STOEL RIVES LLP

ATTORNEYS AT LAW

900 S.W. Fifth Avenue, Suite 2600
Portland, Oregon 97204
main 503.224.3380
fax 503.220.2480
www.stoel.com

KATHERINE A. MCDOWELL
Direct (503) 294-9602
kamcdowell@stoel.com

September 13, 2005

VIA EMAIL

Commission Chair Lee Beyer
Commissioner Ray Baum
Commissioner John Savage
Public Utility Commission of Oregon
PO Box 2148
Salem, OR 97308-2148

Re: AR 498 – In the Matter of the Adoption of Temporary Rules to Implement SB 408

Dear Commissioners:

PacifiCorp appreciates Staff's efforts in preparing draft temporary rule OAR 860-022-0039 to implement Senate Bill 408's reporting requirement, particularly under the tight timelines dictated by the October 15, 2005 reporting deadline. For the reasons explained below, PacifiCorp respectfully requests that the Commission revise or delete as unnecessary certain portions of Staff's proposed temporary reporting rule. These revisions are outlined in the attached redline version of OAR 869-022-0039.

I. General Comments About SB 408 and the Proper Scope of AR 498.

The Commission has been given a difficult but necessary task in this rulemaking as well as in AR 499. Governor Kulongoski, in a letter dated September 2, 2005 accompanying his signature of SB 408, noted that the bill "does not address many of the concerns raised by various stakeholders during numerous public hearings, work sessions and other meetings on [the] subject" and does not incorporate changes that would have ensured that the bill "could be successfully defended against a legal challenge on constitutional grounds." The Governor warned that unintended consequences from SB 408 could undercut the goal of ensuring "the lowest possible rates for consumers in Oregon, while also creating a stable and investment worthy environment for utilities, preferably an environment that encourages Oregon as the headquarters for businesses, including utilities."

As the Governor observed, SB 408 "defers many of the difficult questions about the impact and implementation of SB 408 to the Oregon Public Utility Commission (OPUC)." Thus, the Commission now has the responsibility for addressing concerns ignored in the legislation, avoiding unintended consequences that could undercut the economy of the State and

acknowledging and addressing the myriad of constitutional, legal and administrative issues raised by implementation of SB 408.

The Commission can succeed in these tasks only if it reviews and implements SB 408 deliberately and carefully, with the benefit of significant stakeholder involvement. For this reason, PacifiCorp expressed its concern to Staff in August about the scope of any proposed temporary rules under SB 408, urging that the rules address only that which was clearly necessary to implement SB 408's reporting requirement and not prejudge issues relating to SB 408's automatic adjustment clause. SB 408's reporting requirement takes effect in October 2005, but the balance of the bill applies only to taxes collected and paid after January 1, 2006.

PacifiCorp also noted that this result was required by the legal standard for issuance of temporary rules. Under ORS 183.335(5), the Commission may issue temporary rules only to avoid "serious prejudice to the public interest or the interests of parties concerned." This requirement protects the public interest by assuring that, absent extraordinary circumstances, the Commission will adopt administrative rules in an orderly manner that allows for broad public input. *See Multnomah County v. Davis,* 35 Or App 521, 527-28, 581 P2d 968 (1978) (rulemaking procedures are designed to assure broad public input into agency decisions.)

In general, PacifiCorp's proposed revisions to Staff's temporary rule are designed to streamline and limit the rule to only those issues that are absolutely necessary to allow for the filing of tax reports on October 15, 2005 in compliance with SB 408. PacifiCorp urges the Commission to adopt these proposed revisions and defer the broader issues and controversies, particularly the definition of the key term "properly attributed," to the permanent rulemaking docket, AR 499.

II. Specific Revisions to OAR 860-022-0039 Proposed Definitions.

A. The Commission Should Limit Proposed OAR 860-022-0039 to Only Those Issues that Are Absolutely Necessary to Allow for the Filing of Tax Reports on October 15, 2005.

a. In Particular, the Commission Should Delete the Definition of "Properly Attributed" Contained in Proposed OAR 860-022-0039(2) or, in the Alternative, Define It as the Standalone Tax Liability of the Utility.

PacifiCorp disagrees with Staff's definition of "properly attributed" and submits that it is neither an appropriate nor a necessary aspect of the proposed temporary rule. The definition of this term is among the most critical to the interpretation and implementation of SB 408's automatic adjustment clause. At the same time, as long as the tax report contains the amount of taxes paid

by the consolidated group, an amount designated by the utility as properly attributed to regulated operations, the amount of taxes collected in rates, and a full explanation of the calculations used to compute these amounts, a definition of "properly attributed" in the temporary rule is unnecessary to ensure compliance with SB 408's reporting requirement.

In any event, Staff's definition of "properly attributed" departs from the intent of SB 408, which was intended to provide an adjustment in rates when a utility or its consolidated group pays less tax than the utility collects in rates, but not to require an adjustment when a utility or its consolidated group pays more tax than the utility collects in rates. The bill addresses this situation by attributing to each entity in a consolidated group the tax expense generated by its own economic activities (*i.e.,* its standalone tax expense) and capping the amount deemed to be "properly attributed" and "paid" by the utility by the total consolidated tax payment.

Consistent with the legislative history of SB 408, PacifiCorp proposed defining "properly attributed" to mean the utility's standalone tax liability. While Staff acknowledges that PacifiCorp's "attribution approach would remedy the Enron-type situation that proponents of the bill cited," Staff proposes a definition of "properly attributed" that goes much further, allocating a portion of the tax benefit of any losses from individual unregulated affiliates to the utility on a pro rata basis with other affiliates of the consolidated group. Staff's approach to "properly attributed" expands the reach of SB 408 and significantly increases the potential economic, policy and legal risks associated with bill about which the Governor raised concerns. Further, Staff's approach would require the Commission to examine and potentially audit the separate standalone tax expense of each of the non-regulated affiliates in a public utility's consolidated group. Such an approach would expand the Commission's jurisdiction to an unprecedented and possibly unlawful extent.

In addition to these risks, Staff's proposed approach would also produce arbitrary results dependent on the composition of the utility's consolidated group. That is, whether a rate adjustment occurred when a utility's affiliated group pays taxes in excess of the utility's standalone tax expense could depend entirely on whether a utility's affiliates were separate or merged companies. Taking the example cited by Staff in its September 7, 2005 Report, if Affiliate X and Affiliate Y were merged into one corporate entity, the amount of tax paid and properly attributed to the utility is $130. But, if Affiliate X and Affiliate Y remain separate entities, the amount of tax paid and properly attributed to the utility is $100 – this is despite the fact that under either scenario the consolidated group paid $200, the utility's standalone tax expense was $130, and the non-regulated entities' total tax expense was $70. To illustrate:

			Effect if Affiliate X and Y are Merged	
	Standalone Tax Expense	Staff's Proposed "Properly Attributed" Amount	Standalone Tax Expense	Staff's Proposed "Properly Attributed" Amount
Utility	$130	$100	$130	$130
Aff. X	$130	$100	$70	$70
Aff. Y	($60)	$0		
Consolidated Tax Payment	$200	$200	$200	$200

Thus, under Staff's approach, although the consolidated tax actually paid remains the same, the utility's standalone tax expense remains the same, and the amount of the nonregulated affiliates' tax liability remains the same, whether an adjustment occurred could depend entirely on whether the utility's affiliates were separate or merged companies. This irrational outcome demonstrates both the problematic nature of the Staff's proposed definition and the consequences of interpreting key aspects of SB 408 without sufficient public process.

While AR 498 is a temporary rulemaking proceeding, PacifiCorp takes little comfort in Staff's assertion that "these issues, and others relating to the details of the potential automatic adjustment clause, will be further reviewed in the permanent rulemaking, AR 499." In fact, Staff observes that they "..can find no reason why there would be a different interpretation of 'properly attributed' for the tax report than for the automatic adjustment clause."

PacifiCorp's revisions delete the proposed definition of "properly attributed" and modify the list of information to be included in the tax report to include an explanation of the calculations provided in the report. This will provide the Commission and utilities with enough information to meet the October 15, 2005, reporting deadline. Substantive issues, such as the meaning of "properly attributed" can and should be addressed in the permanent rulemaking docket, AR 499.

In the alternative, if the Commission decides to adopt a definition of "properly attributed" in the temporary rule, it should define the term as the standalone tax liability of the utility. This is the definition most consistent with the legislative intent of SB 408.

b. The Commission Should Also Delete Proposed OAR 860-022-0039 Sections (4) and (6) Through (8).

PacifiCorp recommends that the Commission delete Staff's proposed OAR 860-022-0039 sections (4) and (6) through (8). These sections deal with determinations that are not necessary to allow for the filing of the tax reports on October 15, 2005.

B. The Commission Should Clarify the Definition of "Income" in Staff's Proposed OAR 860-022-0039(2).

PacifiCorp proposes that the definition of "income" be revised to make clear that it refers to taxable income. As presently drafted, Staff's proposed temporary rule incorrectly suggests that "net revenues" (or net income) is synonymous with "taxable income." Under standard accounting principles and regulatory practice, however, "net income" and "taxable income" do not have the same meaning.

Net income is after-tax book income, which includes the tax effects of O&M expenses and miscellaneous revenues and is adjusted for the tax impacts of interest and Schedule M book-to-tax differences. Pre-tax book income, on the other hand, includes the tax effects of O&M expenses and miscellaneous revenues, but does not include Schedule M or interest adjustments. Pre-tax book income is used to compute the effective tax rate. Taxable income, unlike pre-tax or after-tax book income, on the other hand, does not include tax expenses but does include Schedule M and interest adjustments. Taxes "imposed on or measured by income" are imposed on or measured by taxable income. Our proposed revision recognizes these distinctions.

C. Consistent with SB 408's Intent to Avoid Normalization Violations, the Commission Should Revise the Definition of "Taxes Authorized to be Collected in Rates" in Staff's Proposed OAR 860-022-0039 to include Deferred Income Taxes.

PacifiCorp proposes revising the definition of "taxes authorized to be collected in rates" to be consistent with regulatory practice and basic accounting principles and to avoid violation of the normalization conditions of the Internal Revenue Code ("IRC"). SB 408 is clear in its intent to avoid violations of IRC normalization requirements. Because regulated revenue includes both current and deferred income taxes—*i.e.*, the net revenue to which the effective tax rate is applied includes both current and deferred income tax expense—omitting deferred taxes from the components of the calculation of taxes authorized to be collected in rates would result in a revenue calculation that does not match the revenue calculation used to compute rates.

D. The Commission Should also Revise Staff's Proposed OAR 860-022-0039 to Make It Internally Consistent and Workable.

PacifiCorp has recommended a number of small housekeeping changes to the proposed temporary rule. In particular, PacifiCorp recommends that the Commission revise the definition of "tax" to be consistent with the bill, which provides that tax does not include a franchise fee or privilege tax. PacifiCorp also recommends that the Commission revise the definition of "taxes paid" to make it workable. By limiting the definition of "taxes paid" to an amount "properly attributed to the regulated operations of the utility", Staff's proposed definition of "taxes paid" would make the term inapplicable to taxes paid by the non-utility members of the affiliated group.

For the reasons explained above, PacifiCorp respectfully requests that the Commission revise Staff's proposed OAR 869-022-0039 as outlined in the attached redline version of the proposed temporary rule. PacifiCorp appreciates the Commission's consideration of these matters.

Very truly yours,

Katherine A. McDowell

Enclosure
cc: AR 498 and AR 499 Interested Persons List

860-022-0039

Annual Tax Reports and Automatic Adjustment Clauses Relating to Public Utility Taxes

(1) This rule applies to any regulated investor-owned utility, or successor in interest, that provided electric or natural gas service to an average of 50,000 or more customers in Oregon in 2003.

(2) As used in this rule:

(a) "Affiliated group" means an affiliated group of corporations of which the public utility is a member and that files a consolidated federal income tax return.

(b) "Deferred taxes" means the total deferred tax expense of regulated operations as reported in the appropriate FERC deferred tax expense accounts that relate to the year being reported.

(c) "Income" means ~~net revenues or~~ taxable income ~~after deducting expenses, before taxes subject to this rule~~.

~~(d) "Properly attributed" means the product determined by multiplying the following two values:~~

~~(A) The total amount of taxes paid by the public utility or affiliated group to units of government; and~~

~~(B) The ratio of the tax liability of Oregon regulated operations of the public utility to the total tax liability from all affiliates of the public utility or the affiliated group with a positive tax liability.~~

(~~e~~d) "Regulated operations of the utility" means those activities of a public utility that are subject to rate regulation by the Commission.

(~~f~~e) "Tax" means a federal, state or local tax or fee that is imposed on or measured by income and that is paid to a unit of government, but does not include a franchise fee or privilege tax.

(~~g~~f) "Taxes authorized to be collected in rates" means the product determined by multiplying the following three values, calculated excluding ~~deferred income taxes and~~ the revenues and costs related to sales for resale:

(A) The revenues the public utility collects from ratepayers in Oregon, adjusted for any rate adjustment imposed under this rule;

(B) The ratio of the net revenues from regulated operations of the public utility to gross revenues from regulated operations of the public utility, as determined by the Commission in establishing rates; and

(C) The effective tax rate used by the Commission in establishing rates, calculated as the ratio of total taxes to pre-tax book income.

(~~h~~g) "Taxes paid" means net amounts received by units of government from the public utility or from the affiliated group~~and properly attributed to regulated operations of the public utility~~, adjusted as follows:

(A) Increased by the amount of tax savings realized as a result of charitable contribution deductions allowed because of the charitable contributions made by the public utility;

(B) Increased by the amount of tax savings realized as a result of tax credits associated with investment by the public utility in the regulated operations of the public utility, to the extent the expenditures giving rise to the tax credits and tax savings resulting from the tax credits have not been taken into account by the Commission in the public utility's last general ratemaking proceeding; and

(C) Adjusted by deferred taxes related to the regulated operations of the public utility.

(~~i~~h) "Units of government" mean federal, state and local taxing authorities.

(3) By October 15, 2005~~each year~~, each public utility will file a tax report with the Commission.

(a) The tax report will contain the following information for each of the three preceding fiscal years:

(~~a~~A) The amount of taxes paid to units of government by the public utility or its affiliated group, without regard to the tax year for which the taxes were paid;

(~~b~~B) For public utilities that pay taxes as part of an affiliated group, t~~T~~he amount in section (3)(a) of this rule that is properly attributed to Oregon regulated operations of the public utility;

~~(c) The amount of tax liability of Oregon regulated operations of the public utility calculated on a stand-alone basis using Oregon results of operations;~~

(~~d~~C) The amount of taxes authorized to be collected in rates for Oregon regulated operations of the public utility; and

(~~e~~D) An explanation of the method by which the above amounts were calculated and ~~All~~ all supporting workpapers and documents supporting the calculations.

(b) The information filed with the Commission in the tax report pursuant to this section is commercially sensitive tax information and is subject to the limitations on public disclosure contained in Senate Bill 408 Section 11 and the Public Records Law ORS 192.410 – 192.505.

~~(4) Each public utility will provide any information the Commission requires to make the determination in section (6) of this rule.~~

(~~5~~4) The Commission may disclose, or any intervenor may obtain and disclose, the amount by which the amount of taxes that units of government received from the public utility or from the

affiliated group differed from the amount of costs for taxes collected, directly or indirectly, as part of rates paid by customers, including whether the difference is positive or negative. An intervenor may not disclose any further information unless the Commission allows the disclosure. The Commission will not authorize disclosure of any information that is exempt from disclosure under the Public Records Law ORS 192.410 – 192.505.

~~(6) Within 180 days following the filing of the public utility's tax report, the Commission will determine whether the taxes authorized to be collected in rates for any of the three preceding fiscal years differed by $100,000 or more from the amount of taxes paid to units of government that are properly attributed to the Oregon regulated operations of the public utility.~~

~~(7) If the Commission makes a finding of a difference of $100,000 or more in section (6) of this rule, the Commission will require the public utility to make a compliance filing establishing an automatic adjustment clause tariff to be effective within 60 days of the finding.~~

~~(8) If the Commission determines that an automatic adjustment clause would have a material adverse effect on customers of the public utility, the Commission will issue an order terminating the automatic adjustment clause. The order will set forth the reasons for the Commission's determination.~~

Stat. Auth.: ORS Ch. 183, 756, 757 & 759
Stats. Implemented: ORS 756.040 & 756.060
Hist.: New