**BEFORE THE PUBLIC UTILITY COMMISSION**

**OF OREGON**

**UE 170**

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| In the Matter of | ) |
| PACIFIC POWER & LIGHT CO | ) |
| Request for a General Rate Increase in the Company's Oregon Annual Revenues. | ) |

OPENING BRIEF

OF THE

CITIZENS' UTILITY BOARD OF OREGON

August 4, 2005

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# I. Introduction

Thanks to a number of stipulations between the major parties in this case, the remaining issues are modest in number. The Citizens' Utility Board is a party to the First Partial Stipulation, the Second Partial Stipulation, and the Fourth Partial Stipulation. These stipulations have settled a number of issues related to revenue requirement. In addition, a late remaining issue for us, the billing period variability, has been resolved between CUB and the Company.

Therefore, we address our remaining issues here: the treatment of taxes and the Company's proposed Transition Adjustment Mechanism.

## II. CUB's Tax Adjustment

The issue of how the Public Utility Commission of Oregon (Commission) treats utility taxes in rates has been the subject of intense public scrutiny over the past several months. The issue began with the realization that the amounts collected by Portland General Electric from customers in rates for taxes seemed to have nothing to do with the taxes actually paid (or not paid) by Enron to the taxing authorities. The past several months have seen significant activity around the issue, including media reports identifying the disparity between taxes collected by energy utilities and taxes paid, a class action law suit, a Staff white paper, two memos from the Attorney General's Office, a Commission public meeting, comments from interested parties, and, finally, activity on a bill in the Legislature. We think it is fair to say that the public is very interested in this matter, and a change in the Commission's past treatment is necessary to alleviate concerns and maintain public confidence in the Commission process.

In this case, CUB has examined ways to update the Commission's tax treatment in a way that does no offense to existing laws or regulations. We have attempted to follow only safe and rational routes to updating the Commission's tax treatment and we have tried to avoid overreaching. Using the February 18, 2005, Memorandum to the Commission from Assistant Attorney General Jason Jones as a road map, we address the potential constitutional and regulatory issues that are associated with CUB's tax adjustment. Before we do that, we think it is necessary to describe what our adjustment is, and what it does.

## A. CUB's Tax Adjustment Assumes Stand-Alone Tax Treatment

CUB accepts the Commission's historical calculation of utility taxes on a stand-alone basis. What CUB proposes is a single adjustment to the stand-alone approach to more accurately forecast taxes in revenue requirement. CUB/100/Jenks/3. Despite PacifiCorp's attempt to misrepresent CUB's proposal, our adjustment is decidedly not a consolidated tax approach.

In our adjustment, we did not examine or use the interest tax deduction from the consolidated tax filing of PacifiCorp's parent, PHI. We specifically did not examine, and had no access to, the tax filings of PHI's subsidiaries other than PacifiCorp itself. We did not include subsidiary gains or losses, thus completely avoiding any cross-subsidy problems. We completely excluded the issue of deferred taxes.

What we did was to attempt a better revenue requirement forecast by including an adjustment in the Company's tax calculation for a known and measurable item. We did this by finding the interest on the debt that is held by PHI itself, calculating the tax deduction associated with that debt interest by applying the 35% federal tax rate to the interest on the debt, and then allocating that deduction to PacifiCorp based on the proportionate share of cash flow to PHI from its subsidiaries. CUB/100/Jenks/7-9, 18; CUB/102 and CUB/105. In other words, the basis of our approach is a stand-alone tax calculation, to which a known and measurable adjustment is made to more accurately forecast costs and more reasonably address the risks that burden ratepayers due to the debt load of a utility's parent or holding company.

Our adjustment is in complete harmony with other traditional regulatory tools. First, the adjustment is a known and measurable adjustment to the revenue requirement based on a reasonable forecast of costs. Second, the attribution of benefit or cost to the customer is based on a rational allocation to the Oregon jurisdiction just like the allocation of corporate overhead costs or the allocation of costs to Oregon from the PacifiCorp multi-jurisdictional territory.

The result is a $14.8 million dollar adjustment to the Oregon revenue requirement requested in this case. There are only two other alternative tax adjustment proposals developed on the record in this case: Staff's $4.6 million adjustment and ICNU's $27.58 million adjustment. We believe that our adjustment easily meets constitutional and regulatory rationale requirements. Furthermore, given the public's interest in, and concern over, the on-going controversy related to utilities avoiding payment of tax amounts that were collected from customers in rates, we believe that this adjustment is necessary to retain the public's confidence in the utility regulation process. CUB/200/15-16.

## B. Constitutional Requirements

### *i. Hope*

CUB's tax adjustment does not even remotely implicate any constitutional concerns. The starting place for identifying those concerns is *Federal Power Comm. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). *Hope* tells us that, while the Commission's ratemaking process involves a balancing act, the Court's constitutional review is a simple threshold question. "If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry … is at an end." *Hope* at 602.

*Hope* does give us some parameters to judge whether a rate order departs from the just and reasonable and sinks to the level of a confiscatory taking. In reviewing a rate order, it is not the method employed to determine rates that is controlling, it is the result. The Commission is "not bound to the use of any single formula"; it is not the "theory but the impact of the rate order which counts"; the order is "viewed in its entirety"; and even if the method employed contains "infirmities", the only subject of the inquiry is the result. *Ibid*. In short, the Supreme Court does not care what tax approach the Commission uses as long as the order as a whole is reasonable.

In examining the reasonableness of the rate order, a court may look at whether the allowed return is "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." *Id.* at 603. However, the Court says "[t]he conditions under which more or less might be allowed are not important here." *Ibid*. As the Supreme Court summarized the *Hope* standard in *Duquesne Light v. Barasch*, 488 U.S. 299, 310, these questions have constitutional overtones "at the margin."

We are nowhere near the margins. The $14.8 million adjustment offered by CUB, which both better forecasts costs and aligns customer's burden and benefit, is only a 1.7% reduction in PacfiCorp's proposed Oregon revenue requirement. Significantly, PacifiCorp has already stipulated in this case to a rate of return adjustment that is equal to a 2.8% reduction from the Company's proposed Oregon revenue requirement. PacifiCorp has agreed to other downward adjustments, even as they recognize that the tax adjustment is still outstanding. So not only has PacifiCorp already agreed to revenue requirement reductions that are larger than that of CUB's proposed tax adjustment, but

PacifiCorp implicitly accepts that the tax adjustment does not take us toward the land of confiscatory takings, or the Company could not have agreed to settle those issues, especially return on equity and capital structure. We predict that an appeal based on an argument that an order including CUB's $14.8 million adjustment is a violation of PacifiCorp's Fifth Amendment rights will be quickly dispatched to the dust bin by the reviewing court.

We could imagine a utility parent or holding company in the future, especially after repeal of the Public Utility Holding Company Act, whose debt interest deduction is so huge that an attempt to capture it for ratepayers may look like a crippling injury to the investor – until it is realized that under CUB's adjustment, only that which is proportionally represented by the utility's cash flow to the parent is captured. Thus, CUB's tax adjust is not out of proportion, is not overreaching, and is not a takings.

**ii. *Duquesne***

The other constitutional issue identified in the February 18 Memo to the Commission is the Supreme Court's prohibition of a regulator's decision to "arbitrarily switch back and forth between methodologies" in a way that imposes risks on investors at times and denies benefits at other times. *Duquesne*, at 315. It should be noted that technically this pronouncement is dicta, not a holding of the case, because the issue was not presented to the court. Nevertheless, it should be obvious that the problem we have before us is not one of arbitrary shifts, it is one of absolute adherence to a specific tax treatment that is perceived by the public as unfair and broken, and which threatens to undermine confidence in the Commission.

## C. Regulatory Requirements

### i. State Law Expectations

It is firmly established in Oregon that, while the Commission's authority is limited by the Federal and State constitutions and by other legislative limits, the regulation of public utilities constitutes a legislative function. *Pacific Northwest Bell v. Sabin*, 21 Or App 200, 213. This leads courts in Oregon to conclude that where the Commission "has been granted broad legislative authority [the Commission] is not obligated to employ any single formula or combination of formulas to determine what are in each case 'just and reasonable' rates." *Id.* at 224. Between *Hope* and *Pacific Northwest Bell*, the Commission is free to use whatever methodology it chooses to set rates so long as the result is just and reasonable.

The Commission's order must disclose a rational relationship between findings of fact and the legal conclusions. *Chase Gardens Inc. v. Public Utility Commission,* 131 Or App 602, 605 (1994). Assuming this is done, however, the method by which the Commission establishes rates is the Commission's business as long as the result passes constitutional muster.

Our research has not shown any constitutional or legislative mandate or directive that requires the Commission to utilize a pure stand-alone tax approach, a pure consolidated tax approach, or something in between. The Commission's duty is to protect utility customers and the public generally from unjust and unreasonable rates and to obtain for customers "adequate service at fair and reasonable rates." ORS 756.040. In the exercise of this duty, the Commission has fairly expansive discretion in how it treats taxes.

### ii. *Charlottesville*: Benefit/Burden Or Rational Reasoning

The U.S. Constitution and the laws of the State of Oregon grant the Commission fairly wide latitude in designing an appropriate tax policy that furthers the statutory obligations of the Commission. Two questions remain: 1) is there some other limiting or dictating factor, and 2) what standard must the Commission adhere to in crafting a tax policy.

In his February 18, 2005, and March 22, 2005, memos to the Commission, Assistant Attorney General Jason Jones relies heavily on a D.C. Circuit Court of Appeals case, *City of Charlottesville v. FERC*. 774 F.2d 1205 (1985). From his reading of that case, Mr. Jones answers the two outstanding questions in his March 22 Memo: "it is clear that regulators have discretion to use different methods of calculating tax allowances, but it is also true that whichever method is chosen it should be <u>applied</u> in a way that matches benefits and burdens." Emphasis original, March 22, 2005, Memo, p.3. CUB agrees in part and disagrees in part with this finding.

Before we describe our reading of *Charlottesville*, it is worth noting a few points about the case. First, as Mr. Jones points out, *Charlottesville* is not a binding precedent on the Commission. It is simply a thorough analysis of the topic of taxes and regulated utilities. Second, the facts in *Charlottesville* are different enough from the case at hand that the holding is of marginal value. Third, we point out that the circumstance in *Charlottesville* is that the appellant is challenging the FERC's change <u>from a consolidated to a stand-alone approach</u>. Far from the question of whether a regulator has to use a stand-alone approach, the legal questions in *Charlottesville* were, can, and did, the FERC appropriately adopt the stand-alone approach.

We do agree with Mr. Jones that *Charlottesville* stands for the proposition that regulators have wide discretion in choosing a tax policy and approach. The case outlines the history of different approaches and investigates the implications of different approaches.

However, we question Mr. Jones' interpretation that *Charlottesville* requires a benefit/burden test to support a particular policy. We think that *Charlottesville* does not require or even suggest a benefit/burden test. We see the benefit/burden test as the test that the <u>FERC</u> applied in its cases, and the D.C. Circuit Court was determining whether the test itself and as it was applied was reasonable. "It remains to be considered whether the Commission's methodology for allocating tax deductions for stand-alone purpose is reasonable, and whether it has been applied correctly to the facts of this case. The methodology in question is the so-called benefits/burdens test . . ." *Charlottesville* at 1217. The D.C. court did not say one must or should use a benefit/burden test, only that the FERC's test was rational. Had the FERC applied a differently methodology, the court would have applied the same reasonableness test to see if it fit within rational limits.

The precise holding of *Charlottesville* is that there is a range of tax approaches that can be employed by regulators and that the courts will not second guess the approach as long as the approach is within certain rational limits.

> The object of the present exercise is not theoretically accurate assignment of causality for the tax advantages of consolidated filing, but estimation of the tax liability attributable to operations of a regulated company that happens to be an affiliate. 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 deduction 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.

*Id.* at 1221.

In fact, were the court to require a particular test or theory, it would fly in the face of the standard set out in *Hope,* where the Supreme Court repeatedly hammered on the point that the courts were not to tell the regulators how to regulate. Again, *Hope* was very clear when it said a regulator is "not bound to the use of any single formula" and it is not the "theory but the impact of the rate order which counts." *Hope* at 602. *Pacific Northwest Bell* echoed exactly the same reasoning. We believe that the language used in *Charlottesville*, "within certain rational limits," is a recognition of the policy outlined in *Hope* and that the court does not require or necessarily suggest a particular test such as the benefit/burden test.

The legislature can speak to the issue of taxes and require the Commission to apply a benefit/burden test. However, prior to this session, the legislature has not created that mandate to drive how the Commission should approach taxes. A simple rational test is all that is required of the Commission as it contemplates its tax approach. We think *Charlottesville* is consistent with this interpretation.

The Commission can meet this rationality test by any number of justifications. The Commission can say "it is our duty in statute to prohibit unjust and unreasonable rates and develop fair and reasonable rates, and because amounts collected from ratepayers for taxes are dramatically different from the amounts actually paid in taxes, a modest adjustment to our stand-alone tax approach is needed to further that end." Or the Commission can say "it has come to our attention that our current tax approach is woefully inadequate in forecasting utility costs, and a modest adjustment to our stand-alone tax approach is needed to further that end." Our reading of the cases satisfies us that such a rationale would pass muster with a reviewing court.

### iii. Applying The Benefit/Burden Test

Having argued that the Commission need not adopt the benefit/burden test, we will now describe how the record supports adoption of CUB's adjustment if the benefit/burden test is applied. CUB testimony identifies a link between PacifiCorp (and its customers) and its holding company that creates real and potential burdens on customers. The nexus is the debt load held by PHI which is serviced largely by cash flow from PacifiCorp. Yet, while this link creates real and potential burdens on customers of PacifiCorp, these customers get no return benefit from the tax deductions that are directly attributable to the interest on the debt.

#### *a. Rating Agencies Evaluate Consolidated Company*

CUB and PacifiCorp agree that rating agencies look at the consolidated company when determining PacifiCorp's credit rating. CUB and PacifiCorp sparred over whether the presence of ScottishPower was a benefit or a burden to PacifiCorp. PacifiCorp claims that ScottishPower's presence is a net benefit to PacifiCorp. CUB disputes the existence of sufficient information on the record to establish that PacifiCorp customers are the net winner in the relationship. See Staff/1000/Conway-Johnson/7. In fact, we believe that the credit reports we cited indicate a substantial amount of concern by Standard and Poor's at times over nearly a four year period, which is roughly 60% of the term of ScottishPower's ownership of PacifiCorp. CUB/100/Jenks/10-11.

Nevertheless, we do think there is ample testimony on the record from CUB, PacifiCorp, and Staff to establish the credit rating link between the two entities. CUB offered numerous instances of Standard & Poor's examining the entire corporate family and identified where the parent negatively impacts the utility. CUB/200/Jenks/3-4. PacifiCorp witness Williams offered credit agency reports that examined the entire corporate family and identified where the parent helped the utility. PPL/304/Williams/12. Staff looked at the testimony taken together and concluded, "[b]oth CUB's arguments and PacifiCorp's arguments indicate that PacifiCorp's ratings are affected by ScottishPower. This would imply that the ring fencing was not 100% effective." Staff /1000/Conway-Johnson/7.

***b. The Membrane Between Parent & Utility Is Porous***

Not only is the ring-fencing as a result of conditions imposed in Order No. 99-616[1] not 100% effective, but there are already many instances of regulatory treatment that pass through the membrane that separates the utility from its holding company. The utility/parent membrane is porous and has been for some time. CUB identifies numerous costs allocated to PacifiCorp customers that originate at the holding company or above. CUB/100/Jenks/14-18. These costs include the cost of filing consolidated taxes, corporate secretarial and shareholder services, and group finance and corporate strategy.[2] So the Commission already looks at costs that cross-over between the utility and its parent.

[1] Out of ScottishPower's ORS 757.511 application.
[2] It is important to note, here, that while PacifiCorp customers pick up these costs, there is no "benefit/burden" test performed by the Commission to determine a) whether the costs to customers is justified and b) the amount of the costs paid for by customers.

### *c. The Burden On A Utility From Debt At Parent Or Holding Company*

The next step in the analysis, then, is what burden weighs on PacifiCorp customers as a result of the debt held at PHI. CUB focused on the cost of debt at the utility level, the incentive to store debt at the parent, and the behavior of the utility that is pressured to service the parent's debt load. CUB/100/Jenks/10-13. CUB found that debt at the parent level presents a risk to utility customers. Higher capital costs are only one form of risk to the customer. The customer could also suffer when pressure on the utility to service the debt through dividends leads to cost cutting, reduced investment, more frequent rate cases, and the over-collection of taxes. *Id.* at 9.

Staff focuses on the increased capital costs to PacifiCorp customers due to the debt at PHI. Staff/1000/Conway-Johnson/12-13. Based on this analysis, Staff believed that some tax adjustment was warranted, but perhaps not the full amount suggested by CUB or ICNU. After this testimony, however, Staff responded to CUB Data Request 1 through 3. There, Staff identifies additional risks that it had not considered in its earlier testimony. Staff acknowledged that additional risks, other than increased cost of capital, existed as a result of debt being stored at the parent. Staff concluded that parental debt load could also lead to improper maintenance resulting in increased outages. CUB/301. Staff also identified other potential harms in a weakened financial structure: pressure on the utility to make dividend payments, imprudent cost cutting, and reduced capital investment. CUB/301.

Staff's source for the list of potential harms to customers from debt stored at the utility's parent was the Commission itself.

> Staff and Intervenors contend that the large amount of debt held by Oregon Electric would result in the following potential harms: lower credit ratings for PGE, undue pressure on PGE to make dividend payments to Oregon Electric, and the risk of bankruptcy to Oregon Electric and PGE. Staff and ICNU also raise concerns about the amount of variable rate debt Oregon Electric expects to use.
>
> We find these potential harms point to the possibility that PGE will not be able to raise capital as cheaply as it would as a stand-alone company, resulting in a weakened financial structure. Imprudent cost cutting and reduced capital expenditures could also occur. Therefore, the possibility of higher customer rates or reduced reliability arises from these potential harms.

Order 05-114, page 21, UM 1121.

Thus, this Commission has already found that debt load storage at a utility's parent creates potential harms increasing the possibility of higher rates and reduced reliability. Given that Staff did not address most of these harms in its testimony, we think that its determination of an appropriate tax adjustment is faulty.

***d. Match The Debt Burden With The Benefit***

The remaining step in the process is to determine how to match up the benefit (tax deduction on the debt interest) with the burdens discussed above in order to arrive at an appropriate adjustment. Including all the potential harms into the analysis, more expensive capital, a weakened financial structure, imprudent cost cutting and reduced a capital investment, we believe that CUB's adjustment is appropriate. "PacifiCorp represents the vast majority of PHI's income, and is the primary source of income to pay PHI's debt. . . PHI's obligation to pay its debt, regardless of the strength of the corporate family, is a pressure shared by PacifiCorp and its customers. As the burden of the debt is borne by PacifiCorp and its customers, so should the benefit of that debt's interest tax deductions be allocated to them." CUB/200/Jenks/4. CUB's adjustment is elegant because it links up the harms with the cause and because it is proportional to the utility's role in servicing the holding company debt.

We end by noting that we do not address the numerous confusing statements of PacifiCorp witness, Mr. Martin, on this subject. We found most of Mr. Martin's testimony to be designed to confuse the issue rather than clarify it. CUB spent most of our surrebuttal attempting to correct Mr. Martin's obfuscations, and we will let the record speak for itself rather than rehash those arguments here. CUB/200/Jenks/6-14.

### iv. Other States

As we have seen, the law, and thus the Commission's options with regard to tailoring a better fitting tax treatment, is neither static nor monolithic. Perhaps the least convincing argument is a summary of what other jurisdictions are doing. Such a summary is particularly unconvincing if it is out of date. PPL/1400/Uffelman/4 and PPL/1402, a summary of jurisdictions from 1994.

It is enough to know that some jurisdictions have treated or do treat taxes differently. See footnotes 9 and 10 of Jason Jones' February 18, 2005, Memo, page 6. Beyond that, what the Commission should explore is what the Commission can, and should, do for ratepayers in Oregon, without violating the Takings Clause.

We offer two examples of state courts upholding their regulatory commissions' use of a parental tax adjustment. First, *General Telephone Co. of Florida v. Florida Public Service Commission*, 446 So.2d 1063 (1984) is a case decided approximately concurrent with *Charlottesville*. The case was a review of the Florida Public Service Commission's adoption of a rule that required the consideration of the income tax effects of the parent's debt. The Supreme Court of Florida did not review the FERC orders, did not require a benefit/burden tests, and did not even bother, so it seems, to perform a Fifth Amendment takings test on the rule. The court simply upheld the rulemaking and in doing so, said "[o]nce the consolidated liability is determined, each participating entity become jointly and severally liable for payment." *Id.* at 1068. It further stated "[i]n the normal course of a parent-subsidiary relationship, the parent issues debt in order to acquire capital to support the operations of its subsidiaries. … As a practical matter, the equity of the subsidiary is thus directly supported by the debt of the parent." *Id.* at 1069. The court was simply looking for a rational basis to support the rule and found it easily.

In a case that came after *Charlottesville*, *GTE South Inc. v. AT & T Communications*, 527 S.E.2d 437 (2000), the court upheld the Virginia commission's application of a parental debt adjustment in a rate case. The court said "[t]his adjustment is based on tax savings resulting from the parent corporation capitalizing on its equity investment in a regulated subsidiary." *Id.* at 441. The court did not cite to *Charlottesville*, did not apply a benefit/burden test, and never came close to a takings analysis. Again, this court easily found a rational basis to support the outcome of the rate case.

It is enough for this Commission to know that its discretion is broad, and that other states have successfully explored methodologies beyond the unadjusted, stand-alone methodology. It is time for this Commission to adopt a more fair and more accurate tax treatment in rate cases.

### v. CUB's Adjustment Does Not Violate OAR 860-027-0048

PacifiCorp's claim that CUB's adjustment violates OAR 860-027-0048 has no substance. As we have shown, the CUB adjustment is essentially the stand-alone method with an adjustment that is little different from other adjustments made to revenue requirement and is consistent with regulatory adjustments to other revenue requirement costs. OAR 860-027-0048 states:

> (4) The energy utility shall use the following cost allocation methods when transferring assets or supplies or providing or receiving services involving its affiliates:
>
> (h) Income taxes shall be calculated for the energy utility on a standalone basis for both ratemaking purposes and regulatory reporting. When income taxes are determined on a consolidated basis, the energy utility shall record income tax expense as if it were determined for the energy utility separately for all time periods.

Does a solitary adjustment to the stand-alone method wipe out the underlying methodology? We think it does not. Our starting point, like the stand-alone treatment, is the utility's tax liability. Our ending point was a simple adjustment to that stand-alone treatment.

Starting from the forecasted stand-alone tax liability, we did not base the adjustment on the consolidated tax liability, rather we based the adjustment on the forecasted debt of the holding company itself. We did not look at the consolidated tax filing or the gains or losses of subsidiaries to determine the holding company's interest deduction due to its debt load. In order to allocate that amount properly to PacifiCorp, we did look at the consolidated tax filing, but not at the tax liability, and then only to determine PacifiCorp's share of the consolidated gross profits. In this way, our allocation of the tax adjustment is little different from the way the Commission allocates other elements of corporate overhead to PacifiCorp's customers, such as shareholder costs and corporate strategy.

CUB's adjustment is the stand-alone method with a single adjustment to more accurately reflect forecasted costs.

# III. Transition Adjustment Mechanism (RVM)

In its filing, PacifiCorp includes a Transition Adjustment Mechanism (TAM, or Resource Valuation Mechanism, RVM) which it would apply to all customers. The TAM compares the variable power costs for the upcoming year with direct access load to those costs without the direct access load in order determine the credit or charge assigned to departing direct access customers. To do this, PacifiCorp must update the power costs annually as close to the direct access window as possible. "The Company proposed its RVM for purposes of facilitating direct access participation, in response to stakeholder comments and the Commission Order in UM 1081." PPL/702/Omohundro/3. Without direct access for larger customers, PacifiCorp would not be proposing the TAM.

CUB's position is that PacifiCorp's proposed TAM should not apply to residential customers. Residential customers are not eligible for, and cannot benefit from, direct access. In addition, we pointed out that the TAM creates a host of problems, asymmetries, and complications. We think it is reasonable that, since the mechanism is not associated with a benefit to residential customers but does create a number of problems, the TAM should not be foisted on residential customers.

CUB identified the following problems and complications with the TAM:

1. The TAM is resource and time intensive for all advocates, even those who won't benefit from the TAM's raison d'etre, direct access;
2. The TAM is a departure from traditional ratemaking in that some costs are no longer subject to a prudence review, such as contract prices, fuel costs, and market prices;

3. The TAM creates a mismatch between fixed and variable costs, where variable cost changes may be updated in rates but downward trending rate base will not be;

4. The TAM creates a mismatch between allocation factors, because PacifiCorp is a multi-state utility and state loads are growing at different rates. The proposed TAM would apply an older allocation factor to fixed costs and a newer allocation to variable costs, thereby creating a mismatch of cost allocation;

5. The TAM creates an opportunity for gaming, as the forward market curve is internally produced, not independently derived, and the curve used in the final GRID run is developed after the Commission's order and without the Commission's review;

6. The TAM shifts some risk and burden of Utah load growth onto Oregon customers;

7. The TAM includes phantom costs not actually incurred by the utility, as the GRID model uses spot market purchases when the utility may well serve its load with a less expensive option.

CUB 100/Jenks/22-30.

PacifiCorp responds initially by essentially arguing that since Portland General Electric gets to do an RVM, PacifiCorp should get to as well. PPL/701/Omohundro/3. Of course this is no argument at all. PacifiCorp and PGE are very different in a number of ways, such as their respective service territories. Ultimately, the argument fails to rationally address the issue we raised: application of the TAM to residential customers will create burdens, but no benefits.

PacifiCorp's other generic argument is that calculating power cost updates for one set of customers would be too complex. *Id.* at 2. CUB never suggested such a calculation or the need for such a calculation, only that once the update is completed that it not be applied to residential customers who cannot benefit from direct access. CUB/200/Jenks/17.

PacifiCorp did attempt to reply to a number of the problems and complications that we identified in testimony. CUB systematically responded to PacifiCorp's arguments in surrebuttal. *Id.* at 17-25. We will highlight a few of these exchanges.

First, it should be noted that PacifiCorp does not dispute CUB's argument that the TAM adjusts rates for some power purchase contracts, fuel purchases, and forward price curves without any kind of prudence review, because TAM is updated to include transactions that occur after the Commission decision in the TAM case. The Company argues that this is "in the best interest of all of PacifiCorp's customers" because it more accurately represents the value of displaced power applied to departing direct access customers. PPL/701/Omohundro/3-4. An accurate value for departing customers is good, but applying the update to residential customers who cannot depart is not good, and is certainly not outweighed by the loss of essential regulatory protections.

The Company agrees that the TAM will create a mismatch in variable and fixed costs, but argues that the mismatch will benefit customers during the current cycle of heavy capital expenditures. PPL/701/Omohundro/5. First, we do not think it is true to assume that customers will benefit from the current mismatch, as the Company controls the timing of new rate cases and between rate cases the return on ratebase declines. The declining rate base will not be updated by the TAM, even as fuel and other costs will be updated. CUB/200/Jenks/19. Second, PacifiCorp's response indicates that there will be a mismatch under any circumstance, and calls into question the value of applying an imperfect update mechanism to residential customers who cannot benefit from direct access.

Next, PacifiCorp discounted our argument that TAM passes through costs to Oregon customers associated with Utah's load growth by asserting that the Multi-State Process (MSP) showed that Oregon was not subsidizing Utah load growth. PPL/701/Omohundro/6. The TAM, however, does not work the way the MSP analysis assumes. The MSP studies assume that, as new costs of Utah's load growth are added to rates, Oregon's allocated share of system overhead is reduced. CUB/200/Jenks/21-22. On the other hand, the TAM adds costs associated with Utah's load growth to Oregon's customers, but does not reduce Oregon's allocated share of system overhead on a on-going basis. *Id.* at 22. PacifiCorp's argument does not address the problem we raised.

The last issue we highlight is the problem of using pretend market purchases to represent the actual use of new resources that are not yet in the Company's ratebase. Here the TAM "update" is not an update at all, but a phantom cost. Staff implicitly agrees that this is a problem, because Staff recommends using new in-service resources prior to the beginning of effective rate treatment in the annual GRID modeling. Staff/700/Galbraith/18. Even PacifiCorp agreed to this change, but with a set of unclear conditions that were not effectively communicated on the record.

For its part, Staff's ultimate argument in favor of applying TAM to residential customers is that "[o]nce stakeholders and the Commission have gone to the trouble of reviewing the prudence and reasonableness of the company's projected NVPC it makes sense to update the cost-of-service rates for all customers, not just those eligible for direct access." Staff/700/Galbraith/17. Besides admitting that the TAM process is a trouble for stakeholders, Staff does not argue a reason that TAM <u>should</u> be applied to residential arguments. The record is devoid of any policy arguments why the TAM should apply to residential customers, and contains only weak responses to CUB's list of problems and complications.

## IV. Conclusion

There is a very real need for the Commission to more-accurately reflect taxes in utility rates. CUB's tax treatment proposal is consistent with other regulatory tools utilized by the Commission, and does no violence to the Commission's recent historical tax treatment. We think a change is needed to maintain the public's confidence in the Commission's ratemaking obligations. We discover no constitutional or legal bar to implementing CUB's proposal. Indeed, the CUB proposal meets the rational limits test, which we think is the appropriate test, as well as meeting the benefit/burden test. There is every reason to adopt CUB's proposal and no discernable reason to reject it.

Likewise, there is no justification for applying the TAM to residential customers, only arguments that attempt to refute the problems and complexities of the TAM raised by CUB. If applying the TAM to residential customers cannot be proven to provide a benefit to those customers, and the TAM is linked to a number of very real problems, this Commission has no record to support application of the TAM to residential customers.

Respectfully Submitted,
August 4, 2005

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## CERTIFICATE OF SERVICE

I hereby certify that on this 4th day of August, 2005, I served the foregoing Opening Brief 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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