BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 170

In the Matter of

PACIFIC POWER & LIGHT,

Request for a General Rate Increase in the Company's Oregon Annual Revenues.

REPLY OF THE CITIZENS' UTILITY BOARD OF OREGON
TO PACIFICORP'S APPLICATION
FOR RECONSIDERATION

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I. Introduction

PacifiCorp's Application for Reconsideration of Commission Order No. 05-1050 (UE 170) offers every possible justification that the Company's legal team could dream up. The Application includes 16 separate reasons the Commission should review its Order. The vast majority of these are so flawed and inappropriate as to be uninteresting, much less effective. In this Reply, we will address those grounds based on flawed legal reasoning (1, 2, 3, 4, 5, 6, 7, 8, 9, 13, 14, 15, 16) and those that inappropriately injected old facts and arguments as new (10, 11, 12).

A few questions dealing with the Commission's ability to apply the law in the time frame expected by the Legislature, while interesting, do not support granting the Application. SB 408 made it unlawful for the Commission to set rates consistent with its past practices. Not only did the Commission not err in its application of SB 408 in its UE 170 decision, it was compelled to do so by the law. The Commission legitimately based its findings and conclusion in the Order on the facts and arguments contained on the record in UE 170.

The Commission should deny PacifiCorp's Application for Reconsideration.

II. The Order

In Order No. 05-1050, the Commission resolved the issue of appropriate rate treatment of taxes. This issue was the single most-hotly debated issue in the rate case. The issue was paralleled in the Legislature both temporally and substantively.

The Commission began its analysis by reviewing the regulatory and contemporaneous political background. The Commission recognized that its longstanding stand-alone methodology had come under serious criticism because it tended to create a "mismatch between monies collected from ratepayers to pay taxes and the actual amount of taxes paid to the taxing authorities." Order, page 13. The Legislature passed SB 408 "in response to these concerns." *Id. at* page 14.

The Commission then reviewed the positions of the parties. The decision required a two-part analysis: 1) Should the Commission move from its historical tax treatment methodology, and 2) if so, what methodology should the Commission adopt. "Both CUB and ICNU recommend abandonment of the stand-alone methodology, with each party proposing slightly different tax adjustments utilizing the interest deduction at PHI." *Ibid.*

With regard to moving from the stand-alone methodology, ICNU and CUB argued both the benefits/burdens test and a rational reason test. Staff argued that a benefits/burdens test was proper. The Commission notes that ICNU supplied a third reason for moving away from the stand-alone approach: that SB 408 requires a rate-setting approach to taxes that the stand-alone approach cannot meet. *Id. at* 17.

The Commission analyzed SB 408 to determine if the law required a change in the Commission's treatment of taxes even before it was possible to implement the specific automatic adjustment clause mechanism. The Commission found that the law did require such an immediate change in policy. For one, the emergency clause caused the bill to go into effect immediately upon the Governor's signature. If, as PacifiCorp argues, SB 408 only affects rates for 2006, there would have been no reason for the emergency clause.

Further, SB 408 amended 757.210 to require that rates be "fair" in addition to "just and reasonable." This is meaningful because a finding in the preamble, Section 2(1)(f), stated that rates including taxes are only fair if they reflect the taxes paid to government. Since the stand-alone methodology could not meet this test, the Commission had to change its approach to taxes. Since the emergency clause is meaningless if this change only applies in 2006, then the change mandated by SB 408 must be immediate and must be applied in UE 170.

The first step in the UE 170 tax issue is resolved by SB 408, *i.e.*, the Commission must move from the stand-alone approach. The Commission then explores the remaining question of what the appropriate treatment should be. The Order relies on the extensive testimony and briefing of the parties to reach its conclusion. No party was deprived of any right to argue its case on this point because it was squarely before the Commission.

III. There Is No Wheat In This Chaff

We attempt to group PacifiCorp's related arguments together so that we can then efficiently discount the group. Unfortunately, the arguments do not directly parallel the enumerated Grounds listed on pages 2-5, so, for the sake of simplicity, we will address the 16 grounds as they are enumerated in the Grounds for Reconsideration.

A. PacifiCorp Does Not Understand The Meaning Of "Fair"

We treat Grounds 1, 2, and 3 of PacifiCorp's Application as arguments based on the legislative history of SB 408.[1] These Grounds generally allege that the Commission misapplied the law, because the bill required the legislated tax treatment be fair to the utilities, but did not require a change in rate-setting practices.

PacifiCorp argues that the word "fair" should be interpreted as support for the *Hope* standard. Application, pages 13-14. However, such an interpretation renders the word "fair" meaningless, because the Commission is always subject to Article Five of the Constitution as interpreted by *Hope*. Therefore, "fair" must mean something else. Alternatively, PacifiCorp argues that the Legislature was simply trying to clean up discrepancies in ORS 757.040 and 757.210, and that SB 408 did not attempt to change the Commission's ratemaking authority. Application, page 9.

PacifiCorp even cites to Section 2(1)(e) of the preamble, which finds that the rate-making process can result in collecting taxes that are not paid. In wishful thinking, PacifiCorp sees this as an acknowledgment of the past Commission practice and

[1] Ground 2 contains a complaint based on a Fifth Amendment takings argument from *Federal Power Commission v. Hope*, 320 US 591 (1944), but since PacifiCorp argues this later in Ground 16 and since Ground 2 seems to rely on the new "fair" language from SB 408, we think this Ground is based on SB 408, not the Constitution.

presumably a reaffirmation of the practice. This preamble statement, like others found in Section 2, are findings that the Legislature found distasteful and unfair and were the very reasons for legislating a change. The whole point of SB 408 was to fix a manifest unfairness that resulted from the Commission's past treatment of taxes.

PacifiCorp's interpretation of the legislative history is so skewed and so wrong, we wonder if they were paying attention to the 2005 legislative session. The Legislature did not insert the word "fair" into ORS 757.210 – Section 5 of SB 408 – to protect the utilities, as PacifiCorp argues at pages 13-14; the Legislature's use of "fair" in Section 2(1)(f) is not meaningless either.

The word "fair" was first written into SB 408 at the outset, when the Senate sponsors of the bill and consumers drafted the bill to correct the mismatch between taxes collected in rates and taxes paid to taxing authorities. SB 408 B-Engrossed, dated June 6, 2005, includes the preamble statement about fair utility taxes, and the addition of "fair" to ORS 757.210 that made it verbatim into the law. This version of SB 408 emerged after a series of meetings that included the sponsors of the bill, consumer groups, and observers from the Attorney General's office. The use of the term "fair" in the preamble and inserted into the Commission's general rate-making standard, using this tax bill as the vehicle, along with a mandated change in regulatory tax treatment, was the Legislature's attempt to fix a broken system.

The Commission's Order was dead-on when it found that Section 2(1)(f) mandates a change from its former treatment of taxes. That section says that if rates include taxes, then "rates… should include the taxes that are paid to units of government to be considered fair, just and reasonable." Since past Commission rate treatment did not meet this fairness test, and SB 408 inserted the word "fair" in 757.210, the Commission *had* to treat taxes differently in all subsequent setting of rates. Since SB 408 went into effect on September 2, 2005, as a result of the emergency clause, the Commission had to treat taxes differently in UE 170. Treatment of taxes was a major component of UE 170, and the Commission had an adequate record before it.

B. Law Mandates Change & Supercedes Past Rules And Precedents

As discussed above, SB 408 required that the Commission change ratemaking to incorporate the new standard of fairness, and this change superceded and made moot all previous rules and precedents. PacifiCorp's Ground 4 concerning deviation from past precedent willfully ignores the law. Not only is it lawful for the Commission to move from its stand-alone precedent, it would have been unlawful for the Commission to adhere to that precedent.

C. Commission Did Not Need To Adopt Rules To Apply SB 408

Grounds 5 and 6 are based on claims that the Commission was acting unlawfully when it applied SB 408 to UE 170 without first promulgating rules. While an interesting issue at first blush, when one appreciates how the Commission applied SB 408, these arguments dissipate.

The Commission did not use the procedural or the substantive direction provided in SB 408 to establish its tax treatment in UE 170. For its order in UE 170, the Commission used the record in UE 170.

In its Order, the Commission uses SB 408 to answer the threshold question: must the Commission move from the stand-alone approach? "The legislative intent behind

SB 408 is clear – we are to depart from historic practice…" Order at page 18. The threshold question is answered.

"Having decided that we must apply SB 408 to this docket, *we turn to the positions of the parties*." *Ibid.,* emphasis added. The Commission looks to the record in UE 170 which was fully developed on this issue. No rights were abrogated here, because the guts of the issue was developed in a contested case proceeding with all of its due process trappings. Every party to the case knew this was an issue, if not *the* issue, in UE 170.

No rules were necessary to determine the threshold issue of whether SB 408 applied to this case. The Commission found that it did. The rest of the matter, concerning the adoption of a particular tax treatment, was present in UE 170 from the beginning. The Commission's reliance on the record in UE 170 is appropriate, lawful, and contained all the necessary procedural, due process safeguards.

D. Law Was Not Applied Retroactively Or Arbitrarily

Grounds 7 and 8 complain that the Commission retroactively applied SB 408 to UE 170. Application, pages 24-31. The Commission did not apply SB 408 retroactively. First, UE 170 was not proceeding in a vacuum; all the same parties engaged in UE 170 before the Commission were participating in the debate over SB 408 before the legislature. Second, as a result of this, many of the same issues were raised in both arenas. Therefore, the record in UE 170 is a robust debate that centered on two points: 1) whether the Commission should or could change its treatment of taxes, and 2) if it can, then how should the Commission treat taxes? SB 408, which went into effect shortly after oral argument and well before the Commission's Order was issued, answered the first question – the Commission must change its regulatory treatment of taxes to ensure that rates do not include taxes that are not paid to taxing authorities. The remaining question – how the Commission should treat taxes – was thoroughly aired in testimony by the parties, including PacifiCorp:

- CUB/100/Jenks/2-19
- CUB/200/Jenks/1-16
- PPL/1301/Martin/1-15
- PPL/1300/Martin/1-23
- PPL/1400/Uffelman/1-13
- ICNU/200/Selecky/15-18
- Staff/1000/Conway-Johnson/1-17

This testimony was then extensively briefed and argued by the parties.

PacifiCorp argues that the Commission arbitrarily applied SB 408 because the Commission did not expressly follow the procedural and substantive requirements of SB 408. Had the Commission claimed that it was relying on the procedural elements of SB 408 – the automatic adjustment clause, etc. – then the Commission might run into trouble. However, the Commission made no such claim; indeed, it recognized that its rate treatment of taxes had to change when setting rates in UE 170 and, rather than pretend to apply the methods outlined in SB 408, the Commission specifically relied on the facts and arguments on the record in UE 170. Order No. 05-1050, pages 17-19.

E. The Benefits/Burdens Test Is Irrelevant To This Application

Ground 9 reargues the benefits/burdens test that was part of the "Can the Commission change its rate treatment?" issue. The Commission did not rely on this test in crafting the UE 170 Order. So the entirety of PacifiCorp's benefits/burdens argument (pages 34-38) is utterly irrelevant.

We should note that CUB's adjustment did meet the benefits/burdens test, so even if the Commission were to agree to PacifiCorp's application for reconsideration and change its reasoning, the Commission could rely on the benefits/burdens test as detailed in CUB's testimony which would result in a similar rate adjustment.

F. PacifiCorp's New Evidence Is Neither New Nor Relevant

Grounds 10, 11, and 12 claim to raise new evidence. Grounds 10 and 11 identify changes to PacifiCorp Holding Company, Inc.'s debt structure and United Kingdom tax laws that PacifiCorp claims would cause changes to the adjustments in the Commission's Order. Again, the issue of taxes in rates should not have been a surprise to PacifiCorp in UE 170, as it was a major contested issue and PacifiCorp submitted testimony and briefs on the issue. Why PacifiCorp would remain silent during the case on changes in PHI's debt structure and U.K. tax law if they believed it would impact the tax determination is a mystery to us. PacifiCorp had ample time to raise these issues as they moved toward maturation during the rate case. They chose not to raise these issues.

The Ground positing a change in the PHI debt structure is a red herring. All kinds of costs change after, and sometimes even during, a rate case. Evidence was placed on the record identifying PHI's debt structure during the case. PacifiCorp seizes on a single particular direction, and tries to undo the rate case Order. This should not be allowed, or, in the alternative, all parties should be allowed to identify costs that have changed since the record closed, *i.e.,* the Commission should allow an unending rate proceeding.

The U.K. tax law argument is an even redder herring. How the U.K. levies taxes on Scottish Power has never been and will never be an issue for Oregon ratemaking.

Oregon regulation is concerned with PacifiCorp's costs as determined by state and federal (United States) taxes.

As for Ground 12's assertion, that a new "fact" has arisen based on a relative taxable income methodology, this is not a new fact at all, but a new methodology. It is way too late to argue new methodologies. PacifiCorp had the opportunity to raise the methodology supported by hard evidence, but PacifiCorp did not do so in a timely manner. PacifiCorp's after-the-fact testimony offered with its Application must be stricken. The Commission's entire process will collapse if parties can submit new arguments and methodologies as "fact" in a post-order application.

None of these bits are "new evidence" which were "unavailable and not reasonably discoverable," as required in the rules for reconsideration. OAR 860-014-0095(3)(a). In fact, the "new evidence" is not new, relevant, or even evidence.

G. The Order Does Not Impair Merger Contract

Ground 14 claims the Commission's Order impairs the merger contract between PacifiCorp and Scottish Power. The basis of the complaint is that, after having approved the acquisition of PacifiCorp by Scottish Power (UM 918), and the Stipulation between the entities, the Commission can do nothing inconsistent with that Stipulation. PacifiCorp is arguing that the Commission's Order in UM 918 binds all future Commissions. That a Commission cannot bind a future Commission is a basic tenet of administrative law. We know it, and PacifiCorp knows it, and Scottish Power knows it. It is silly to suggest that the Commission cannot change its tax policy generally because of a past agreement between PacifiCorp and Scottish Power.

H. The Tax Policy Does Not Violate The Constitution

PacifiCorp creates a new constitutional prohibition on asymmetrical rate-making to support Ground 13. There is no such constitutional prohibition. In the cited case, *Duquesne Light v. Barasch,* 488 US 299 (1984), that issue was not before the Court, so the issue was never decided. The Court opined *in dicta* that arbitrarily switching back and forth between methodologies to the shareholders' detriment would raise constitutional questions. First, while questions may arise, there are no answers, much less constitutional principles yet; and second, there is no arbitrary switching back and forth in the present case. The Supreme Court will never say that a regulator cannot switch rate-making methodologies. The Commission switched methodologies because the Legislature told it to do so. There is no constitutional implication here.

The charge that the UE 170 Order violates the Equal Protection Clause of the Constitution is too silly and far-fetched to warrant a response. PacifiCorp is unable to mount a credible argument here.

As for the great big question – the 5th Amendment takings claim – it is interesting to note that the case that seemed to be the starting place for the benefits/burdens analysis also ends the takings claim analysis. In *City of Charlottesville v. FERC*, 774 F. 2d 1205 (1985), the court recounts the history of FERC's former tax treatment, which included the consideration of affiliate losses.

> There are a number of plausible ways to make that estimation – ranging, perhaps, from an approach that would give the utility's ratepayers the benefit of all tax deductions of the consolidated group offset against the utility's income (since the deductions would have been worthless without the income) to an approach that would give ratepayers the benefit of none of them (since the utility would have had no deductions on its own). Within certain rational limits that have clearly not been exceeded here,

which approach to choose is more a matter of regulatory policy than of logic.

City of Charlottesville, at 1221.

This goes beyond what the Commission did in UE 170, and yet the court never seems disturbed by this approach, constitutionally or otherwise. In addition, the State of Pennsylvania has long required a tax approach more far-reaching than that adopted by the Commission in UE 170. Yet there has been no constitutional challenge.

IV. Conclusion

PacifiCorp substituted quantity for quality in its Application for Reconsideration. Though extensive, the Company's list of so-called "Grounds" contains very little of interest and nothing of substance. The Oregon Legislature passed a law putting an end to the Commission's past tax treatment, and the Commission was bound by that law to change its tax methodology in UE 170. PacifiCorp's application should be dismissed.

Respectfully Submitted,
November 14, 2005,

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CERTIFICATE OF SERVICE

I hereby certify that on this 14th day of November, 2005, I served the foregoing Reply of the Citizens' Utility Board of Oregon in docket UE 170 upon each party listed below, by email and U.S. mail, postage prepaid, and upon the Commission by email and by sending 6 copies by U.S. mail, postage prepaid, to the Commission's Salem offices.

Respectfully submitted,

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