxes paid" framework to ensure fair and rational outcomes.

Given its long history of following the matching principle, the Commission should look critically at the suggestion that other principles compete with and override the matching principle in this context. For example, customer groups have claimed that their proposed "proportional" attribution methods are the only "fair" way to ensure equal treatment of the utility with unregulated members of the consolidated group. But the fundamental issues of fairness and rationality are raised primarily by the question of which non-utility tax benefits are attributed not how the attributed amounts are allocated among members of the consolidated group. A ratable distribution of tax benefits selectively and irrationally attributed cannot be justified as promoting this Commission's policy of regulatory fairness. *See* Commission White Paper at 12 (there is no economic rationale for a regulatory body to pick and choose which non-utility revenues and expenses—including tax savings—to include for purposes of setting Oregon customers' rates).

2. Authenticity.

As the opinion of the Attorney General made clear, the Commission must effectuate the policy of SB 408 in defining "properly attributed." The Commission can and should look to SB 408's legislative history to better comprehend this policy. This history supports a limited and moderate construction of "properly attributed," one designed to effectively

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insulate the utility's tax liability from tax gains and losses in the consolidated group, not to make the two more deeply intertwined.

Taken as a whole, the legislative history of SB 408 makes clear that the bill was a reaction to the fact that, under Enron ownership, Portland General Electric ("PGE") paid far less taxes to government than were collected from ratepayers. SB 408 sponsors Senators Rick Metsger and Vicki Walker stated that the purpose of the bill was to fix this issue, the so-called "Enron problem." *See* Public Hearing on SB 171 Before the Senate Business and Economic Development Committee (Mar. 24, 2005) (statement of Sen. Rick Metsger, Committee Chair) ("I will say that as I said this morning, this is an issue that I think is in front of you and was in front of the Commission largely because of people's perceptions primarily in the Enron ownership of PGE that they were paying rates that included expenses for taxes and in effect those taxes never flowed through to the Oregon Treasury or the federal government or Multnomah County or anybody else. I think that's the issue, it's a perception of fairness. These recommendations are an attempt to recognize that."); Senate Chamber Session (June 8, 2005) (statement of Sen. Vicki Walker) ("For several years the large electricity and gas utilities regulated by the [Commission] have been charging the Oregon ratepayers hundreds of millions of dollars for state income taxes and federal income taxes that have not in fact been paid to any government entity." (explaining that SB 408 was drafted to correct this problem)); Public Hearing on SB 408 Before the House State and Federal Affairs Committee (June 30, 2005) (statement of Michael Early, ICNU) ("As you know, the corporate structure of investor owned utilities has changed rather dramatically over the last 10 years. * * * And one of the consequences has been – a very public consequence of some of these acquisitions, particularly in the Enron/PGE situation has been a sustained situation where taxes have been collected from ratepayers, both residential customers and industrial customers, and no taxes have actually been received from those entities either in

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Salem or to other taxing authorities. Now that's the fundamental question we have before us and the fundamental policy question we are asking you to resolve.").

SB 408 was designed to fix the Enron problem, which occurred through the offsetting of utility positive tax liability with losses from unregulated members of the consolidated group. It is thus the prevention and minimization of such unregulated tax offsets against utility tax liability that is the focus of the law, not the affirmative and arbitrary appropriation of affiliate tax attributes to lower rates.

SB 408's legislative history affirms that the policy of aligning taxes paid with taxes collected is satisfied when a utility's tax liability is insulated from unregulated losses because these losses will net fully against unregulated gains. This policy construction is consistent with the complete dearth of SB 408 legislative history supporting new and far-reaching proportional loss allocation approaches to utility taxation or selective attribution of parent interest-related tax deductions. As the legislative and rulemaking processes demonstrate, the limited aims of SB 408 are complex enough without throwing in additional unwarranted and unintended issues. The legislative history demonstrates instead the modest and limited aims of the law and clarifies that it was not designed to change existing ratemaking and tax policies except as necessary to prevent recurrence of an Enron-type situation. *See* House of Representatives Chamber Session (July 30, 2005) (statement of Rep. Brian Boquist, carrier of SB 408 on the House floor) (SB 408 did "not change the original ratemaking process"); Statement of CUB/ICNU regarding SB 408, "Utility Customers Ask for Fairness and Equity: Taxes Collected Must Align with Taxes Paid; Vote Yes on SB 408-C" ([T]the effect of the bill is very straightforward: utilities will have to report how much they have collected in taxes and they will have to report how much they paid in taxes. If there's a difference between the two amounts of more than $100,000, there will have to be a true up. That's it. Nothing in utility ratemaking is changed. Nothing in tax policy is changed. * * * The bill

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could have fundamentally changed tax policy or ratemaking. The bill could have done many things that could be labeled extreme. But SB 408-C is very moderate in its approach....").

3. Consistency.

Because SB 408 addresses only one aspect of utility rate making, the calculation of tax expense, it cannot be construed in a vacuum. Instead, it must be interpreted in a manner that is as consistent as possible with the Commission's overall statutory scheme for regulation of energy utilities. These other regulatory policies weigh against allocating tax benefits from unregulated companies except as expressly required by SB 408 to ensure taxes paid align with taxes collected.

The attribution of taxes between the utility and the unregulated companies in the consolidated group implicates the Commission's general policies on affiliated interests. These policies are designed to isolate, or "ring-fence," the utility from its unregulated affiliates. The Commission's policies on ring-fencing have become more, not less, rigorous in recent years. *See In re MEHC*, Order No. 06-082 (OPUC Feb. 24, 2006), *amended by* Order No. 06-121 (OPUC Mar. 14, 2006). Tax benefits from unregulated affiliates cannot be allocated to the utility without breaching the ring-fence between regulated and unregulated operations, contrary to general Commission policy.

Additionally, the Commission has a statutory obligation to enact rules that "prohibit cross-subsidization between competitive operations and regulated operations." ORS 757.646(2)(c). The rules enacted under this mandate require separation of utility and non-utility tax liability for accounting and ratemaking purposes, even when the utility files as part of a consolidated group. *See* OAR 860-027-0048. Allocation of tax benefits from unregulated operations to the utility constitutes a cross-subsidy of the utility by its unregulated affiliates. *See* Commission White Paper (because standard ratemaking principles prohibit cross-subsidization between utility and non-utility operations, most states calculate

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utility taxes separately). The Commission must construe the term "properly attributed" to reconcile the conflicting mandates of SB 408 and ORS 757.646(2)(c) as much as possible.

4. Practicality.

SB 408 contains strict timelines around operation of the annual automatic adjustment clause. The Commission has a maximum of 180 days to set the amount of the tax true-up. The Commission must conduct the process simultaneously with the four utilities in Oregon that are subject to the law, each of which is differently situated. For example, PacifiCorp is now part of the Berkshire Hathaway consolidated group, which has more than 600 unregulated affiliates and a total tax liability of approximately $3 billion. The amounts involved in these automatic adjustment cases are potentially substantial, ensuring that all parties will actively represent their interests.

As a matter of administrative law, parties are entitled to clear notice of the Commission's standards under SB 408 before they are applied. *See Vier ex rel Torry v. State Office for Serv. to Children and Families*, 159 Or App 369, 374-75, 977 P2d 425, 428 (1999) ("an agency remains bound by the practices and policies declared by its rules, even in the face of newly enacted legislation changing the agency's responsibilities," unless and until existing practices and rules are judicially declared invalid or are changed by agency pursuant to formal rulemaking procedures). Additionally, to be workable, the Commission's interpretation of properly attributed must be objective and straightforward in application. An ambiguous or factually contingent definition of properly attributed does not meet these requirements.

5. Sustainability.

The Commission should interpret properly attributable in a manner that guards against having to soon redefine it. The more the definition is supported by the policies outlined above, the more lasting that definition will be. Contrarily, an interpretation of SB 408 that adds to its basic asymmetry by causing an unprincipled value transfer from

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utility investors to customers is not sustainable from a regulatory or legal perspective. *See* Op Atty Gen at 16 (Dec. 27, 2005) (Commission's actions in properly attributing taxes paid must result in rates that are fair, just and reasonable); Department of Justice Memorandum re Legality of Setting Rates Based upon the Tax Liability of the Parent (February 18, 2005) (Commission could adopt an actual-taxes-paid doctrine to calculate tax expenses, but must do so in a rational, symmetrical way); *Vorm v. David Douglas School Dist. No. 40*, 45 Or App 225, 228, 608 P2d 193 (1980) (when a statute is susceptible to more than one interpretation, the one that is more constitutionally sound should prevail).

This same point is true from a utility credit-rating perspective. There is no question that an interpretation of properly attributed that adopts a selective or proportional loss-allocation approach beyond that actually required by SB 408 will result in the immediate deterioration of the credit ratings of any Oregon utility in a large consolidated group. Indeed, PacifiCorp has already suffered a ratings downgrade associated with the application of SB 408 in its general rate case. The three major credit rating agencies, Standard & Poor's ("S&P"), Moody's Investors Service, and Fitch Ratings, have all warned that the outcome of the permanent rulemaking could affect PacifiCorp's credit quality. *See* Fitch Ratings, "PacifiCorp, Subsidiary of Scottish Power plc" (Mar. 7, 2006); S&P, "Credit FAQ: MidAmerican's Acquisition of PacifiCorp – Implications for PacifiCorp's Bondholders" (Mar. 21, 2006); Moody's Investors Service, "Credit Opinion: PacifiCorp" (Mar. 1, 2006).

A decline in Oregon utility credit ratings will place upward pressure on rates and impede utility access to the capital markets, problematic developments in the midst of the current utility build cycle. It also could result in rates being increased to reflect the additional return on equity necessary to produce fair, just and reasonable rates.

PacifiCorp submits that, when taken as a whole, these policies strongly support its "Lesser Of" and "With and Without" Straw Proposals on attribution and weigh heavily

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against the adoption of the selective loss allocation straw proposals submitted by the customer groups.

B. PacifiCorp's Straw Proposals on Properly Attributed Are Supported by the Five Key Policies and Principles.

PacifiCorp has submitted two Straw Proposals for defining the phrase properly attributed: the "Lesser Of" attribution approach and the "With and Without" approach. The "Lesser Of" approach is PacifiCorp's baseline approach, which ensures full satisfaction of the requirements of SB 408 with respect to allocation of unregulated losses. The approach allocates affiliate losses to the utility when those losses are used to offset utility tax liability and produce a consolidated group tax liability that is less than the utility's stand-alone tax liability.

This approach is as consistent as possible with the matching principle, fixes the Enron problem, is as consistent as possible with Commission policies on affiliated interests, is simple to apply and, because it does not push beyond the actual requirements of the law, is the outcome most sustainable from a regulatory, legal- and utility credit-rating standpoint.

The "Lesser Of" approach is a significant change in utility regulation. By effectively prohibiting consolidated group tax benefits from ever being used to offset utility tax liability for ratemaking purposes, this approach gets at the heart of solving the Enron problem. *See* Staff Report, AR 498 at 2 (OPUC Sept. 7, 2005) (PacifiCorp's "attribution approach would remedy the Enron-type situation that proponents of the bill cited.").

The debate over SB 408 in the Oregon legislature focused on the "Lesser Of" approach, with customers supporting the approach and utilities opposing it. With the passage of the bill, utilities have accepted this approach, only to find others now pushing for allocation of unregulated tax benefits to customers beyond anything ever raised in the legislature.

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With considerable effort and in an attempt to provide a possible compromise outcome in this process, PacifiCorp has also developed a second approach to defining properly attributed: PacifiCorp's "With and Without" proposal, which addresses the position of customers that, in addition to fixing the Enron problem, SB 408 should properly attribute to customers all benefits the utility contributes to the consolidated group.

The policy basis for the "With and Without" approach is strong and straightforward. Although it attributes to customers more tax benefits than required by SB 408, it does so in a manner that remains as consistent as possible with the matching principle and the Commission's affiliated-interest policies. It fixes the Enron problem and goes a step further. It is comprehensive, but by employing traditional tax and accounting "but for" analysis, is practical and mechanical. Because it is principled and well defined, it also scores high on the sustainability scale.

Under the "With and Without" Straw Proposal, properly attributed taxes are the lower of two outcomes: (1) the result of a "With and Without" test; or (2) the result of the section 3(12) "lesser of" test. In this manner, the "With and Without" approach to properly attributed works asymmetrically in favor of customers; it can only serve to lower rates, never to raise them.

The "With and Without" approach is as inclusive as possible, both in terms of tax benefits and affiliated companies considered. By including the entire affiliated group, it avoids the potential for artificial rate reductions or increases through selectively choosing which affiliates are in the tax group and which are not. It is also fully compliant with the definition of "affiliated group" found in section 3(13)(a) of SB 408.

The "With and Without" approach also renders all tax attributes in the consolidated group subject to allocation to customers, including asset gain and loss, percentage depletion, charitable contribution limitations, net operating losses, business tax credits, and AMT-related items such as accelerated depreciation. Among the full array of tax attributes

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considered in this process are interest-related tax deductions, which are a major focus of the customer group proposals. This process therefore clearly addresses interest-related deductions, but without the problems associated with reviewing these deductions in isolation from other elements of the consolidated group's overall tax return and underlying capital structure.

The "With and Without" approach meets the objectives of aligning taxes collected with taxes paid so that the underlying public policy rationales for SB 408—that customers pay no more for taxes in rates than are actually paid, and that utilities pay their fair share of taxes to government—are preserved.

C. The Straw Proposals of ICNU/NWIGU and CUB on Properly Attributed Should Be Rejected Because Their Objective Is Cross-Subsidization of the Utility by Unregulated Operations Rather Than the Promotion of Sound Regulatory Policies and Principles.

1. ICNU/NWIGU Straw Proposal.

ICNU/NWIGU propose that the "proper" attribution of taxes paid to the utility be the lowest of three quantities:

- Total taxes actually paid by the tax-paying entity;
- The share of the taxes paid by the tax-paying entity incurred as a result of income generated by the utility. This share would include tax deductions and credits incurred by other entities within the corporate family, including deductions related to interest payments on debt, if they are supported, directly or indirectly, by the utility; or
- Either the results of the Temporary Rule or a proportionate share of the taxes paid and attributed to a subgroup of the corporate family. The subgroup would include the utility and certain other entities. ICNU/NWIGU's proposed subgroup is described by nine separate provisions. The subgroup would include, for instance, entities with debt supported "directly or indirectly" by

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the utility. The meaning of indirect support in this context is not specified. Similarly, the subgroup would include entities engaging in indirect transactions with the utility without defining such transactions.

ICNU/NWIGU characterize their "subgroup" proposal as a compromise because the proposal would exclude certain unrelated entities from the attribution of taxes paid. In reality, ICNU/NWIGU's subgroup approach has the potential to be much more extreme than the Temporary Rule. Only under an unrealistic scenario such as that presented in ICNU/NWIGU's Revised Straw Proposal (which changed only the numbers in the examples to reverse the results of their original straw proposal) does the approach appear more moderate than the Temporary Rule. Under facts that resemble actual consolidated tax groups, the proposal is significantly more extreme than the Temporary Rule.

Consider the example that was included by ICNU/NWIGU in their original straw proposal. In that case:

I. Comparison of Temporary Rule to Straw Proposal	**Temporary Rule**	**Straw Proposal**
Utility	150	150
Other gain companies	900	100
Utility share of total	14%	60%
Total loss companies	(150)	(150)
II. Loss allocated to utility	(21)	(90)

The Straw Proposal allocates many more losses to the utility simply because the subgroup excludes a number of tax-paying entities and does not exclude any loss-making entities.

ICNU/NWIGU describe the determination of their proposed subgroup in nine specific provisions. They do not describe an overall policy framework for their subgroup proposal,

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however. Even at the detailed level, ICNU/NWIGU provide no reasoning to support any of their specific subgroup provisions.

ICNU/NWIGU's proposal is also inconsistent with the language of SB 408, which defines an affiliated group as "an affiliated group of corporations of which the public utility is a member and that files a consolidated federal income tax return." SB 408, section 3(13)(a).

The Attorney General's opinion makes clear that the Commission must seek to align taxes paid with taxes collected in defining properly attributed. Op Atty Gen at 11, 2. ICNU/NWIGU's proposal fails to do this because it is based upon the hypothetical tax liability of an arbitrary grouping of entities. Contrary to the express language of the bill, it ignores the actual taxes paid by the consolidated group to units of government.

ICNU/NWIGU's subgroup proposal would also be unworkable in practice. The proposal would attribute taxes without reference to an actual tax return. Instead, it would refer to hypothetical tax returns for subgroups of the tax-paying entity. This approach would create substantial verification issues for the Commission. Disputes could arise every year because ICNU/NWIGU would define the subgroup based on the volume of transactions between affiliated entities and the utility, and other factual issues. Computational costs and burdens would be significant for the utility as well. The utility would not know in advance which entities would be in the subgroup. Implementation of this approach would thus require separate record keeping for all entities that might become part of the group. These costs would be passed on to ratepayers in the form of higher rates.

An important feature of subgroups has become clear as a result of this proceeding. Defining a relevant subgroup is subjective. It seems likely that proceedings needed to implement ICNU/NWIGU's approach would be characterized by results-oriented wrangling between utilities and customer groups. The Commission would be required to resolve these

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disputes without clear policy principles and without explicit statutory guidance from the legislature.

ICNU/NWIGU's proposal regarding tax deductions and credits is vague and inconsistent with statutory provisions. ICNU/NWIGU propose to credit utility customers for tax benefits "supported by utility revenues." It is far from clear which specific credits and deductions would fall into this definition or which specific entities would be included. In PacifiCorp's case, for instance, credit agencies have recently confirmed their credit ratings of PacifiCorp, citing the stabilizing benefits PacifiCorp will receive under the ownership of MidAmerican Energy Holdings Company and Berkshire Hathaway. *See* Fitch Ratings, "PacifiCorp, Subsidiary of Scottish Power plc" (Mar. 7, 2006); S&P, "Research Update: PacifiCorp's Short-Term Rating Raised to 'A-1' Following Sale to MidAmerican Energy Holdings" (Mar. 22, 2006); Moody's Investors Service, "Moody's Affirms the Ratings of PacifiCorp (Baa SR. Unsecured); Revises Rating Outlook to Stable from Developing" (Feb. 28, 2006). Additionally, PacifiCorp projects that it will be another six years before there are net cash flows out of PacifiCorp to shareholders, completely undermining the argument that PacifiCorp ratepayers somehow support debt held in companies upstream in the Berkshire Hathaway group. In any event, PacifiCorp's consolidated parent, Berkshire Hathaway, has no net debt on a consolidated basis and has a triple-A credit rating. It seems unreasonable on its face to argue that PacifiCorp supports the credit rating of its owner.

ICNU/NWIGU's treatment of debt-related tax deductions is out of step with business reality. CUB's proposal shares this defect. ICNU/NWIGU and CUB seem to base their proposals on the idea that ratepayers "fuel" the holding company debt. These proposals, however, fail to ask whether cash is flowing *to* or *from* the utility and its upstream parents. ICNU/NWIGU's provision here is inconsistent with provisions of the statute. The statutory language refers to taxes incurred as a result of income *generated* by utility operations. These comments have discussed how the "supported by" standard would be difficult to apply.

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More fundamentally, the "supported by" standard seems to suggest that the Commission should look into how the parent uses the dividends it receives. Such an investigation would be wholly inappropriate and was not contemplated by the legislature in passing SB 408. One must ask also ask if Oregon is saying that investors are not allowed to earn a dividend from their Oregon utility investment if the use of the dividend will be questioned in this manner.

The impact of ICNU/NWIGU's debt-related provisions are unreasonable. Even if every entity in an overall corporate structure were profitable, and therefore had a positive tax liability, the ICNU/NWIGU approach could result in a downward adjustment to utility rates because of its treatment of specific tax benefits.

ICNU/NWIGU's proposal to capture renewable resource tax credits is similarly unworkable. ICNU/NWIGU would adjust taxes paid to reflect tax credits associated with renewable resource development if the renewable resource were developed by an affiliate of the utility and if the tax credits were not reflected in the price paid for power. There is no reason to expect that the price charged by the seller of a renewable resource would be cost-based. It would thus generally not be possible for the Commission to examine the accounting records of the seller and determine whether tax credits were included in the price.

For all of these reasons, the ICNU/NWIGU Straw Proposal cannot pass the policy screens suggested above. It is an unfair and asymmetrical proposal that goes far beyond anything ever contemplated in the legislative process, as reflected in the legislative history of SB 408. It is contrary to Commission policies requiring separation of regulated and unregulated interests and prohibiting cross-subsidization. It is more extreme than the Temporary Rule, rendering it potentially disastrous for utilities from a credit rating standpoint and undermining its viability from a legal and policy standpoint. Last but not least, many of the details of the approach remain undefined, and those that are identified suggest that the approach is impractical and could never be implemented in the timelines required for review of the automatic adjustment clause.

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D. CUB Straw Proposal.

CUB's proposal would attribute tax deductions using methods that depend on the type of deduction:

- Accelerated depreciation would be adjusted out of the computation of taxes paid.
- Tax deductions for interest paid (less interest income) for each entity in the chain of ownership upward from the utility would be allocated to the utility.
- Tax benefits associated with affiliates with negative tax liabilities would be attributed to the utility to the extent that the utility earned in excess of its authorized rate of return.
- Oregon Business Energy Tax Credits purchased by an unregulated affiliate would not be attributed to a regulated utility.

Regarding treatment of interest-related tax deductions, several of PacifiCorp's comments on ICNU/NWIGU's proposal apply to CUB's proposal as well. CUB states, "The rationale behind this attribution is that the interest payments are paid with income from subsidiaries. This puts earnings pressure on the subsidiaries and can impact the credit rating of the subsidiaries." CUB's written proposal does not contain provisions that limit the attribution of net interest deductions to situations in which the rationale is applicable. Discussion at the workshop on April 17, 2006, indicates that CUB believes that such analysis may be needed. Otherwise the proposal could result in interest-related rate reductions that are completely unrelated to the requirements of SB 408.

Thus, to implement this provision, the Commission would need to determine each year whether an interest cost was being paid with income from the utility and whether the presence of the debt adversely affected the utility's customers. It seems unlikely that such issues could be resolved in the short time period required to implement an automatic adjustment clause.

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At the April 17 workshop, CUB indicated that the Commission would forecast parent interest deductions in rate cases. Such forecasts would unnecessarily expand utility rate case issues into a wide range of financial matters that are otherwise unrelated to utility rate case issues. Certainly such a process is far afield from the issue of aligning taxes collected with taxes paid.

Netting of interest deductions against interest income is a step in the right direction, but CUB's proposal still creates the wrong incentives regarding corporate debt. The tax code provides that interest can be deducted, in part, to promote investment. In the midst of a significant build cycle, it is poor public policy to discourage investment by the parent in the utility. CUB's proposal would discourage investment by the consolidated group in all of its businesses, not just the utility. It would do this even when the utility and its affiliated group paid their taxes. Nothing in SB 408 or its legislative history indicates that the legislature wanted the OPUC to discourage investment in Oregon utilities by allocating interest deductions to Oregon ratepayers even when the utility and its affiliated group are both positive taxpaying entities. Clearly debt plays an important role in the capital structure of regulated utilities by optimizing the overall cost of capital. To penalize holding companies and other affiliates of the group by attributing tax benefits from other businesses is an unfair taking.

CUB would attribute to the utility a share of net interest deductions at the utility's parent and at each level up the ownership chain. Interest cost deductions are netted against interest income at each level of the chain, but not across levels. The result is a selective structure that may encourage companies to move interest costs or to consolidate them at higher levels. There are many complicating factors at individual levels, such as inter-company guarantees and equity commitments, that would require analysis and dispute resolution. CUB's proposal does not address how it would deal with any of these complexities.

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The Commission should not adopt such a "cobbled together" approach to parent interest deductions. A workable and accurate view of taxes paid is only possible by looking at the actual taxpayer. Applied to CUB's proposal, this concept means that interest income and expense should be netted across all levels, not just at each level. PacifiCorp's "With and Without" proposal accomplishes this directly and in a verifiable way, without CUB's selective hunting of specific tax benefits throughout the consolidated group of businesses.

CUB's proposal regarding parent interest deductions, and to some degree ICNU/NWIGU's proposal, appear aimed at double-leverage concerns and not tax concerns. Certainly to the degree that the proposals would reduce rates based on an affiliate's interest payment even when the affiliate and every other member of the consolidated group is a positive taxpayer, the proposals go far beyond the attribution of taxes paid.

High degrees of parent leverage could negatively affect the utility. Similarly, a financially healthy parent could provide benefits to a utility. CUB's concerns regarding highly leveraged parent companies could be addressed in a rate case using some form of financial stability test. A provision that imposes penalties on unstable parents should reward parents that provide benefits to the utility. PacifiCorp's "Lesser Of" attribution approach and its "With and Without" Straw Proposal address these concepts in a less subjective and more verifiable manner.

CUB's and ICNU/NWIGU's proposals are entirely one-sided. They give ratepayers rate reductions when the ratepayers are assumed to provide a benefit to shareholders, but do not provide any corresponding benefit for shareholders when, for instance, the larger structure gives ratepayers more stability.

CUB's proposal would create other unworkable analytical requirements. CUB proposes to allocate, under some circumstances, the negative stand-alone tax liabilities of loss-making entities and, at the same time, adjust for the impact of accelerated depreciation out of the calculation of taxes paid. Before the Commission could allocate affiliate losses to

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the utility, it would have to determine the portion of those losses that are from accelerated depreciation. This determination would require comparison of affiliate-specific data from various sources, including the consolidated tax return. For utilities with numerous affiliates, this process could require an amount of time that could not be accommodated within the statutorily mandated time frame.

CUB's Straw Proposal also fails to pass the policy screen suggested at the outset of these comments. While PacifiCorp appreciates CUB's attempt at moderation in its proposal, its approach toward interest deductions and loss allocation nevertheless continues to violate the matching principle and the Commission's affiliated interests policies. The proposal is inconsistent with SB 408 legislative history and has too many subjective aspects to be workable and practical. For all of these reasons, it also would produce an unsustainable outcome.

E. The Straw Proposals of NW Natural, Avista and PGE on Expenses Between Rate Cases Promote SB 408's Policy of Taxes Collected/Paid Alignment.

PacifiCorp supports the earnings tests proposed in the Straw Proposals of NW Natural, Avista and PGE. These proposals limit operation of an adjustment clause so that no adjustment would take place unless the adjustment brought the utility closer to earning its authorized rate of return. Refunds to customers would occur only if the utility were earning in excess of its authorized rate of return. This is consistent with concerns underlying SB 408 that tax issues were allowing utilities to earn excessive returns. These proposals also are designed to satisfy in a mechanical and objective way the requirement that SB 408 produce rates that are "fair, just and reasonable." Finally, these proposals are in keeping with the uniform use of earnings test in automatic adjustment clauses adopted previously by the Commission.

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III. CONCLUSION

For the reasons stated above, the Commission should reject the selective and asymmetrical approaches presented in the Straw Proposals of ICNU/NWIGU and CUB, and instead adopt PacifiCorp's "Lesser Of" or "With and Without" proposal, both of which provide an approach to "properly attributed" that is consistent with the key policies and principles implicated by SB 408.

DATED: May 3, 2006.

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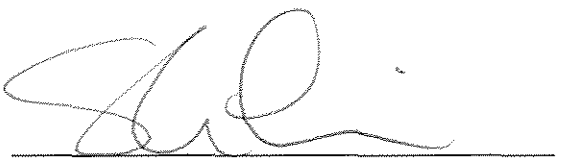

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I hereby certify that I served a true and correct copy of the foregoing document in Docket AR 499 on the following named person(s) on the date indicated below by email and first-class mail addressed to said person(s) at his or her last-known address(es) indicated below.

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