McDowell & Rackner PC

KATHERINE A. MCDOWELL
Direct (503) 595-3924
katherine@mcd-law.com

July 16, 2007

VIA ELECTRONIC FILING

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

Re: Docket AR 517

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

Very truly yours,

Katherine A. McDowell

Enclosures
cc: Service List AR 517

BEFORE THE PUBLIC UTILITY COMMISSION OF OREGON

AR 517

In the Matter of Housekeeping and Clarification Changes to OAR 860-022-0041.	**OPENING COMMENTS OF PACIFICORP**

I. INTRODUCTION

This rulemaking presents a combination of issues, all aimed at ensuring the effective operation of Senate Bill 408 (SB 408).[1] This rulemaking began, at least informally, at a September 27, 2006 workshop, just shortly after the final rules for SB 408 were issued in AR 499 on September 14, 2006. *In re Permanent Rules to Implement SB 408 Relating to Utility Taxes,* Order No. 06-532 (2006) (AR 499 Order). In the September 27, workshop, the parties reviewed the final rules, making note of areas where rule amendments might be needed. In the spring of 2007, the parties gathered again in informal workshops to review the rules, with the additional knowledge gained from the preparation and filing of the utilities' requests for Private Letter Rulings (PLRs) on normalization from the Internal Revenue Service (IRS).

In the course of these meetings, the parties identified the need to address two "housekeeping" issues, eliminating the iterative tax effect and refining the one-time election. The parties also decided to address two issues concerning normalization, a change to the depreciation add-back for the Apportionment Method floor calculation and the need to protect deferred taxes from the impact of a negative current tax result. Finally, the parties addressed how to exclude Oregon business energy tax credits (BETCs) from SB 408, to

[1] Codified at ORS 757.267-268 and Or. Laws 2005, c. 845, § 4 (eff. Sept. 2, 2005).

McDowell & Rackner PC
520 SW Sixth Avenue, Suite 830
Portland, OR 97204

conform the rules to the AR 499 Order and to House Bill 3201 (HB 3201),[2] which expressly excludes purchased BETCs from the operation of SB 408.

In large part, the draft rules compiled by Staff represent consensus positions among the parties. PacifiCorp appreciates Staff's facilitation of this rulemaking and, with the exception of the rule changes that impact normalization, PacifiCorp supports Staff's draft rules. Because PacifiCorp supports a more conservative position on normalization, PacifiCorp recommends against a change to the depreciation add-back in the floor calculation. In the case of Staff's draft rule on the negative current tax result, PacifiCorp has proposed revisions to this rule to make it more comprehensive and effective.

II. HOUSEKEEPING RULE CHANGES

A. Removing the Iterative Tax Effect of SB 408 Adjustments.

1. Overview of Staff's Proposed Rule Changes.

Through the addition of a new definition and two amendments to the existing rules, Staff's proposed rules prevent rate increases or decreases based on differences between taxes collected and taxes paid caused solely by SB-408 related rate adjustments. Specifically, the proposed rules add a new subsection, OAR 860-022-0041(2)(g), defining "iterative tax effect" as the tax effect of any SB 408-related tax adjustment in the tax reporting period that includes the adjustment. Then, in two different rule amendments, the proposed rules provide for removal of the iterative tax effect from the calculation of taxes paid. First, to eliminate the iterative tax effect as it manifests under ORS 757.268's automatic adjustment clause ("AAC"), OAR 860-022-0041(2)(b) amends the definition of deferred taxes. This amendment requires the exclusion of deferred taxes related to a regulatory receivable or payable account for an AAC adjustment in the year the deferred tax

---

[2] The Oregon Legislature passed HB 3201 on June 25, 2007. The Governor is expected to sign the bill into law imminently.

McDowell & Rackner PC
520 SW Sixth Avenue, Suite 830
Portland, OR 97204

is established but inclusion of these deferred taxes thereafter. Second, to cover SB 408-related rate adjustments made in a rate case, OAR 860-022-0041(4)(d)(D) and (4)(e)(C) permit an adjustment to federal/state and local total taxes paid, respectively, to eliminate the iterative tax effect in this context.

2. Discussion.

PacifiCorp supports these proposed rule changes. Staff's draft rules in AR 499, filed on July 17, 2006, included a similar, but less well developed, provision to remove the iterative effect. *See* OAR 860-022-0041(2)(n)(C) ("Deferred taxes do not include deferred tax items related to an adjustment under section (9) of this rule [referring to the automatic adjustment clause.]"). No party opposed this provision, and its omission from the final Commission rules approved in AR 499 appears to have been inadvertent. Indeed, a key impetus behind this AR 517 housekeeping rulemaking was to restore and refine rule amendments eliminating the iterative tax effect.

The fair and rational operation of SB 408 requires removal of the iterative tax effects of SB 408 rate adjustments. The iterative tax effect itself drives differences between taxes collected and taxes paid in the years following the adjustment, undermining the purpose of the adjustment in the first place, which is to align taxes collected and taxes paid. *See* ORS 757.267(1)(a). The Commission should eliminate the iterative tax effect of SB 408 adjustments to ensure that SB 408 adjustments operate to align taxes collected and paid, and not contribute to their nonalignment.

The proposed changes to rule sections (2) and (4) appropriately implement this policy. The rule eliminates the tax effect of SB 408 adjustments under the AAC in a manner that is consistent with the accounting associated with such adjustments. Under normal accrual accounting and financial reporting, a utility must book a probable refund or surcharge to customers, along with a corresponding deferred tax entry reflecting the tax-timing effect of the adjustment. The proposed rule initially excludes this deferred tax from

McDowell & Rackner PC
520 SW Sixth Avenue, Suite 830
Portland, OR 97204

the taxes paid calculation to avoid causing a recalculation of taxes paid and an incremental refund or surcharge.

In the year that the refund or surcharge is implemented, the adjustment will increase current taxes in the case of a surcharge and decrease current taxes in the case of a refund. To eliminate this iterative tax effect on current taxes, the previously excluded deferred item is reversed and included in the taxes paid calculation, thus offsetting and eliminating the iterative tax effect from the taxes paid calculation.

Eliminating the iterative tax effect by reversing a deferred tax entry is not an option, however, when the SB 408 adjustment is made in a rate case because the adjustment is immediate. Instead, the iterative tax effect must be removed through a direct add-back to taxes paid for the year or years in which the rate case adjustment is in place, handled in the same manner as the add-backs for deferred taxes and charitable contributions.

To illustrate the operation of these proposed rules, take the example of a utility that paid taxes of $100 and collected taxes of $110 in Year X. The AAC would operate to provide a rate refund of $10 for Year X, which has a tax effect of $4 in Year Y when the refund is paid. Under normal accounting, the utility would book a deferred tax entry of $4 concurrently with recording the $10 refund liability. This deferral is excluded from the taxes paid calculation for Year X, so not to further increase the $10 refund (by lowering taxes paid by $4). In Year Y when the refund is paid, the deferral is reversed and added to adjust taxes paid upward for Year Y to account for the $4 tax impact of the $10 refund.

A second case demonstrates the operation of these rules when a utility's revenue requirement for Year X has been reduced by $10 under SB 408 in a rate case (through application of ORS 757.267 and ORS 757.210). In this case, the utility removes the iterative tax effect of the adjustment by directly adding back to taxes paid in Year X the tax effect of that adjustment, $4. In both examples, the steps to eliminate the iterative tax effect are

McDowell & Rackner PC
520 SW Sixth Avenue, Suite 830
Portland, OR 97204

necessary to prevent the $10 Year X rate adjustment under SB 408 from operating to become a $14 rate adjustment in Years X and Y.

The same analysis applies if the numbers in the example are changed to reflect a $10 undercollection of taxes and either a $10 AAC surcharge or a $10 revenue requirement increase. In this case, the proposed rules eliminating the iterative tax effect would operate to prevent the $10 rate surcharge from increasing to a $14 rate surcharge.

B. One Time Election.

1. Overview of Staff's Proposed Rule Change.

The SB 408 rules currently provide two alternative methodologies for calculating the multi-state tax rate and allow utilities to make a one-time election between the two methods. Staff's proposed rules allow a new utility owner to make the election between the methods in the first tax report filing that includes a period reflecting the new ownership. *See* OAR 860-022-0041(3)(c)(C).

2. Discussion.

PacifiCorp supports this housekeeping change, which it first proposed in the September 27, 2006 workshop. In the final rulemaking order, the Commission required utilities to make a one-time election between the alternative methods for determining the multi-state tax rates. The Commission acted in response to customer concerns that the utilities would unilaterally switch between the alternative methods to produce better outcomes for the utilities and worse outcomes for customers. AR 499 Order at 7.

These concerns are not implicated by the limited exception to the one-time election proposed. The amendment preserves the protection and simplicity of the original one-time limitation by providing a new utility owner a one-time opportunity to choose which method it will follow. Requiring a new utility owner to adhere to the election made by the previous owner is poor policy, given the potential differences in consolidated tax groups and the possibility that an election that makes sense for one consolidated tax group would not make

McDowell & Rackner PC
520 SW Sixth Avenue, Suite 830
Portland, OR 97204

sense for another. Additionally, permitting the new owner to make the election in the first tax filing that reflects the new ownership is fair because it ensures that the one-time election of the new owner is fully informed. The simplifying principle of a one-time election is also preserved, as the new owner is thereafter bound by its own irrevocable, one-time election.

III. RULE CHANGES THAT IMPLICATE NORMALIZATION ISSUES

A. Change in Apportionment Method Floor Calculation.

1. Overview of Staff's Proposed Rule Changes.

Staff's proposed rules add a new definition of "income tax losses" at OAR 860-022-0041(2)(d). Under this definition, losses exclude depreciation and investment tax credits (ITC) related to public utility property (PUP). At the same time, the proposed rules eliminate the general depreciation and ITC add-back for the Apportionment Method floor calculation for federal income taxes, at OAR 860-022-0041(3)(b)(A), and for state income taxes, at OAR 860-022-0041(3)(d)(A) and (3)(d)(B)(i). The effect of these changes is to remove the depreciation/ITC add-back in the Apportionment Method floor calculation unless the utility has a regulated loss affiliate.

2. Discussion.

PacifiCorp has concerns about the proposed change to the depreciation add-back in the floor calculation, because it may increase the risk that the Apportionment Method will violate normalization. This is inconsistent with the conservative policy on normalization risk adopted in the Commission's AR 499 final rulemaking order. AR 499 Order at 3-5; *see* OAR 860-022-0041(8)(f) (prohibiting operation of the AAC in a manner that allocates any portion of the benefits of deferred taxes resulting from accelerated depreciation of the utility or a regulated affiliate); OAR 860-022-0041(4)(o) (allowing utility to adjust its tax report "to avoid probable violations of federal tax normalization requirements").

In the AR 499 Order, the Commission concluded that "the Apportionment Method for determining properly attributed could result in a violation of federal tax law normalization

McDowell & Rackner PC
520 SW Sixth Avenue, Suite 830
Portland, OR 97204

requirements unless certain adjustments are made." *Id.* at 4. To address this problem, the Commission directed utilities to remove the tax benefits of depreciation and ITC from the taxes paid calculation by adding back the related tax effects. *Id.* PacifiCorp's PLR request describes the function of the depreciation/ITC add-back:

> "The general architecture of the 'normalization protection' process is to adjust the starting tax liability (either consolidated or standalone, as the case may be) by 'stripping out' the two tax benefits that are subject to the normalization rules—depreciation and ITC claimed with respect to public utility property ('PUP').... In each of the three methods [standalone, consolidated and apportionment], the benefits of depreciation and ITC are, thus, effectively isolated and handled discretely. In this way, the process is designed to ensure compliance with the normalization rules." PacifiCorp Request for PLR at 6 (December 29, 2006).

Consistent with this, the final AR 499 rules adopted a floor for the Apportionment Method and expressly directed the add-back of depreciation and ITC in the calculation of this floor. OAR 860-022-0041(3)(b)(A); OAR 860-022-0041(3)(d)(A) and (3)(d)(B)(i). The floor was adopted to prevent the "unjust result" of the Apportionment Method allocating tax benefits to customers in excess of the total losses of the utility's consolidated group. AR 499 Order at 9. The floor amends the Apportionment Method so that it cannot produce a taxes paid number that is lower than standalone taxes less total group losses, adjusted for depreciation. In effect, the floor adds a fourth potential outcome for the taxes paid calculation, as an alternative to the result produced by the Apportionment Method.

Staff's proposed rules eliminate the depreciation/ITC add-back in calculating the floor for the Apportionment Method in most cases. Under the proposed rules, the floor calculation includes a depreciation/ITC add-back only if the group includes a loss company with PUP depreciation and ITC. The rationale for the change is two-fold.

First, Staff has voiced concerns about the operation of the floor in a scenario where the imputed negative tax of the consolidated group is relatively low and PUP depreciation is

McDowell & Rackner PC
520 SW Sixth Avenue, Suite 830
Portland, OR 97204

relatively high. In this case, the PUP depreciation can offset all group losses, which results in a floor amount equal to the standalone taxes of the utility. In effect, Staff's concern is that the full depreciation/ITC add-back sets the floor too high to allow the Apportionment Method to allocate modest losses, particularly in a consolidated group that has more than one company with PUP. In this regard, it is important to note that Staff's concerns about the operation of the floor are *not* implicated in a situation where tax losses are significant (such as in the Enron scenario which led to SB 408's enactment), because the floor would not operate to offset losses with PUP depreciation and ITC in this situation. This fact militates against the conclusion that there is a design flaw in the floor which must be corrected to allow the Apportionment Method to function properly.

Second, Staff has suggested that because the floor calculation includes only loss companies, a full depreciation/ITC add-back in the calculation is unnecessary for normalization protection. Because the depreciation/ITC add-back is central to the Commission's "general architecture" for protecting normalization, however, proposed limitations to this add-back should be viewed with caution from a normalization protection standpoint. This is especially true because any change to the depreciation/ITC add-back must be included in an amendment to the utilities' PLR requests now pending with the IRS. PLRs are based upon the specific set of facts and circumstances presented to the IRS, so any material change in facts or circumstances must be included in an amended request to ensure the validity of the PLR. Rev. Proc. 2007-1 IRB, Sect. 3.02 at 121 (Jan. 2, 2007).

The general elimination of the depreciation/ITC add-back from the floor calculation creates two specific concerns from a normalization perspective. The first occurs when the floor is greater than the amount produced by the Apportionment Method and the floor becomes one of the three potential "taxes paid" outcomes (i.e., floor, stand-alone and consolidated). Under the Staff's proposed changes, if the floor amount becomes the final

McDowell & Rackner PC
520 SW Sixth Avenue, Suite 830
Portland, OR 97204

taxes paid number, this outcome is harder to defend as one derived only after clear and complete isolation of all PUP depreciation and ITC in each step of the methodology.

The second concern about the elimination of the depreciation/ITC add-back from the floor calculation is that it decreases the buffer effect the floor has on extreme results under the Apportionment Method. Because the Apportionment Method allocates taxes on a basis that is unrelated to taxable income, it can produce irrational results—such as a reduction of utility taxes paid even when there are no losses in the consolidated group or a negative taxes paid for the utility even when the consolidated group pays taxes. These results, in turn, can threaten normalization by reducing taxes paid to below the level necessary to cover current taxes, potentially producing AAC refunds that include a component of deferred taxes.

While the rule change discussed in the next section is designed to specifically address this problem, the best approach for normalization protection is to prevent possible encroachment of deferred taxes in the first place. The Apportionment Method floor helps guard against such encroachment by setting a minimum threshold below which taxes paid cannot fall. The more robust the floor is in operation, the more likely it is to prevent normalization-threatening outcomes. The general elimination of the depreciation add-back from the floor calculation reduces the buffer effect of the Apportionment Method floor and, in so doing, removes an important layer of normalization protection now in the rules.

Continuation of the Commission's conservative approach toward normalization is the surest way to obtain the clear and timely PLR necessary to permit the AAC to go into effect. *See* OAR 860-022-0041(8)(g) (AAC adjustments may not go into effect while PLR is pending); OAR 860-022-0041(9) (AAC adjustments may not go into effect during Commission review of potential material adverse effect on customers from AAC, and AAC may be terminated on this basis). For this reason, PacifiCorp recommends against adoption of Staff's proposed change to the calculation of the Apportionment Method floor.

McDowell & Rackner PC
520 SW Sixth Avenue, Suite 830
Portland, OR 97204

B. Change to Protect Deferred Taxes.

1. Overview of Staff's Proposed Rule Change and PacifiCorp's Revision.

In OAR 860-022-0041(4)(d), Staff proposes an important modification to the "lesser of" methodology for determining taxes paid. This modification sets a new floor for taxes paid, requiring the result to reflect all deferred taxes related to the utility's PUP depreciation, reduced by the apportioned amount of any tax refund recognized in the reporting period.

PacifiCorp supports Staff's goal of protecting normalization by isolating deferred taxes from the operation of the AAC. Indeed, PacifiCorp's view is that the rule amendment should go further to strengthen the protection against a normalization violation, eliminating consideration of any result that encroaches on deferred taxes by producing a negative current taxes paid amount. Thus, PacifiCorp proposes the following revision to Staff's proposed rule, with PacifiCorp's language in bold and Staff's omitted language in italics:

> "(d) The lowest of the amounts in Subsections (4)(a), (4)(b) and (4)(c) of this rule, after making adjustments in paragraphs (4)(d)(A), (4)(d)(B), (4)(d)(C), (4)(d)(D) and (4)(d)(E),<< **that produces a result greater**>>[*but no less*] than the deferred taxes related to depreciation of public utility property for regulated operations of the utility, except the deferred tax amount must be reduced by any tax refunds recognized in the reporting period and <<**allocated**>>[*apportioned*] to regulated operations of the utility."

In summary, Staff proposes to substitute a "zero" when one of the calculations for taxes paid produces a negative result for current taxes. PacifiCorp proposes instead to take normalization risk out of the picture entirely by setting aside (*i.e.,* invalidating) any calculation that produces a negative result for current taxes and, in such a case, relying upon a comparison of the remaining two calculations in the "lesser of" review to produce the final taxes paid amount.

McDowell & Rackner PC
520 SW Sixth Avenue, Suite 830
Portland, OR 97204

2. Discussion.

Staff's proposal to change the depreciation/ITC add-back in the floor calculation has caused parties to carefully consider AAC normalization issues and the status of the utility's PLR requests. Among the issues that have been drawn more sharply into focus is how the Apportionment Method can operate to produce negative current taxes paid number. PacifiCorp's PLR request, at pages 16-18, demonstrates such a result.

PacifiCorp's PLR request states that the Apportionment Method is consistent with both depreciation and normalization rules, notwithstanding the fact that the example in the PLR produces a negative taxes paid amount. After the PLR was submitted, PacifiCorp concluded that a negative current tax result most likely violates normalization requirements because it encroaches on deferred taxes. PacifiCorp's current view is that obtaining a favorable PLR on the AAC will require a rule change to address this scenario, along with an amendment to the pending PLR request explaining the rule change.

Staff's proposed rule change to address this problem amends the "lesser of" methodology to require a current taxes paid result that is at least zero. While this proposal provides an important new safeguard prohibiting deferred taxes from being reduced by a negative current tax result, it is the narrowest solution available for the problem. It is also an approach that results in taxes paid being set at the lowest possible level—zero—without a clear methodological basis for this outcome. While Staff's approach is a clear step in the right direction from a normalization standpoint, it produces an arbitrary outcome for taxes paid.

PacifiCorp's revision to Staff's rule change considers the larger set of issues implicated when the Apportionment Method produces a negative current tax result. First, tax refunds related to prior periods aside,[3] a negative taxes paid outcome is facially

[3] Staff's proposed rule change expressly accounts for the impact of tax refunds related to prior periods.

irrational, given the fact that a consolidated group's tax liability cannot be negative (*i.e.*, the IRS does not recognize a corporate tax liability that is less than zero – the concept of a current negative tax does not exist in corporate tax law). Such an outcome also is facially unjust, given that the point of the Apportionment Method is to fairly allocate consolidated taxes among members of the consolidated group. In a scenario such as that presented in the PLR request—where the consolidated group pays positive taxes and the utility has taxable income—the fact that the Apportionment Method could assign the utility less than zero credit for taxes paid is analytically indefensible and may create additional questions or confusion by IRS reviewers. Staff's proposal resetting such an outcome to zero is incrementally less harsh, but no more rational or fair.

PacifiCorp's revision proposes to address both the normalization problems and fundamental irrationality of a negative taxes paid outcome by removing such a result from the "lesser of" methodology for a particular tax year, thus rendering it ineligible for selection as the final taxes paid amount. Because the "lesser of" methodology chooses from among three potential results, elimination of one potential result still permits the "lesser of" methodology to function in favor of ratepayers.

Staff's rule change attempts to rehabilitate a calculation that produces a negative number by arbitrarily resetting it to the lowest permissible level necessary to protect normalization. The proposal functions more as a band-aid to treat the symptoms of the problem, than a cure designed to fully eliminate it. Because PacifiCorp's revision to Staff's rule change invalidates, rather than partially rehabilitates, a calculation that violates normalization, the IRS may view this as a stronger response, one that provides additional normalization protection. Particularly if the Commission decides to remove the depreciation/ITC add-back to the calculation of the Apportionment Method floor, a strong and transparent response to the negative tax problem is important to obtain the requested PLR.

McDowell & Rackner PC
520 SW Sixth Avenue, Suite 830
Portland, OR 97204

Finally, PacifCorp's revision to Staff's rule change is consistent with the policy underlying the adoption of the Apportionment Method floor. The Commission adopted the floor to provide "a safety net" against "an unjust result" produced by the Apportionment Method. AR 499 Order at 9. Similarly, PacifiCorp's revision produces a safety net eliminating the unjust result of a negative taxes paid outcome. Staff's rule change fails to provide this safety net and instead substitutes one unjust result (zero taxes paid) for another (negative taxes paid).

For all of these reasons, PacifiCorp strongly urges the Commission to amend the SB 408 rules to eliminate the possibility that current taxes paid will go below zero and encroach deferred taxes. At a bare minimum, the Commission should adopt Staff's proposed rule change. But, to address the problem more clearly and comprehensively, the Commission should adopt PacifiCorp's proposed revision to this rule change.

IV. RULE CHANGES TO IMPLEMENT HB 3201

A. Changes to Exclude BETCs from SB 408.

1. Overview of Staff's Proposed Rule Changes.

Staff's proposed rule changes implement Section 19 of HB 3201, which was recently enacted by the Oregon Legislature. These changes also better implement the Commission's policy on the treatment of BETCs under SB 408 articulated in the AR 499 Order.

Through a new add-back to taxes paid under OAR 860-022-0041(4)(d)(D), the proposed rule excludes *all* tax credits associated with BETCs from the operation of SB 408. The rule changes also delete the partial exclusion for BETCs previously contained in the rules at OAR 860-022-0041(3)(c)(A)(ii).

2. Discussion.

The interplay of BETCs and SB 408 has been a subject of controversy and confusion. Utilities have historically invested in BETCs as a good-will gesture to

McDowell & Rackner PC
520 SW Sixth Avenue, Suite 830
Portland, OR 97204

communities and customers, without the expectation of earning a profit on this investment. SB 408 deters utility investment in BETCs by capturing the associated tax credit for customers, even when utility shareholders fund the investment, as is typically the case.

SB 408 was enacted with an add-back (*i.e.,* an exclusion) for certain tax credits at ORS 757.268(13)(3). This tax credit add-back covered the small portion of BETCs generated by utilities through direct investment related to their regulated operations. However, due to the narrow wording of this add-back, purchased BETCs – which constitute the vast majority of utility BETCs – were nevertheless covered by SB 408. In other words, the "taxes paid" reported by utilities under SB 408 included purchased BETCs, thereby allocating the tax savings from purchased BETCs to ratepayers despite the fact that ratepayers bore none of the costs of purchased BETCs.

In the AR 499 Order, the Commission attempted to remedy this problem by expanding the add-back as a part of the taxes paid calculation:

> "On the state level, we agree that BETCs related to conservation and renewable resources for all affiliates should be added back so that these kinds of investments are encouraged. This will allow the benefits of these credits to go to shareholders as intended under the law and not be flowed through to ratepayers except where they bear the associated cost." AR 499 Order at 5.

Unfortunately, the implementation of this policy in the final AR 499 rules was incomplete, expressly covering only the Apportionment Method calculation and limiting the add-back to conservation and renewables BETCs. *See* OAR 860-022-0041(3)(c)(A)(ii).

HB 3201 enacted an important plank of the Governor's energy-related agenda for the 2007 legislative session, expanding the scope of Oregon's BETC law. To encourage utilities to again make BETC investments—investments that appear to have effectively ceased after passage of SB 408—Section 19 of HB 3201 specifically excludes BETCs from the operation of SB 408 through the following amendment to ORS 469.206:

McDowell & Rackner PC
520 SW Sixth Avenue, Suite 830
Portland, OR 97204

> "(3) Notwithstanding any other provision of law, a tax credit transferred pursuant to this section does not decrease the amount of taxes required to be reported by a public utility."

Staff's proposed rule implements the comprehensive exclusion of BETCs from SB 408 required by the AR 499 Order and this new statutory provision.

On its face, Section 19 excludes all purchased BETCs from the operation of SB 408. Specifically, the statute provides that "notwithstanding any other provision of law"—*e.g.,* SB 408—"a tax credit transferred pursuant to this section"—*i.e.,* purchased BETCs—"does not decrease the amount of taxes required to be reported by a public utility." Nothing in the statute limits the exclusion of purchased BETCs to BETCs related to certain types of projects. Thus, pursuant to the statute's plain meaning, purchased BETCs may not decrease the amount of taxes paid reported by utilities pursuant to SB 408.

Moreover, the legislative history of HB 3201, and its predecessor bill, HB 2211, supports this construction of Section 19. *See* ORS 174.020(1)(b) (permitting use of legislative history to assist in construction of a statute). At a hearing before the Senate Environment and Natural Resources Committee on April 5, 2007, Department of Energy Director Mike Grainey provided the following testimony on what was then Section 5a of HB 2211:

> MR. GRAINEY: There's also a provision in Section 5a of the bill that clarifies, that ties into what we call the "pass-through provision." That's a mechanism that allows entities that don't have tax liability or much tax liability to benefit from the tax credit by partnering with what we call a pass-through partner that makes the payment at the present value of the tax credit, and then that other entity takes the tax credit over the 5 years that normally happens under the business tax credit. We've had utilities and banks and other corporations partner with small businesses, with schools, with local governments, as programs before to be able to get good energy projects for both energy efficiency and renewable energy.
>
> What section 5a does is, it's designed to protect the utilities' pass-through investment by preventing the credit from lowering the amount of taxes paid that a utility is required to report each year under ORS 757.268, that's the PUC statute regarding adjustments to rates [by reason of] taxes paid by the utility. Again, this section is needed to clarify that investor-owned

McDowell & Rackner PC
520 SW Sixth Avenue, Suite 830
Portland, OR 97204

utilities can participate as pass-through partners for those entities that want to use the tax credit but don't have tax liability. There's been some question in the last couple of years that it has restricted investor-owned utilities' ability to participate and it's a very important provision to them to be able to participate and to success the program for those individuals and businesses that can't use the tax credit directly.

SENATOR ATKINSON: So this provision will clear it up, once and for all?

MR. GRAINEY: Yes, Senator Atkinson, that is correct. That provision was drafted by our attorney general with consulting with the PUC staff and PUC's assistant attorney general and we believe that that takes care of the problem.

CHAIRMAN AVAKIAN: Well, and I'm very glad you brought it up because it has been an issue that I know has been bandied about around the building for a couple sessions now, and it should be very clear on the record that it would be the intent of this committee and of the body that the way you just described it, where the credit is prevented from lowering the amount of taxes owed by a utility company, is the clear intent in what we are doing with that section. So thanks for putting that on the record.

MR. GRAINEY: Thank you, Mr. Chairman.

Similar testimony was provided to the Senate Finance and Revenue Committee Hearing on June 15, 2007, this time on Section 19 of HB 3201. This hearing addressed an amendment to HB 3201 proposed by ICNU, designed to limit the BETC exclusion from SB 408 to BETCs related to conservation and renewable energy. After the hearing, the Committee rejected this amendment, opting to retain Section 19's unrestricted language.

CHAIR DECKERT: ... So we have heard from a lot of the beneficiaries of these pass-through credits, that our IOU utilities just spoke to, who have at least let me know, and I think other members of the committee, that they're concerned that they've been beneficiaries of the program and it's helped on several fronts. The question I had was, are there other entities out there, say the ICNU amendment was included in the bill and that Gary Bauer's NW Natural example went forward, that they would just no longer participate in the program at all, are there other entities out there that would purchase these tax credits so the Metro's of the world would continue to do their program.

MIKE GRAINEY: Mr. Chairman, Mike Grainey from the Dept. of Energy. There have been other pass-through partners that have participated, but the IOUs are important ones, and they're some of the larger companies in terms of their ability to acquire tax credits and use them. So they're very important players. And after SB 408 passed, the three largest IOUs that you just heard from, stopped while they evaluated the tax implications of that law in terms of their ability to participate. And they have not been participating since that time.

CHAIR DECKERT: They have not?

MIKE GRAINEY: No. They stopped even before we had the problem with SB 819 and the kicker issue. And that reduced the number of companies that we could pair schools and nonprofit organizations up with.

CHAIR DECKERT: And who instigates these partnerships? Is it the DOE, "instigates" is kind of a loaded word, who brings the partners together?

MIKE GRAINEY: We can do that, we offer to do that. Individual taxpayers can do that themselves. Some, for example, have a relationship with a bank that they'll do that with or another company. The law allows it either way.

CHAIR DECKERT: But one of the first persons or entities that y'all might contact would be our IOU utilities?

MIKE GRAINEY: Yes, very definitely, as well as some of the larger banks have been very active as well.

SEN MONROE: Well Mr. Chair, this program then becomes very valuable to nonprofits because there's a market for their credits that are of no value to them since they're not a tax-paying entity.

MIKE GRAINEY: Yes, Mr. Chair, that's correct. It has allowed many schools, hospitals and other nonprofit entities, and also businesses that don't have tax liability, and we have that with a number of the renewable energy companies that are start-up companies that have in their initial years not a lot of revenue so not a lot of tax liability. So that is a key factor in terms of the tax credit.

SEN MONROE: Mr. Chair. We worked so hard on 819 to get it through, dealing with really the same kind of issue, making those credits valuable once again. I'd hate to see us mess them up.

SEN GEORGE: I'm looking at a Metro piece that we have right here and they're talking about these cash payments and the cash payment again and they're talking about, they have something they can't use, which is the credit. But they did do what we asked them to do by going to energy-saving vehicles or whatever programs. Alright, with the cash payment, they multiply the savings on the energy efficiency we're asking them to do because now they have more money to do the same. I don't see this going to be a burden upon the ratepayer, I just can't see that, and maybe it's just my mind. So I'm

McDowell & Rackner PC
520 SW Sixth Avenue, Suite 830
Portland, OR 97204

> trying to think where the loser is here? We accomplished the social goal we wanted, and provided cash and at the same time allowed somebody to avoid some taxation which did not come from the ratepayer. So is there anyone that ends up being negatively impacted?
>
> MIKE GRAINEY: Mr. Chairman, Senator George, I agree with your analysis. I think you're correct. And I think ***the ICNU amendment tries to make a distinction between different energy savings measures that's really not valid. Transportation measures, for example, that qualify for the tax credit, whether they're transit passes, vanpooling expense, those all save energy, we document the energy savings. And in fact it's probably the most important sector because it directly reduces the consumption of oil, and that affects utility prices, both natural gas prices for the natural gas utilities, and the natural gas that the electric utilities use for generating electricity. So there's a direct relationship there. Recycling, which was another area of concern for ICNU, is a huge energy savings, both in terms of raw materials that are reused, and in terms of finished products. So there's direct energy savings there too, which is why the policy decision the legislature made some years ago to include those projects as eligible for the BETC, that it's not just the hardware equipment in buildings, commercial lighting or heating, or industrial processes.***
>
> CHAIR DECKERT: Thank you. . . .

Testimony on HB 3201, Senate Finance and Revenue Committee Hearing (June 15, 2007) (emphasis added).

Consistent with the AR 499 Order, the policy embodied in HB 3201, the plain language of Section 19, the legislative history of HB 3201 and HB 2211, and the original tax credit add-back included in SB 408, Staff's proposed rule change appropriately provides a complete exclusion for BETCs from SB 408. PacifiCorp supports adoption of this proposed rule.

McDowell & Rackner PC
520 SW Sixth Avenue, Suite 830
Portland, OR 97204

V. CONCLUSION

PacifiCorp appreciates the opportunity to comment on the draft rules. PacifiCorp urges the Commission to amend the rules as outlined above.

DATED: July 16, 2007

MCDOWELL & RACKNER PC

Katherine A. McDowell

Attorneys for PacifiCorp

McDowell & Rackner PC
520 SW Sixth Avenue, Suite 830
Portland, OR 97204

CERTIFICATE OF SERVICE

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

Ryan Fuller
PacifiCorp
825 NE Multnomah STE 800
Portland OR 97232
ryan.fuller@pacificorp.com

Steve Evans
MidAmerican Energy Holdings Company
srevans@midamerican.com

Natalie Hocken
PacifiCorp
825 NE Multnomah STE 800
Portland OR 97232
natalie.hocken@pacificorp.com

D Douglas Larson
PacifiCorp
One Utah Center
201 S Main ST - Suite 2300
Salt Lake City UT 84111
doug.larson@pacificorp.com

Oregon Dockets
PacifiCorp
oregondockets@pacificorp.com

Paul M Wrigley
PacifiCorp
825 NE Multnomah STE 800
Portland OR 97232
paul.wrigley@pacificorp.com

DATED: July 16, 2007.

Katherine A. McDowell

Of Attorneys for PacifiCorp