**BEFORE THE PUBLIC UTILITY COMMISSION**

**OF OREGON**

**UE 170 (RECON)**

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| In the Matter of | ) | |
| | ) | POST-HEARING BRIEF OF THE |
| PACIFIC POWER & LIGHT | ) | INDUSTRIAL CUSTOMERS OF |
| (dba PACIFICORP) | ) | NORTHWEST UTILITIES |
| | ) | |
| Reconsideration of Order No. 05-1050. | ) | |
| | ) | |

The Public Utility Commission of Oregon ("OPUC" or the "Commission") identified two discrete issues for reconsideration: 1) whether Senate Bill ("SB") 408 applies to UE 170, and, if so, how it applies; and 2) is the Commission's income tax adjustment unconstitutional? PacifiCorp's (or the "Company") "new" evidence of all the alleged changes in circumstances since the record closed in the evidentiary phase of UE 170 addresses neither of these issues. PacifiCorp has failed to demonstrate that the tax adjustment in Order No. 05-1050 (or the "Order") was inconsistent with SB 408 or resulted in unconstitutional rates. The Industrial Customers of Northwest Utilities ("ICNU") urges the Commission to deny PacifiCorp's request to vacate the tax adjustment for the following reasons:

1. Allowing PacifiCorp to relitigate the tax adjustment on reconsideration would constitute prohibited single issue ratemaking, and unlawfully and arbitrarily depart from the Commission's standard ratemaking process and principles.

2. SB 408 established new policy in Oregon that the Commission should match "taxes collected" and "taxes paid" in setting utility rates, and SB 408's emergency clause required the Commission to implement that policy in UE 170. SB 408's plain language is unambiguous in that respect.

3. PacifiCorp does not propose an alternative as to "how" the Commission should apply SB 408 in this case. The Company merely seeks to provide "updated" evidence that eliminates the tax adjustment. The Commission



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cannot lawfully recognize MidAmerican Energy Holdings Company's ("MEHC") ownership of PacifiCorp or changes to PacifiCorp Holdings Inc.'s ("PHI") tax liability without examining all changes in other costs.

4. PacifiCorp has not demonstrated that the tax adjustment is unconstitutional or violates ORS § 756.040. The Company does not identify any clearly defined constitutional right that the Commission violated and presents no credible evidence that its rates are confiscatory. The Commission's tax adjustment is without question constitutional.

The Commission stated in the Order that it would adopt the tax adjustment even in the absence of SB 408, and PacifiCorp has acknowledged that ordering the tax adjustment "is probably something that [the Commission] could do" without the law. Order No. 05-1050 at 18 n.15; Transcript ("Tr.") 38: 5-6 (Larson). Under these circumstances, PacifiCorp's complaints about the applicability of SB 408 and the need to provide updated evidence are moot. PacifiCorp has filed a new rate case in UE 179, and the Commission is considering the appropriate costs, including income tax expense, to include in rates on a prospective basis in that proceeding. The Commission should deny PacifiCorp's request for reconsideration and allow the parties to move forward with that case. Allowing PacifiCorp to relitigate the tax issue in UE 170 based on "updated" evidence will only establish precedent encouraging utilities that are dissatisfied with a rate order to seek relief based on allegedly changed circumstances.

## BACKGROUND

The Commission granted reconsideration to examine two questions:

1. Does SB 408 apply to this rate case, and, if so, how should it be applied?

2. Did the $16.07 million tax adjustment result in rates that are unconstitutional?

Order No. 05-1254 at 3 (Dec. 19, 2005). Administrative Law Judge ("ALJ") Kathryn Logan ordered the parties to address four issues to resolve the Commission's questions:



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1. Was the Commission required to apply or prohibited from applying SB 408 to this docket?

2. Assume that the Commission could apply SB 408 or "its principles" to this docket. How should SB 408 or "its principles" be applied?

3. Did the $16.07 million tax adjustment result in rates violative of ORS 756.040?

4. What is the appropriate remedy if the Commission should determine to modify the revenue requirement from the original order?

Ruling at 1 (Feb. 3, 2006). ALJ Logan also permitted ICNU to address why the Commission should deny PacifiCorp's deferred accounting application in UM 1229. Id. ICNU addresses these questions below.

## ARGUMENT

### I. The OPUC Was Required to Apply SB 408 in This Proceeding

The Commission granted reconsideration in part to "ensure that PacifiCorp, along with the other parties, will have a full and fair opportunity to comment on the meaning and implementation of [SB 408]." Order No. 05-1254 at 2. After having the opportunity to thoroughly review SB 408 and its legislative history, PacifiCorp's arguments that the Commission was prohibited from applying the law are no more persuasive than when the Company first requested reconsideration. SB 408 is an unequivocal legislative directive that the mismatch between "taxes collected" and "taxes paid" that resulted under the stand-alone methodology is unacceptable, and the statute's emergency clause demonstrates that the legislature intended the Commission to correct that mismatch immediately. PacifiCorp presents no new arguments that SB 408's plain language prohibited the Commission's action in UE 170, and its selective citation of the legislative history is unconvincing. Finally, the Company refuses



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to recognize the distinction between the Commission's implementation of SB 408's policies and its implementation of an automatic adjustment clause, which will happen in the future.

### A. SB 408's Plain Language Provides That Rates Should Reflect the Actual Taxes Paid to Government to Be Fair, Just, and Reasonable

The legislature explicitly found in passing SB 408 that "[u]tility rates that include amounts for taxes should reflect the taxes that are paid to units of government to be considered *fair, just and reasonable*," and the plain language of SB 408 provides that "[t]he Commission may not authorize a rate or schedule of rates that is not *fair, just and reasonable*." SB 408 §§ 2(1)(f), 5(1)(a) (emphasis added). The Commission correctly determined in Order No. 05-1050 that this language required it to implement SB 408 immediately. Order No. 05-1050 at 17. The Oregon Attorney General has since confirmed the Commission's interpretation, stating that the "identical words" in sections 1 and 5 provide that "*in setting utility rates*, the Commission generally must strive to include amounts of taxes in rates only to the extent that those amounts reflect taxes that are received by units of government from the regulated utility or from the affiliated group of which the utility is a member." Op. Att'y Gen. at 12 (Dec. 27, 2005) (emphasis added). Setting fair, just, and reasonable rates that reflect the amount of taxes paid is exactly what the Commission did in Order No. 05-1050. Order No. 05-1050 at 17.

PacifiCorp's argument that including "fair" in ORS § 757.210 did not change the Commission's just and reasonable standard misses the point. PacifiCorp Opening Brief at 3. SB 408 clarified that the just and reasonable standard requires a matching of taxes collected with the amount of taxes paid. PacifiCorp disregards the connection between SB 408's legislative findings and the amendment to ORS § 757.210. The meaning of the two provisions read together is unambiguous.



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### B. PacifiCorp's Selective Citation of Legislative History Fails to Demonstrate That the Commission Was Prohibited from Applying SB 408

PacifiCorp's reliance on legislative history to support its argument that adding "fair" to ORS § 757.210 did not require the Commission to take immediate action also is unpersuasive. The Commission has already found that "there is nothing in the legislative history to indicate the intent of the legislature when it added ['fair']" to ORS § 757.210. Order No. 05-1050 at 17. The legislative history that PacifiCorp cites does not change that conclusion.

#### 1. SB 408 Did Not Change the Ratemaking Process or Oregon's Income Tax Policy but It Did Require the Commission to Align Taxes Collected with Taxes Paid

To support its claim that SB 408 did not require an immediate change to the income tax costs included in fair, just, and reasonable rates, PacifiCorp cites Representative Boquist's statement that SB 408 did not "change the original ratemaking process." PacifiCorp Opening Brief at 4 (quoting Chamber Session on SB 408, House Chamber, 73d 1eg., Regular Sess. (July 30, 2005) (Statement of Rep. Brian Boquist). Representative Boquist referred only to the OPUC's ratemaking *process*, however, and there is no dispute that the process did not change. The fact that SB 408 did not change the ratemaking process does not mean that it did not immediately require the Commission to authorize recovery of only the costs of income taxes that would be paid to the government.

PacifiCorp also misrepresents the legislative memorandum that ICNU and the Citizens' Utility Board ("CUB") prepared to correct the utilities' previous misrepresentations about SB 408. Id. at 5. PacifiCorp quotes the following passage:

> [T]here have been serious misrepresentations about SB 408-C. Yet 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



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> 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 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 and is not a reaction to the Enron bankruptcy, although customers do not want that situation to occur again.

PacifiCorp Opening Brief at 5; PPL/1703, Larson/6; Application for Reconsideration at 2. Despite PacifiCorp's claims, this memorandum actually confirms that SB 408 changed the income tax expense that the Commission could include in fair, just, and reasonable rates. The statement that "[n]othing in utility ratemaking is changed" merely confirms that SB 408 did not change the OPUC's ratemaking *process*. Within that process, however, SB 408 required the Commission to consider the amount of actual taxes paid in setting rates.

The statement that "[n]othing in tax policy is changed" merely confirms that SB 408 did not change Oregon's tax code or income tax policy. The statements that SB 408 is a moderate approach to addressing the mismatch between taxes paid and taxes collected indirectly refer to a different approach first suggested in SB 171, which would have amended the Oregon tax code to prohibit public utilities from filing consolidated income tax returns.[1/] See, e.g., Work Session on SB 171, Sen. Bus. and Economic Development Comm., 73d Leg., Regular Sess., Exh. E at 1 (Apr. 7, 2005). PacifiCorp and PHI opposed this concept on the basis that it would

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1/ The memorandum also makes clear that SB 408 was more moderate than certain groups' suggestions to require utilities to refund any differences between taxes collected and taxes paid over the past several years. ICNU is not aware that PacifiCorp has publicly provided information indicating the amounts, if any, by which its taxes collected differed from taxes paid from 1997-2001, but it has been reported that PGE has collected more than $800 million since 1997 that was never paid to taxing authorities. When considered in terms of these amounts, the Commission's tax adjustment is moderate by any measure.



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have established a discriminatory tax policy for Oregon. See, e.g., Work Session on SB 171, Sen. Bus. and Economic Development Comm., 73d Leg., Regular Sess., Tr. 17-18 (Mar. 24, 2005) (Statement of Kevin Lynch, Representative of PHI).

PacifiCorp fails to discuss other relevant legislative history. For example, PacifiCorp ignores the statements in the ICNU-CUB memorandum that most directly address the question at issue in this proceeding: "Is it a change from the current practice? Yes. But that's the point." PPL/1704, Larson/1. In addition, PacifiCorp does not mention that the Legislature rejected certain amendments to SB 408 that would have limited the immediate policy change. For example, the Legislature did not adopt a proposed amendment to SB 408's preamble that stated, "Nothing in this section creates any claim for relief," as well as an amendment that stated, "Utility rates that include amounts for taxes should, *over time*, reflect the taxes that are actually received by units of government to be considered fair, just and reasonable." Public Hearing on SB 408, House Comm. on St. and Fed. Affairs, 73d Leg., Regular Sess., Exh. E at 2 (June 30, 2005); Work Session on SB 408, House Comm. on St. and Fed. Affairs, 73d Leg., Regular Sess., Exh. B at 3 (July 15, 2005) (emphasis added). The legislature's rejection of language that limited SB 408's immediate effect demonstrates that the Commission correctly implemented the policy change in setting rates in UE 170.

**2. Adding "Fair" to ORS § 757.210 Does Not Protect the Utilities**

PacifiCorp's selective citation of legislative history also does not support the Company's claim that the "real" reason that "fair" was added to ORS § 757.210 was to "ensure that SB 408 was read in conjunction with ORS 756.040, which protects utilities against rate reductions that violate the Hope standard." PacifiCorp Opening Brief at 5. First, none of the



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statements that PacifiCorp quotes from the legislative history refer to ORS § 756.040 or even suggest that "fair" was added to ORS § 757.210 to ensure that SB 408 and ORS § 756.040 are read together.

Second, prohibiting rates that are not fair, just, and reasonable protects customers just as much as the utility. Despite PacifiCorp's claims, the fair, just, and reasonable standard does not exist to protect utilities against downward rate adjustments. The Commission lacked authority to approve rates that were not fair, just, and reasonable prior to SB 408. The fact that SB 408 explicitly precludes that action merely confirms that lack of authority.

Third, PacifiCorp's argument that the legislature amended ORS § 757.210 as a means of specifically referring to ORS § 756.040 is nonsensical. The legislature did not amend ORS § 756.040 to include the "fair, just, and reasonable" language that it included in sections 1 and 5 of SB 408, and SB 408 does not refer to ORS § 756.040. The Commission should presume that the legislature would have added a specific reference to ORS § 756.040 if it had intended to include one in SB 408 rather than drawing the irrational conclusion that the legislature indirectly referred to one statute (ORS § 756.040) by inserting the word "fair" in another (ORS § 757.210). See Bayridge Ass'n Ltd. Partnership v. Dep't of Revenue, 321 Or. 21, 31 (1995). Inserting a reference to ORS § 756.040 where one does not exist runs afoul of basic rules of statutory construction. ORS § 174.010.

Fourth, PacifiCorp reduces ORS § 756.040 to a singular purpose that does not reflect the overall intent. ORS § 756.040 enumerates the Commission's general powers:

> In addition to the powers and duties now or hereafter transferred to or vested in the Public Utility Commission, the commission shall represent the customers of any public utility . . . and the public generally in all controversies respecting rates, valuations, service



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> and all matters of which the commission has jurisdiction. In respect thereof the commission shall make use of the jurisdiction and powers of the office to protect such customers, and the public generally, from unjust and unreasonable exactions and practices and to obtain for them adequate service at fair and reasonable rates.

PacifiCorp's claim that the purpose of ORS § 756.040 is to protect utilities against rate reductions that violate Hope ignores the statute's plain language. ORS § 756.040 explicitly requires the Commission to represent and *protect* customers in all matters. PacifiCorp focuses on language that the 2001 legislature added to ORS § 756.040, requiring the Commission to balance the interests of customers and the utility in setting rates:

> The commission shall balance the interests of the utility investor and the consumer in establishing fair and reasonable rates. Rates are fair and reasonable for the purposes of this subsection if the rates provide adequate revenue both for operating expenses of the public utility…and for capital costs of the utility, with a return to the equity holder that is:
>
> (a) Commensurate with the return on investments in other enterprises having corresponding risks; and
>
> (b) Sufficient to ensure confidence in the financial integrity of the utility, allowing the utility to maintain its credit and attract capital.

The language in ORS § 756.040 stating what constitutes "fair and reasonable" rates is strikingly similar to the legislature's finding in SB 408 § 2(1)(f) that rates "should reflect the taxes that are paid to units of government to be considered fair, just, and reasonable." This parallel supports the Commission's finding that it was required to give immediate effect to the legislature's findings in setting fair, just, and reasonable rates in UE 170.



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### C. Sections 1 and 5 of SB 408 Took Effect Immediately, but Section 3 Applies to Taxes Collected and Taxes Paid After January 1, 2006

The Commission correctly recognized in Order No. 05-1050 that it was required to implement certain of SB 408's provisions immediately upon passage, but that it could not implement other provisions until later. Order No. 05-1050 at 17. PacifiCorp refuses to recognize this distinction, arguing that: 1) the Commission could authorize changes to rates based on income taxes only through a SB 408 automatic adjustment clause; and 2) the automatic adjustment clause applies only to taxes collected in rates and taxes paid after January 1, 2006.

PacifiCorp essentially tries to force the tax adjustment into a box that does not fit the Commission's actions. The Commission did not adjust rates in UE 170 based on comprehensive implementation of a SB 408 automatic adjustment clause and it could not possibly have done so. The Commission heeded an explicit legislative directive that utility rates should reflect the amount of taxes paid to the government and relied on the consolidated tax adjustments that ICNU and CUB had proposed even before the legislature enacted SB 408. The Commission should not vacate its Order simply because PacifiCorp disagrees with SB 408's policy.

PacifiCorp claims that Order No. 05-1050 "violates section 4(2) of SB 408" because it "adjusted pre-2006 rates based on pre-2006 data." PacifiCorp Opening Brief at 7. SB 408 § 4(2) provides:

> If an automatic adjustment clause is established under section 3 of this 2005 Act, notwithstanding any other provision of section 3 of this 2005 Act, the automatic adjustment clause shall apply only to taxes paid to units of government and collected from ratepayers on or after January 1, 2006.



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By its express terms, this section only applies if the Commission establishes an automatic adjustment clause under section 3 of SB 408. The Commission did not establish an automatic adjustment clause in UE 170, it could not possibly have had the record to do so, and the limitations on SB 408 automatic adjustment clauses are irrelevant to the express language in sections 1 and 5. PacifiCorp seeks to arbitrarily project the limitations in SB 408 § 4(2) on all other provisions of the law.

The fact that parties agreed, as a compromise in the AR 499 workshops, that the SB 408 tax reports filed in 2005 and 2006 are for the sole purpose of determining whether the automatic adjustment clause is triggered only confirms that PacifiCorp's arguments are far off the mark. PacifiCorp Opening Brief at 6. The tax reports required under SB 408 § 3 provide the basis for establishing and implementing an automatic adjustment clause, but they have nothing to do with the Commission's adjustment in Order No. 05-1050.

PacifiCorp's argument regarding the "potential broad implications" of adjusting rates independent of the automatic adjustment clause presumes that the Commission will act arbitrarily. Id. at 7. The Commission did not conclude in UE 170 "that it has essentially limitless authority under section 5 of SB 408 to apply an actual-taxes standard to any utility at any time in any manner," nor did it indicate that it will arbitrarily construe or apply its authority in that manner in the future. Id.

### D. The Commission Has the Discretion to Implement SB 408 Through Rulemaking, Adjudication, or Both

PacifiCorp's argument that the Commission cannot apply SB 408 until it adopts application standards mischaracterizes Oregon law and, once again, assumes that the Commission could lawfully give effect to SB 408 only by implementing an automatic adjustment



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clause.[2/] Id. The Commission has discretion to implement SB 408 through rulemaking, adjudication, or both. Regardless of that discretion, however, generally applicable rules governing SB 408 were unnecessary in UE 170, because the Commission ordered a fact-specific disallowance based on the evidence in the record.

PacifiCorp argues that the Commission cannot apply SB 408 or its principles prior to adopting formal rules, in part, because SB 408 delegates to the Commission policymaking discretion regarding certain terms. Id. at 7-8. According to the Company, the Commission could not lawfully adjust the income tax expense in rates to align taxes collected with taxes paid without specifically defining "taxes collected," "taxes paid," and "properly attributed," or determining how to implement SB 408's other adjustments to these amounts. Id. at 12.

First, SB 408 delegates to the Commission policymaking discretion in interpreting and applying terms that are necessary to implement an automatic adjustment clause, which the Commission did not do in UE 170.

Second, PacifiCorp's summaries of Trebesch v. Employment Division and Megdal v. Board of Dental Examiners mischaracterize Oregon law regarding required agency rulemaking. Id. at 8 (citing 300 Or. at 270 and 288 Or. 293, 304-16 (1980)). PacifiCorp cites Trebesch for the proposition that "prior rulemaking [is] required before [a] policymaking term in [a] statute is applied in a contested case hearing"[3/] and Megdal for "implied legislative intent that terms delegating policymaking discretion be examined by rule, not by contested case hearing."

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[2/] There are two primary ways for an agency to adopt "application standards" to implement a law that the agency administers: 1) rulemaking; and/or 2) adjudication in contested cases. Trebesch v. Employment Div., 300 Or. 264, 273 (1985); PacifiCorp Opening Brief at 7. Given that PacifiCorp challenges the OPUC's application of SB 408 in a contested case, the Company apparently claims that the Commission was required to adopt "application standards" through rulemaking.

[3/] It is unclear if PacifiCorp claims that this was the holding in Trebesch or a particular rule of law stated in that case, but both arguments are incorrect.



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Id. (citing Trebesch, 300 Or. at 270, Megdal, 288 Or. at 304-16). The Trebesch court specifically rejected both of these points, stating that the "implied intent" in "Megdal does not mean that all terms delegating policymaking discretion can be applied only after rulemaking" and clarifying that Megdal was a fact-specific decision. Trebesch, 300 Or. at 270. Furthermore, the Trebesch court did not even find that rulemaking was required to implement the statute at issue in that case. Id. at 273.

Contrary to PacifiCorp's suggestion, Oregon has not adopted a bright line rule requiring rulemaking to implement a statute. In fact, Trebesch specifically states that "[a]gencies generally may express their interpretation of the laws they are charged with administering either by adjudication or by rulemaking, or both." Id. Furthermore, the fundamental rule in Trebesch is that, absent an explicit requirement to adopt rules, whether a statute allows implementation through rulemaking or adjudication is a case-specific decision based on: 1) the character of the statutory term in dispute; 2) the authority delegated and the tasks assigned to the agencies; and 3) the structure by which the agencies execute their tasks. Id. at 270.

SB 408 does not explicitly require the Commission to adopt rules to implement the law and provides no other basis to depart from the general rule that the Commission may implement the law through rulemaking and/or adjudication. Indeed, the Commission has implemented other statutes that delegate interpretative and policy making functions through both adjudication and rulemaking. See, e.g., OAR § 860-027-0300, Re PGE, OPUC Docket UM 1071, Order No. 04-108 (Mar. 2, 2004); Re Staff Request to Open an Investigation Related to Deferred Accounting, OPUC Docket No. UM 1147, Order No. 05-1070 at 3 (Oct. 5, 2005) (establishing procedural and substantive requirements governing deferred accounting under



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ORS § 757.259); see also OAR § 860-027-0200, Re Oregon Electric Utility Co., OPUC Docket UM 1121, Order No. 05-114 (Mar. 5, 2005), and Re Investigation into the Legal Standards for Approval of Mergers, OPUC Docket No. UM 1011, Order No. 01-778 (Sept. 4, 2001) (establishing procedural and substantive requirements for applications regarding acquisitions of energy utilities under ORS § 757.511). Neither the character of the terms in SB 408, the authority and tasks assigned to the Commission, nor the structure by which the OPUC will execute those tasks provides any basis to restrict the Commission's implementation of SB 408 to rulemaking. Trebesch, 300 Or. at 270. Order No. 05-1050 is merely the Commission's first decision interpreting and implementing SB 408's policy.

## II. The Commission Should Apply SB 408 or "Its Principles" in the Manner Ordered in Order No. 05-1050

The Commission's order granting reconsideration asked: "Does Senate Bill 408 apply to this rate case, and, if so, how should it be applied?" PacifiCorp's primary argument that SB 408 does not apply is incorrect. With respect to the question about "how" SB 408 should apply if it does, however, PacifiCorp merely seeks to present "new" evidence that allegedly is "the most accurate and up-to-date information possible" rather than offering a specific proposal. PacifiCorp Opening Brief at 16. The Commission did not grant reconsideration based on new evidence and did not solicit evidence of the changed circumstances since the record closed in UE 170. Order No. 05-1254 at 2. The Commission should reject the Company's attempt to relitigate the income tax expense issue.

PacifiCorp requests that the Commission: 1) eliminate the tax adjustment because Berkshire Hathaway allegedly will pay PacifiCorp's full stand-alone income tax liability to government under MEHC ownership; or 2) reduce the adjustment to $0.7 million based on



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evidence of changed circumstances regarding taxes paid by PHI. These arguments fail as a matter of policy, fact, procedure, and the plain meaning of SB 408.

### A. Adjusting Tax Expense Based on MEHC Ownership is Arbitrary and Unlawful

PacifiCorp asks the Commission to drastically and unlawfully depart from the standard ratemaking process by adjusting income tax expense based on a MEHC ownership scenario that the Company admits became "known and measurable" only well after the Order in UE 170. PacifiCorp Opening Brief at 13. MEHC completed its acquisition of PacifiCorp on March 21, 2006. This was eight months after the record closed in UE 170, six months after the Commission issued Order No. 05-1050, and five months after PacifiCorp requested reconsideration. Recognizing MEHC ownership for purposes of PacifiCorp's income tax expense constitutes unlawful single issue ratemaking, is unsupported by the evidence in the record, and is inconsistent with the Company's argument in its Washington rate case that MEHC ownership was not a known and measurable change. Many of PacifiCorp's costs other than income taxes may have changed since the record closed in UE 170, but none of these changes have been addressed here because they are more properly addressed in UE 179.

#### 1. Updating One Set of Costs on Reconsideration Violates the OPUC's Ratemaking Process

The Commission has described its role in setting rates as follows:

> A basic premise of utility regulation is that when the Commission prescribes or approves a utility's rates, it does so according to the rules of rate setting in a rate case. If it follows those court-prescribed rules in the review of a utility's proposed rates, its job is finished, until the next rate case. All the Commission is obliged or authorized to do is prescribe or approve rates which, in the context of the application of rate case principles in the case only, provide



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> the utility with an opportunity to earn a reasonable return on property used and useful in presently providing service.
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> As every utility scholar knows and declares: The rate case decision must provide the opportunity only, no promises, no guarantees. This means that once a rate case is completed and rates are set which, by the court standards, provide the opportunity, it makes no difference what actually happens from then on. The reasonableness of the rates under consideration is judged at an instant in time - namely, the rate case decision.

Re PGE, OPUC Docket Nos. UE 47/UE 48, Order No. 89-687 at 8 (May 24, 1989) (internal citations omitted).

PacifiCorp's proposal drastically departs from setting rates based on an instant in time in favor of adopting test year costs that span two different owners and changes in circumstances that occurred well after the evidentiary record closed. Such a process is unlawful:

> A utility is not entitled to segregate costs and revenues relating to its revenue requirement for future rates and insist that their allowability be judged on different bases. There is one appropriate adjusted test period on which to base future rates . . . . A company cannot, in effect, preclude the Commission from examining all relevant costs and offsets to costs by separating a case into several parts.

Id. at 7.

Recognizing MEHC ownership would violate the "rules of rate setting in a rate case" and completely undermine the evidentiary record upon which the Commission approved PacifiCorp's other costs. Id. PacifiCorp's UE 170 filing was based on a 2006 test year under the Scottishpower/PHI structure, and none of the costs authorized for recovery in UE 170 reflect MEHC ownership. Including income tax costs in rates assuming MEHC ownership but establishing all other costs based on ScottishPower/PHI is inherently arbitrary and unlawful. In fact, establishing income tax expense based on different assumptions than all other costs is



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particularly inappropriate, because PacifiCorp's income tax liability ultimately is a product of the revenues that the Company collects through rates. Under PacifiCorp's proposal, the amount of income tax expense in the Company's rates would be completely divorced from the Company's other costs.

**2. Updating PacifiCorp's Income Tax Expense Without Examining Other Expenses Constitutes Prohibited Single Issue Ratemaking**

A fundamental assumption in the ratemaking process is that the Commission examines all utility costs simultaneously. "Updating" income tax expense in isolation violates the Commission's prohibition against single issue ratemaking:

> To determine the total revenue requirement, the Commission is required to consider all aspects pertinent to the utility's operations. This is the rule against single-issue [rate]making. Recognizing that the revenue formula used in ratemaking is designed to determine the revenue requirement based on the aggregate costs and demand faced by a utility, the rule appreciates that a change in one item of the revenue formula may be offset by a corresponding change in another component of the formula. Consequently, the rule makes it improper to consider any change to components of the revenue requirement in isolation.

Re PGE, OPUC Docket Nos. DR 10/UE 88/UM 989, Order No. 04-597, Appendix A at 17 (Oct. 18, 2004) (internal citations omitted). If the Commission intends to examine the impact of MEHC ownership on income tax expense, then establishing fair, just, and reasonable rates requires considering the change in PacifiCorp's other costs as well. One known change is MEHC's agreement to provide $142.5 million in rate credits to customers. ICNU does not suggest that the Commission reopen UE 170 to determine the impact of MEHC ownership. PacifiCorp's prospective costs under MEHC ownership is an issue to determine in UE 179. It would be arbitrary, inequitable, and unlawful, however, to set rates that recognize a change in



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income tax expense as a result of MEHC ownership but do not recognize all other currently known and measurable changes.

### 3. PacifiCorp Claimed That MEHC Was Not a Known and Measurable Change in January 2006 in Washington

PacifiCorp's claim that MEHC ownership is known and measurable lacks credibility. The Company argues in this proceeding that MEHC ownership was known and measurable as of January 2006 for purposes of adjusting income tax expense. Transcript ("Tr.") at 11:6 (Larson). During the January 11, 2006 oral argument in the recent Washington rate case, however, PacifiCorp's counsel stated that considering MEHC ownership in setting rates in that case "virtually abandons the known and measurable requirement that has guided utility rate-making not only before [the WUTC], but throughout the country." ICNU/602 at 11-12. The Commission should not reward PacifiCorp's doubletalk with an after-the-fact adjustment to the disallowance ordered in UE 170.

### 4. The Commission Lacks Sufficient Evidence to Determine PacifiCorp's Income Tax Expense Under MEHC Ownership

The record on reconsideration also is insufficient to support any change based on MEHC ownership. PacifiCorp has alleged that Berkshire Hathaway will be the relevant taxpayer in the consolidated group for PacifiCorp under MEHC ownership, but the record lacks any "hard" evidence supporting that claim. Tr. 70:6-7, 91:4-16 (Selecky). PacifiCorp has claimed that Berkshire Hathaway's income tax liability will exceed $3 billion, but there is no supporting evidence for that fact either. Tr. 29:12 (Larson). The record contains no evidence depicting the Berkshire Hathaway corporate structure, no documentation regarding the treatment of debt by Berkshire Hathaway, and no evidence regarding Berkshire Hathaway's consolidated tax returns.



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Tr. 70:8-12 (Selecky). PacifiCorp cites a number of ICNU witness James Selecky's responses to inquiries about the theoretical impact of MEHC on PacifiCorp, but Mr. Selecky specifically pointed out that there was no basis to conclude that the claimed impacts would occur and that PacifiCorp had not provided "any kind of evidence supporting" those impacts. PacifiCorp Opening Brief at 14-15; Tr. 69-70 69:20 – 70: 12 (Selecky). Furthermore, the PacifiCorp witness that testified about the Berkshire Hathaway income taxes for 2006 obtained the data he used from Berkshire Hathaway's 2005 10-k, but he was unaware of details regarding the sources for interest, dividend, and other investment income of Berkshire Hathaway. ICNU/607. Such a record lacks substantial evidence to support any finding regarding PacifiCorp's income taxes under MEHC ownership.

### B. PacifiCorp Failed to Provide Evidence During the Rate Case Regarding the Appropriate Consolidated Tax Expense Under PHI

PacifiCorp also requests that the Commission recognize changed circumstances under PHI that essentially would eliminate the tax adjustment. Again, such a selective update to one cost long after the Commission approved all other costs amounts to prohibited single issue ratemaking and undermines the ratemaking process. As PacifiCorp witness Doug Larson noted, "there are probably a whole myriad of events that have changed" since the Order. Tr. 19:2-3 (Larson). There must be some finality to the costs that the Commission uses to set rates to help ensure procedural fairness in OPUC proceedings.

The record demonstrates that PacifiCorp could have raised certain of the alleged changed circumstances in the evidentiary phase but did not do so. For example, PacifiCorp claims that the Order does not reflect that ScottishPower is subject to a 30% tax rate in CY 2006 following passage of the UK Finance Act of 2005. PacifiCorp Opening Brief at 17. Even if UK



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tax law was relevant, PacifiCorp neglects to mention that these provisions of the UK Finance Act of 2005 took effect on March 16, 2005, and the Company could have provided information on this tax rate long before the Order. Staff/1003 at 1. Furthermore, it appears that a "UK Finance Act" establishing annual income tax rates must be passed each year in the United Kingdom, which only demonstrates why utility rates are based on circumstances at an instant in time. Even if the Commission accepted PacifiCorp's argument and ScottishPower still owned PacifiCorp, it could never be certain that the relevant tax rate would not change the next year.

PacifiCorp also suggests that the Commission use relative taxable income to determine PacifiCorp's share of the PHI tax benefit. PacifiCorp Opening Brief at 16. PacifiCorp made the same argument in sur-surrebuttal testimony in UE 170, and the Commission obviously rejected it in favor of CUB's proposed allocation. PPL/1301, Martin/8. Reconsideration is not a forum to urge the Commission to consider the same evidence and legal arguments to make a different ruling. Re Verizon Northwest, Inc., OPUC Docket No. UD 13, Order No. 02-639 at 4 (Sept. 12, 2002). The Commission should reject PacifiCorp's efforts to relitigate the issues simply because the Company disagrees with the Order.

### C. The Commission Is Not Required to Demonstrate a "Need" to Implement SB 408

PacifiCorp wrongfully claims that "the Commission has no authority under SB 408 to make a tax adjustment unless substantial evidence exists to demonstrate that it is necessary to align taxes collected with actual taxes paid." PacifiCorp Opening Brief at 12. This "need" to justify the Commission's decision is not found in SB 408 or any other Oregon law. PacifiCorp maintains that the Attorney General found that the Commission's discretion in implementing SB 408 "is bounded by the need to effectuate the policy of aligning paid taxes



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with taxes collected," but the Attorney General did not identify such a "need." Id. The Attorney General found that SB 408 established a policy of aligning taxes collected and taxes paid and that the Commission must interpret and implement SB 408 in accordance with that policy. Op. Att'y Gen. at 2, 11-12.

Even if PacifiCorp were correct, however, ICNU and CUB provided evidence demonstrating that, due to the PHI interest deduction, the Company would collect amounts for taxes under the test year filing that would substantially exceed the amount paid to government. This evidence illustrates the "need" to order an adjustment to fulfill SB 408's policy goals and provides "substantial evidence" to support the Commission's decision.

## III. The $16.07 Million Adjustment Did Not Result in Rates that are Unconstitutional

The second issue that the Commission identified for reconsideration is whether "the $16.07 million tax adjustment results in rates that are unconstitutional" or violate the "fair, just, and reasonable" standard in ORS § 756.040.[4/] Order No. 05-1254 at 3. PacifiCorp has failed to articulate any clearly defined constitutional or statutory injury in this respect.

### A. PacifiCorp Fails to Identify a Violation of a Clearly Defined Constitutional Right

In assessing the constitutionality of utility rates, the courts examine the "total effect of the rate order" and not the methodology by which the rate was established or the

[4/] The specific question that the Commission posed in the ordering provisions granting reconsideration is whether "the $16.07 million tax adjustment results in rates that are unconstitutional." Order No. 05-1254 at 3. Other statements in the order granting reconsideration as well as the ALJ's ruling regarding the issues frame this question as whether the rates violate ORS § 756.040 or are not "fair, just, and reasonable." The statutory and constitutional standards are not equivalent. A rate may not be fair, just, and reasonable for any number of reasons, but the primary reason for constitutional concern regarding utility rates is whether they are confiscatory.



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individual components of the rate. Fed. Power Comm'n v. Hope, 320 U.S. 591, 602 (1944). Thus, the tax adjustment by itself cannot be unconstitutional; it is the overall rate that is at issue.

PacifiCorp implies that the Company's rates are unconstitutional because the adjustment violates the ratemaking matching principle. PacifiCorp Opening Brief at 18. The matching principle is at best, as Mr. Selecky described, a "general theme of ratemaking." It is not found in Oregon statute and certainly has no bearing on whether rates are constitutional.

PacifiCorp also suggests that an asymmetrical approach to ratemaking raises constitutional concerns, but the Company does not identify those concerns. PacifiCorp Opening Brief at 18. PacifiCorp refers to the Attorney General's discussion of principles that the U.S. Supreme Court discussed in *dicta* in Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989). The Supreme Court said that "a State's decision to arbitrarily switch back and forth between methodologies in a way which required investors to bear the risk of bad investments at some times while denying them the benefit of good investments at others would raise serious constitutional questions." Duquesne, 488 U.S. at 315. The Supreme Court has subsequently explained the meaning of this *dicta*: "In other words, there may be a taking challenge distinct from a plain-vanilla objection to arbitrary or capricious agency action if a rate making body were to make opportunistic changes in rate setting methodologies just to minimize return on capital investment in a utility enterprise." Verizon Communications, Inc. v. FCC, 535 U.S. 467, 527 (2002) (internal footnotes omitted). Hence, the "constitutional questions" referred to in Duquesne would only arise if the Commission adopted a methodology that was "arbitrary, opportunistic, or undertaken with a confiscatory purpose." Id. at 528. The argument about



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Duquesne violations emerged in the fight against SB 408 in the legislature and has persisted in this proceeding and others despite the fact that it plainly prohibits arbitrary and punitive action.

**B. PacifiCorp's 10% Return on Equity is Far From Confiscatory**

PacifiCorp claims that the tax adjustment effectively results in an 8.4% return on equity ("ROE"), which allegedly is 160 basis points below the Company's authorized ROE and will prevent it from having a reasonable opportunity to earn its approved return. PacifiCorp Opening Brief at 18. PacifiCorp's authorized ROE is 10%, and this is separate from the costs included in revenue requirement. The costs included in rates must be prudent, used and useful, and otherwise appropriate for recovery, and the Commission determined that income tax costs that would not be paid to government were inappropriate for recovery based on SB 408's policies. PacifiCorp's claim that it effectively received an 8.4% ROE ignores these principles.

Even accepting PacifiCorp's claims for the sake of argument, however, the Company provides no legal basis to conclude that an 8.4% ROE is unconstitutional or unjust and unreasonable. An 8.4% ROE is at the low end of the range of the ROE analysis performed by ICNU, CUB, and Staff. See, e.g., Staff/200, Morgan/5; CUB-ICNU/400, Gorman/31. In fact, Staff's analysis demonstrated that an 8.4% ROE was within the range of reasonable results for three of its four discounted cash flow models presented. Staff/200, Morgan/5.

PacifiCorp obtained a $25 million revenue requirement increase in UE 170 and final revenue requirement of over $800 million. The implicit rate of return in these rates is commensurate with that in other enterprises with similar risks and sufficient to the Company's financial integrity. One of the most telling indicators of the investment community's concern



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regarding the order is that MEHC continued to aggressively pursue its efforts to purchase PacifiCorp following UE 170. ICNU/212, Selecky/10.

PacifiCorp points to Fitch's downgrade of its credit rating following the Order, but Fitch's report demonstrates that the agency considered multiple factors unrelated to SB 408 or the Order. PPL/321, Williams/1. Although Fitch identifies the regulatory environment as a concern, it also indicates that below normal hydroelectric conditions and exposure to high natural gas prices factored into the downgrade. PPL/321, Williams/1. Subsequent Fitch reports identify other concerns. PPL/326, Williams/1. In other words, PacifiCorp would have the Commission view Fitch's ratings in isolation when, in reality, they are the result of a combination of factors. In any event, PacifiCorp was downgraded from A- to BBB+, which is far from indicating that rates are unconstitutionally low.

Standard & Poor's and Moody's have both affirmed PacifiCorp's credit ratings since the Order was issued, and Standard & Poor's removed the Company's ratings from CreditWatch with negative implications. PPL/325, Williams/1; PPL/327, Williams/1. Standard & Poor's also noted the Order's negligible impact from the consolidated perspective: "the pre-tax $26 million disallowance represents about 1% of consolidated cash flows. Thus, the immediate consequences of the rate case are nominal from the consolidated perspective." PPL/322, Williams/4. Furthermore, to the extent that the financial community is concerned about the impact of SB 408, the payment of millions of dollars to a parent company for income taxes that are not paid to government would have a far greater effect on earnings than the tax adjustment. ICNU/212, Selecky/10.



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## IV. The Appropriate Remedy if the Commission Modifies the Revenue Requirement Is to Adopt ICNU's or CUB's Proposed Adjustment

The Commission should affirm the Order for the reasons described above. Nevertheless, the Commission specifically noted that "[a]ssuming, *arguendo*, that we are incorrect in holding that the legislature intended SB 408 to apply to this rate case, we choose to use our discretion and apply SB 408 principles to this rate case." Order No. 05-1050 at 18 n.15. Under these circumstances, if the Commission finds that SB 408 does not apply, the proper remedy is to adopt the adjustment that either ICNU or CUB proposed. If the Commission decides to modify the Order and consider new evidence as PacifiCorp suggests, then the only lawful remedy is to fully examine all of PacifiCorp's costs in association with establishing the appropriate level of tax expense.

## V. PacifiCorp's Application for Deferred Accounting is Unjustified According to ORS § 757.259 and the Commission's Deferred Accounting Policies

PacifiCorp's application for deferred accounting related to the petition for reconsideration fails to satisfy ORS § 757.259 or warrant an exercise of the Commission's discretion. OPUC Docket No. UM 1147, Order No. 05-1070 at 2. Allowing PacifiCorp to relitigate the income tax issue in a single-issue reconsideration proceeding, along with authorizing deferred accounting to permit collection of revenue changes due to any modification of the Order, would establish dangerous precedent and poor policy regarding the "finality" of Commission orders. Such a result effectively undermines the statutory presumption that rates are just and reasonable until proven otherwise and that reconsideration does not stay the effectiveness of those rates. ORS §§ 756.565, 756.561(2).



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### A. PacifiCorp's Application Does Not Satisfy ORS § 757.259

PacifiCorp requests deferred accounting under ORS § 757.259(2)(e), which permits deferrals to "minimize the frequency of rate changes or the fluctuation of rate levels or to match appropriately the costs borne by and benefits received by ratepayers." Re PacifiCorp, OPUC Docket No. UM 1229, Application at 3 (Oct. 28, 2005). At the hearing, PacifiCorp's witness Larson admitted that the Company's application was not intended to minimize the frequency of rate changes:

> Q. Is PacifiCorp seeking to defer the amount of a tax disallowance because it will minimize the frequency of rate changes?
>
> A. No.

Tr. 32:14-17 (Larson). Furthermore, Mr. Larson admitted that PacifiCorp had provided no evidence that deferred accounting would match the timing of collecting the tax costs with the "benefit" to customers and stated that deferral actually would result in a "mismatch" in this timing. Tr. 33:8-14 (Larson).

An applicant for a deferred account is responsible for initially producing evidence to support its request and it retains the burden of persuasion throughout the proceeding. OPUC Docket No. UM 1147, Order No. 05-1070 at 5. PacifiCorp admits that: 1) its application does not minimize the frequency of rate changes; and 2) the Company provided no evidence to demonstrate that the application matches appropriately costs and benefits. These are statutory, non-discretionary requirements that all applicants seeking deferred accounting under ORS § 757.259(2)(e) must satisfy. Id. at 2-3. Given that PacifiCorp admits it does not meet these requirements, the Commission should deny the application.



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### B. PacifiCorp's Application Does Not Satisfy the Commission's Discretionary Requirements for Deferred Accounting

The Commission exercises its discretion to authorize deferred accounting according to two inter-related factors: 1) the type of event that caused the request for deferral; and 2) the magnitude of the event's effect. Id. With respect to the type of event, the Commission examines the nature of the event in terms of "stochastic" and "scenario" risks. Id. at 3. Stochastic risks are those that are subject to prediction as part of the normal course of events. Id. Scenario risks are not subject to quantification or prediction. Id.

The Commission considers the magnitude of the event's effect in terms of the financial impact on the utility. For stochastic risks, the financial impact must be "substantial." Id. at 6-7. For scenario risks, the financial impact must be "material." Id.

PacifiCorp has not provided evidence to justify approving the Company's application according to these criteria. An adjustment to rates in a rate order regarding an issue that was litigated in the evidentiary phase of the proceeding is a stochastic risk. It can be predicted as part of the ordinary course of events.

PacifiCorp has not demonstrated a "substantial" financial impact on the Company. The Company has claimed that the order effectively reduces its authorized ROE 160 basis points to 8.4%, but, as described above, that figure unjustifiably assumes that the tax expenses were appropriate for recovery. In an event, the Commission has found that an alleged 172 basis point earnings impact was insufficient to justify deferral of costs related to a "stochastic" event. OPUC Docket No. UM 1071, Order No. 04-108 at 9. Furthermore, the Commission has noted that this impact was far below the 250 basis point deadband that it authorized in UM 995 and that it had authorized Idaho Power to defer excess power costs when



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that utility experienced a 700 basis point impact on earnings. Id. PacifiCorp's claims fall far short of these measures for what constitutes a substantial financial impact.

## CONCLUSION

PacifiCorp has failed to demonstrate that the Commission was prohibited from applying SB 408 or that the tax adjustment was unconstitutional. Granting PacifiCorp's request would be an unjustified, unlawful, and arbitrary departure from the Commission's basic ratemaking principles and process. ICNU urges the Commission to deny PacifiCorp's request to vacate the tax adjustment for all the reasons described in this Brief.

Dated this 15th day of May, 2006.

Respectfully submitted,

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May 15, 2006

***Via Electronic and U.S. Mail***

Public Utility Commission
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Re: In the Matter of PACIFIC POWER & LIGHT Request for a General Rate Increase in the Company's Oregon Annual Revenues
**Docket No. UE 170 RECON**

Dear Filing Center:

Enclosed please find the original and six copies of the Post-Hearing Brief of the Industrial Customers of Northwest Utilities in the above-referenced docket.

Sincerely,

*/s/ Ruth A. Miller*
Ruth A. Miller

Enclosures
cc: Service List

## CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing Post-Hearing Brief of the Industrial Customers of Northwest Utilities, upon the parties on the service list, shown below, by causing the same to be mailed, postage-prepaid, through the U.S. Mail and by email to those parties who have an email address.

Dated at Portland, Oregon, this 15th day of May, 2006.

*/s/ Ruth A. Miller*
Ruth A. Miller

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