BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

AR 499

	)
In the Matter of the Adoption of Permanent	)
Rules to Implement SB 408, Relating to	)
Matching Utility Taxes Paid with Taxes	)
Collected.	)
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RESPONSE COMMENTS

OF THE

CITIZENS' UTILITY BOARD OF OREGON

May 19, 2006

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I. Introduction

This has been a long, arduous, and simultaneously exciting and discouraging process. It has been exciting to participate in much-needed tax attribution reform, but it has been discouraging to meet so much resistance to change when the public has demanded it and the legislature has mandated it. The straw proposals and the opening comments demonstrate that the AR 499 process did not work, and that utilities and Staff did not participate meaningfully, while the customer groups made a one-sided attempt at exploring reasonable middle-ground options. We hope the Commission finds the customer straw proposals helpful, but, despite our exploration of alternative options, CUB's concludes that the temporary rules best characterize the intent of SB 408 and provide the fairest attribution of consolidated tax liability to affiliates within a conglomerate.

The Commission should define "properly attributed" as the phrase is defined in the temporary rules, thereby evolving from the historical practice of stand-alone tax attribution, to proportionate share tax attribution[1] which recognizes the tax implications of holding company structures on regulated utilities. If the Commission decides to take a less-encompassing approach, we recommend the customer groups' straw proposals or a variation thereof applying the different conceptual approaches we describe later in these comments.

II. The AR 499 Process Has Failed

The AR 499 process has failed, as demonstrated by Staff's complete about-face on the proper implementation of SB 408. Here we stand, in May of 2006, but we stand in the same place we stood in February 2005 when Staff issued its White Paper, Treatment of Income Taxes In Utility Ratemaking. Staff and the utilities all advocate for stand-alone[2] tax attribution – never mind that the Governor put his signature on SB 408 in September 2005 and that customers clamor for change. This is disappointing to those of us who thought that the debate had moved forward with SB 408 to a discussion of how to incorporate the effects of tax consolidation on how customers are charged for utility taxes.

An intense schedule of workshops, drafts, and straw proposals was designed to develop middle-ground definitions of "properly attributed," and explore different parties' proposals. Unfortunately, the only parties who really stuck their necks out in this process were the customer groups. PacifiCorp's supposed middle-ground proposal is simply a reworked version of stand-alone attribution, Avista's proposal appears to acknowledge

[1] Primarily called the "loss allocation approach" by Staff, but Staff also notes the term "modified effective tax rate." We chose not to use the terminology "loss allocation," as it is imprecise. There are many tax deductions beside deductions due to business losses, such as interest payment tax deductions, accelerated depreciation, etc.

[2] As we explained in our Opening Comments, PacifiCorp's With-and-Without proposal and PacifiCorp's Lesser-Of Attribution are, in any practical sense, the same thing as stand-alone attribution. We interpret supporting any of these proposals as supporting stand-alone attribution.

inequity, though with little likely practical result, and Staff didn't even bother to participate in offering a middle-ground proposal.

It took time and effort to brainstorm the middle-ground proposal that we felt responsible for providing in answer to Judge Logan's request and the workshop process as a whole. Putting forth another proposal was not, and is not, in our best interest. It detracts from CUB's principled stand on the temporary rules, and weakens our position before this Commission by providing an option other than what we view as the proper implementation of SB 408. However, in a process such as this, if all parties participate in good faith and stretch beyond proposals they can support, then everyone is disadvantaged equally. Unfortunately, in this case, that is not what happened.

CUB, ICNU, and NWIGU brought middle-ground proposals for "properly attributed" to the table, PacifiCorp sprinkled powdered sugar on its stand-alone bookend, Avista at least tipped its hat at a middle-ground proposal, and Staff provided nothing while giving no indication that its position had completely reverted to what it had been before SB 408. As can be seen in CUB's Opening Comments, we believed Staff stood behind the temporary rules. The Attorney General's opinion was released in December, but Staff's Opening Comments were the first indication we had that Staff's position on "properly attributed" had moved, let alone reversed. The AR 499 workshop process clearly did not have the participation, and therefore the results, that were intended.

III. Stand-Alone = Lesser-Of Attribution = With-and-Without

We make no bones about it, PacifiCorp's With-and-Without proposal for "properly attributed" is the same, in any meaningful sense, as the stand-alone methodology the Commission has used in the past, and that PacifiCorp would like codified in its Lesser-Of Attribution.

To calculate a utility's stand-alone tax liability you can add up the taxable income or you can subtract that income out of a consolidated filing and take the difference. The first path to stand-alone PacifiCorp calls Lesser-Of Attribution; the second path to stand-alone PacifiCorp calls With-and-Without; they both, however, seek to produce a utility's stand-alone tax liability even when the utility is not stand-alone.

IV. Stand-Alone Tax Attribution Is An Anachronism

Enron purchased PGE in 1997; before then, reaching back into the 1970s, Oregon energy utilities were true stand-alone utilities. Stand-alone tax attribution is not without reason. As Staff is quick to point out, stand-alone tax imputation is easy, and it requires the least change from regulatory practice as it applies to true stand-alone utilities.

We now know that a utility's corporate family cannot be ignored as irrelevant, especially in regard to taxes and debt. Stand-alone tax attribution has a rather sordid history in Oregon, but regulatory practice has developed, and awareness of holding-company impacts on a utility are better understood. We have before us an opportunity to create a better system. Unfortunately, Staff and the utilities appear to be quite comfortable dragging the stand-alone attribution methodology out of the La Brea tar pits, hosing it off, and pretending it is something new.

A. How Can SB 408 Be Read As Anything Other Than A Call For Change?

It is difficult to reconcile proposals to continue using stand-alone attribution with what has happened over the last 18 months, most particularly the passage of SB 408. There was a clear belief that the way customers were being charged for taxes (stand-alone attribution) was neither fair nor reasonable, and needed to be changed. While SB 408 has delegated to the Commission the implementation of this change in tax attribution methodology, it cannot realistically be argued that SB 408 was not a rejection of the historic stand-alone approach.

i. SB 408 Could Have Been A One-Sentence Bill, But It Wasn't

If the legislature were simply trying to cap the taxes charged to customers at the level of the consolidated company's taxes, SB 408 could have been a one-sentence bill: A utility shall refund to customers any taxes it collects in excess of what it or its consolidated group pays to the government. Period. There would have been no reason to direct the Commission to begin with the consolidated taxes and "properly attribute" a share of those taxes to the regulated operations of the utility. Under Staff's view, most of SB 408 is meaningless.

ii. If SB 408 Does Not Require Change, Why Was It So Contentious?

The utilities, led by PacifiCorp, fought hard against SB 408. They obviously believed that the bill would require a change in the tax attribution methodology. Customer groups fought hard for it. They obviously believed that it would change the tax attribution methodology. To suggest that SB 408 was not intended to change utility tax attribution is to suggest that the parties involved were fighting passionately over something they believed was nothing.

iii. Stand-Alone Definition Of "Properly Attributed" Was Removed

While the Attorney General's opinion on "properly attributed" states that it is a delegative term for the Commission to interpret, it does note that one version of SB 408 had a definition of "properly attributed," which was then removed. The definition that was removed was one that defined properly attributed as stand-alone. This definition was placed into the bill by Representative Butler, who opposed SB 408 as currently written. The legislature made a very specific choice not to require stand-alone tax attribution.

V. Stand-Alone, Even With Consolidated Cap, Is Unfair

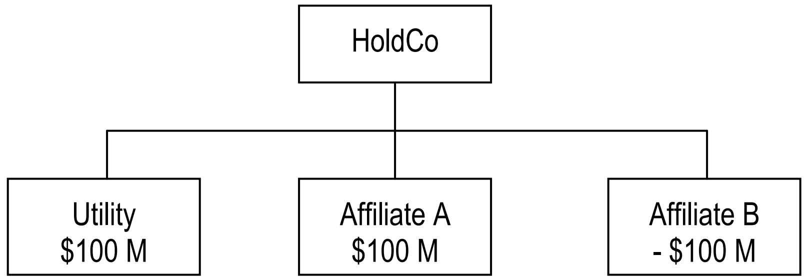
When a utility is part of a consolidated group,
what is the utility's fair share of the consolidated tax liability?

This is the fundamental question that needs to be answered in the definition of "properly attributed," it was the fundamental concern of CUB when we advocated for SB 408 in 2005, and it remains our fundamental concern today. It was also the concern that CUB sought to address in our testimony in UE 170. PacifiCorp's suggestion that CUB's position on SB 408 was simply the Section 3(12)(b) cap is ridiculous in light of CUB's concurrent arguments made in PacifiCorp's then-current rate case, UE 170, about the impacts of debt at a parent company, and the proper attribution of those interest deductions to the utility.

A. Unfair For Customers To Pay Greater Share Of Consolidated Liability

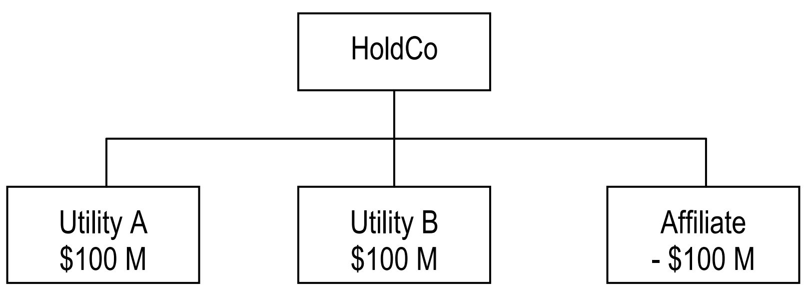
If, as Staff and the Utilities would like, taxes were attributed to an Oregon utility using the stand-alone approach, capped only by its corporate family's consolidated tax liability, then Oregon utility customers would be liable for up to 100% of the consolidated tax liability, regardless of the utility's contribution to the consolidated net income upon which the consolidated tax liability is based.

Consider the following example:



The holding company's consolidated tax liability in this example is $100 million, but the utility only contributed 50% of the holding company's net income. Is it fair for a utility to pay 100% of the consolidated tax liability when it only contributes 50% of the consolidated net income? Obviously, conglomerate corporate structures get far more complex, but the same principle applies. If a utility contributes 20% of the consolidated net income, should it pay 90% of the consolidated tax liability?

Consider this variation of the previous example:



In this case, there are two affiliate utilities, each with a $100 million stand-alone tax liability. The holding company's consolidated tax liability is $100 million. Neither Utility A nor Utility B have stand-alone tax liabilities greater than the holding company's consolidated tax liability, so the Section 3(12)(b) cap does not apply. Therefore, each utility's customers must pay $100 million in taxes – $200 million in total – to a holding company with a consolidated tax liability of $100 million. How is it possible to interpret this as the legislature's intent?

B. Stand-Alone Attribution Doesn't Work With Cost-Based Ratemaking

A fundamental principle of cost-based regulation is that rates should reflect the cost and a reasonable rate of return. In order to do this, one must identify the actual cost –the cost that is actually paid to the final recipient, not the cost that is paid by the utility to the holding company, who may or may not pay that cost to the final recipient. PacifiCorp's creative misapplication of the matching principle inflates a utility's tax cost, from the actual tax cost paid to the government, to a theoretical stand-alone tax cost that doesn't exist when a utility is part of a holding company structure. Ratepayers should not be required to pay a tax cost that doesn't really exist.

Though we don't typically look at taxes in light of the lower-of-cost-or-market standard, it is important to remember this basic principle when addressing affiliate relationships. With regard to taxes we have an actual cost (the conglomerate's consolidated tax liability) and we have a proxy for market (what the utility's stand-alone liability would have been were it actually stand-alone). Under this standard, customers should pay the lower of either the utility's fair share of the consolidated tax liability or the utility's theoretical stand-alone tax liability.

Cost recovery for a utility within a holding company structure must be based on appropriate consolidated costs. When a utility is part of a consolidated company, its costs for CEO salary, shareholder services, tax preparation, and other various overhead costs are presumed to be lower than if the company were stand-alone, as the utility now shares these costs. We don't charge ratepayers for these costs as if the utility were stand-alone.

If an actual consolidated cost or a utility's proportionate share of a cost is lower than what it would have been for a stand-alone utility, customers are not charged the higher, theoretical cost. It is immaterial whether a lower cost is due to economies of scale, corporate structure, or federal tax law. The cost that should be reflected in rates is the utility's share of the actual cost as part of a consolidated company.

C. Stand-Alone Attribution Encourages Exploitation Of Double-Leverage

The equity in a stand-alone utility's capital structure represents an equity investment. The equity in a subsidiary utility's capital structure, however, often represents debt elsewhere in the corporate structure. This was a serious concern of the Commission when it rejected Texas Pacific's bid to purchase PGE, and this circumstance also has serious tax implications for utilities within holding company structures.

Equity shareholders of a utility act as shock absorbers for the utility. When serious, unusual events happen such as the energy crisis of 2000-01, the 1962 Columbus Day storm, or the failure of the steam generator tubes at the Trojan nuclear plant, the utility's net income most likely drops, but its loan payments are likely to be steady. Under such circumstances, the utility can pay less in dividends to its shareholders, thus taking pressure off the utility. In the case of a consolidated company, however, where equity investment in the utility is financed by debt, the holding company's need to service this debt can result in pressure on the utility to pay dividends, even when it could be harmful to the utility and/or lead to inappropriate cost-cutting.

One reason consolidated companies finance equity in a utility with debt at the holding company is that the interest on that debt is tax deductible, and (using stand-alone attribution) can be used to reduce the conglomerate's consolidated tax liability without reducing the amount of taxes paid to the holding company by the utility customers. Double-leverage financing also allows a holding company to increase its return by increasing the higher-value equity portion of the utility's capital structure. As a result, the holding company earns a profit not only from the spread between the return on equity from the utility and the cost of debt at the holding company, but also on interest tax deductions that are not recognized in rates even though that debt supports equity at the utility. Debt-financed equity, however, can harm the utility and its customers. Stand-alone tax attribution is not only unfair, but it encourages the use of double leverage, and thereby puts utilities and their customers in a riskier position.

VI. Temporary Rules Remain The Best Implementation Of SB 408

The definition of "properly attributed" in the temporary rules remains the best implementation of SB 408. The clean and plainspoken definition in the temporary rules preserves the principle of fairness behind SB 408, and does not adulterate fair and proportional tax attribution by permitting customers to bear a greater proportion of the consolidated tax liability than is their share – even if the amount is capped. Unfairness is still unfair, even when it is capped. The definition of "properly attributed" in the temporary rules applies to all affiliates equally, all the time, and is therefore the simplest and most equitable implementation of tax attribution.

The definition of "properly attributed" in the temporary rules is both the simplest conceptual implementation, and the simplest practical implementation of those proposals that represent genuine change from stand-alone attribution. Staff's and Pacificorp's cries of burdensome work loads are over-blown and self-serving. The data needed would be supplied by the entity preparing the consolidated tax filing, it can all be managed on a spreadsheet, and Staff can request work papers as necessary and do spot audits to ensure proper compliance.

With regard to Staff workload, there is no need to audit an entire conglomerate every year. Staff doesn't do that with other large volume costs. Staff doesn't audit all power sales or purchases, the utility provides the information for each transaction, and Staff spot checks the data as necessary; Staff doesn't look into the details of every transaction. With regard to a utility's workload, reasonable costs of complying with SB 408 are certainly recoverable.

VII. Conceptual Approaches to Middle Ground

We have given a lot of thought about how to define "properly attributed," and have spent a good deal of time trying to identify possible middle-ground approaches to defining "properly attributed." Unfortunately, the workshops were not fertile ground for conceptual exploration, so the proposals before the Commission are limited to specific mechanisms. It is worth backing up a step and describing 3 conceptual approaches that could be used in defining "properly attributed."

A. Limit The Number Of Affiliates Considered

The first approach is to narrow the universe of affiliates that are being examined when looking at the consolidated company. The industrial customers' proposal is an example of this approach as they sought to limit the number of affiliate companies that "properly attributed" would apply to by looking at transactional relationships. There are likely other alternatives to limiting the number of affiliates.

B. Limit The Number Of Tax Deductions Considered

The second approach is to reduce the size and scope of a consolidated tax adjustment by examining the nature of the tax deductions. CUB's proposal is an example of this approach by eliminating accelerated tax deductions from affiliates, applying an interest deduction only when it is in the direct chain of utility ownership, and limiting the circumstances under which reductions due to affiliates' operating losses are considered. Certainly there are a variety of ways that this approach could be applied, as well.

C. Limit To Specific, Unfair Consequences Of Stand-Alone Attribution

Another approach is to limit tax adjustments to only those circumstances wherein the utility is paying an unjustly large share of the consolidated company's tax liability, in a manner that is not fair to customers of the utility. Avista's proposal modestly takes this approach by addressing the inherent unfairness that regulated utilities could pay <u>more</u> than a conglomerate's consolidated tax liability when a consolidated company owns more than one utility. Avista's proposal would still allow utility customers to pay up to 100% of the consolidated tax liability, however, even if the utility were providing only a fraction of the consolidated company's net income.

A better use of this approach would be to state that a utility's share of the consolidated taxes cannot be significantly greater than the utility's share of net income, and define what constitutes a significantly greater share. For example, the Commission could decide that a utility's contribution to payment of consolidated taxes cannot be more than 10% higher than the utility's contribution to consolidated net positive income from affiliates with positive income. Under this definition, if a utility represents 10% of the positive income, customers would not have to pay any more than 20% of the consolidated tax liability.

D. Conceptual Approaches Are Not Mutually Exclusive

Should the Commission choose to define "properly attributed" differently than in the temporary rules, any or all of these conceptual approaches could be used. In addition, each of these conceptual approaches has a variety of alternatives that could be considered. CUB sees no reason the Commission could not mix and match these concepts in crafting a middle-ground definition of "properly attributed."

VIII. Staff Opening Comments

Staff provided no middle-ground proposal in the workshops, and gave no indication of their about-face on "properly attributed." Instead, Staff cited the discretion afforded to the Commission by the Attorney General, and returned to the position staked out in Staff's February 2005 White Paper – a position which has since then been largely discredited by the passage of SB 408. Staff appears to be deaf to the legislature's directive, and mired in a historic tax attribution methodology that has shown itself to be unjust.

A. Staff Analysis

Staff's analysis of the options is decidedly wanting. Staff failed to analyze the practical implication of PacifiCorp's With-and-Without proposal, and simply accepted the Company's theoretical explanation as to why With-and-Without might produce a result different than that produced by stand-alone attribution. Staff was incorrect in stating that the With-and-Without proposal could be implemented using information from the tax forms themselves.

i. Stand-Alone Attribution Vs. With-And-Without

Staff appears to be comfortable with PacifiCorp's demonstration that the Company's With-and-Without proposal would produce different results, at a practical level, than stand-alone attribution:

> There are various reasons why this figure would be different from the utility standalone tax liability – e.g., affiliated tax losses that could only be offset by the utility's taxable income, impact of alternative minimum taxes, general business tax credits, etc.

PacifiCorp "With-and-Without" Proposal, footnote 1, page 2.

> As PacifiCorp stated in its proposal, this figure may be different from a traditional utility standalone tax liability due to factors such as affiliate losses offset by the utility's taxable income, alternative minimum taxes, and general business tax credits.

Staff Opening Comments, page 3.

While Staff parrots PacifiCorp's explanation of why the Company's With-and-Without proposal could theoretically yield different results than traditional stand-alone attribution, Staff, like PacifiCorp, provides zero support that, as a practical matter, this would ever be the case. We point out, with some amusement, that even the spelling "standalone" in Staff's quote is the same as in PacifiCorp's quote, while everywhere else in Staff's comments the spelling used is "stand-alone." CUB submitted a data request to PacifiCorp on May 4th asking the Company to substantiate its claim with actual numbers from its, ScottishPower's, and MidAmerican's tax reports over the last three years. As of yesterday, we have received no response.

If we are confident that PacifiCorp's With-and-Without proposal would produce no meaningfully different attribution than stand-alone attribution, and PacifiCorp has yet to demonstrate a meaningful difference, is Staff not even curious about the possibility that no meaningful difference would result? Does Staff not think this analysis would be helpful to the Commission?

ii. Not Quite That Simple

Staff's bias toward stand-alone attribution has led Staff to paint a rosier picture of the implementation ease of PacifiCorp's With-and-Without proposal, and a darker one of the temporary rules and customers' proposals. Specifically, Staff extols PacifiCorp's With-and-Without proposal as a "straightforward approach" involving a "pro forma calculation – using tax forms."[3] Staff seems to misunderstand the With-and-Without proposal. Staff appears to believe that PacifiCorp is proposing the removal of the corporate entity that includes the regulated operations of the utility from the consolidated filing, but that is not Pacificorp's proposal, and doing so would violate PacifiCorp's matching principle. PacifiCorp is proposing to remove, not the corporate entity that includes the utility, but rather the regulated operations of the utility. As the regulated operations of the utility are not separately identified on the tax forms, this approach requires something more than "a pro forma calculation – using tax forms."

B. Staff Reasoning

While Staff's practical analysis of the proposals on the table is deficient, Staff's theoretical reasoning for its conclusion is far behind.

[3] Staff Opening Comments, page 3.

i. Where Does Staff Stand?

Certainly, adjusting one's position based on new information or a developing rationale is perfectly reasonable; however, going from one extreme to the other and then back again is a neat trick.

Staff claims in its Opening Comments that, when writing the temporary rules, Staff believed that Section 3(7), which requires the Commission to properly attribute tax liability to affiliates, required a proportionate share approach.[4] Since the Attorney General's opinion had a different interpretation of Section 3(7), Staff claims that they now are free to revert to supporting stand-alone attribution, which Staff argues is fair to utilities. However, in support of the temporary rules, Staff argued that using stand-alone attribution would result in "unreasonable outcomes under certain circumstances," and that the loss allocation approach was more equitable. Consider the following excerpt from the Staff Report to the Public Utility Commission in September 2005:

> In response to staff's questions, PGE and PacifiCorp both indicated the public utility's stand-alone tax liability, up to the amount of the consolidated tax payment, should be used as the amount of taxes paid to government units that is properly attributed to the utility. This attribution approach would remedy the Enron-type situation that proponents of the bill cited. Staff, however, believes this approach would lead to unreasonable outcomes in certain circumstances. Consider the following example:

	Stand-Alone Tax Liability	PGE/PacifiCorp Proposed Attribution
Regulated Utility Operations	130	130
Affiliate X	130	70
Affiliate Y	-60	
Consolidated Tax Payment	200	200

> As shown, the PGE/PacifiCorp stand-alone approach would attribute the public utility's stand-alone tax liability of 130 as the public utility's "taxes paid." However, this also would mean that Affiliate X, with the same

[4] Staff Opening Comments, page 2.

> stand-alone tax liability as the public utility, could be attributed no more than 70 (that is, the 200 consolidated payment minus the public utility's 130 attribution). This is not a logical result. It is also inconsistent with Section 3(7) that requires a "properly attributed" calculation for unregulated affiliates.
>
> … A more equitable approach, …, is to determine an attribution or allocation based on the stand-alone tax liability of the affiliates that have a positive tax liability.[5]

Regardless of Staff's initial interpretation of Section 3(7) and the Attorney General's subsequent interpretation of Section 3(7), Staff's defense of the definition of "properly attributed" in the temporary rules as "a more equitable approach" than stand-alone attribution is correct.

ii. Genuine Costs – Just Don't Look Too Closely

> PGE, for example, made cash payments to Enron based on its stand-alone tax liability … It would be unreasonable not to recognize as taxes paid … payments, made for purposes of income taxes, when they are a genuine cost, <u>at least for the utility itself</u>.

Staff Opening Comments, page 3. Emphasis added.

First of all, in this quote, Staff completely abdicates any responsibility for costs utility customers pay when those costs come from outside the utility. If Enron had paid Ken Lay $5 million for his services, and the Commission had found that amount to be unreasonable, what could the Commission have done? From Staff's perspective, as long as PGE paid that amount to Enron, it would have been unreasonable not to charge customers the entire $5 million because this would have been a "genuine cost" by Staff's definition, regardless of how appropriate or reasonable the cost was. Staff's rationale leads to the conclusion that a utility pays its share of the conglomerate's CEO, therefore, customers must pay that amount, in full, regardless of how exorbitant it may be.

[5] AR 498, Staff Report, September 7, 2005, footnotes omitted, pages 2-3.

Fortunately, the Commission may disallow any cost it finds to be inappropriate, and customers are protected, despite Staff's reasoning, from paying such a salary.

Second, that salary payment would have been a "genuine cost," at least in the sense that the money actually would have reached the final recipient. Taxes on the other hand are not a "genuine cost" in this sense. Yes, customers pay tax dollars, but some of those tax dollars don't actually reach the government. Staff circular logic: the customers were charged for taxes, therefore, the taxes are a genuine cost, regardless of where the dollars go from there. It may be convenient and easy for Staff to acknowledge only the Section 3(12) cap, but otherwise blinding itself to a utility's place in a conglomerate holding company is negligent.

iii. Of Course Taxes Attributable Are A Function Of Corporate Family

Staff claims that a "loss-allocation approach could result in inequitable results among the four Oregon utilities,"[6] because two utilities with the same taxable income, but different corporate families, could be attributed different amounts of taxes. Well, of course, that's the point. Neither do utilities within holding companies make stand-alone tax filings to the government, nor do their affiliates. All the affiliates are rolled together into a consolidated filing. Why should a utility bear a greater burden of that consolidated filing than any other affiliate?

Proponents of SB 408 expressed concern that conglomerates, with Enron being the poster child, were collecting from customers more taxes in rates than was the utility's rightful share of the consolidated tax liability. That being the case, of course different corporate families – with different affiliates and different consolidated tax liabilities – will each have a different impact on their utilities, regardless of the utilities' theoretical

[6] Staff Comments page 3.

stand-alone tax liability. These different impacts are not inequitable. Quite the contrary, proportional attribution makes the share of the consolidated tax burden paid by a utility within its corporate family equitable.

Consider also the attribution of the costs of shareholder services, insurance, or other services provided to a utility by its corporate family. The utility pays a fraction of those costs based upon its share within the conglomerate. Utility customers don't pay 100% of these costs, or some arbitrarily established amount of these costs, regardless of the utility's place within the conglomerate. This kind of proportional attribution isn't inequitable; the costs in question are different, just as the tax circumstances within one utility's conglomerate will be different than those of a different utility within a different conglomerate.

Not only is Staff's "inequitable" rationale ridiculous, it also contradicts Staff's own suggestion that it would be okay for the Commission to adjust a tax forecast in a rate case if a "utility is affected by any factors that are not reflected in a stand-alone calculation." First, as Staff acknowledges, the Commission has already done this in UE 170. Second, the adjustment made by the Commission in UE 170 would, according to Staff's interpretation, create an "inequitable" circumstance, because PHI's debt, MidAmerican's debt, and other holding company debt are all different, so two utilities with the same taxable income, but different corporate parents would have different adjustments. By Staff's reasoning, the Commission's adjustment in UE 170 was inequitable because the exact same adjustment would not have been made to a utility that was not owned by PHI.

iv. The Automatic Adjustment Clause Shouldn't Be Automatic?

Staff questions whether the Commission should "adopt an approach that automatically reduces the utility's 'properly attributed' tax liability."[7] If we have this straight, the legislature directed the Commission to establish an automatic adjustment clause that Staff doesn't feel should capture tax differences automatically. Staff places a criteria on "properly attributed" that it should reflect tax adjustments the Commission has made in a rate case based on the benefit/burden test. From this criteria that Staff establishes, Staff concludes that the Commission is free to make these determinations in rate cases, but that these tax differences cannot automatically be captured in an automatic adjustment clause established by the legislature.

v. Rate Case Adjustments Cannot Meet The Demands Of SB 408

Staff recommends to the Commission stand-alone tax attribution (in the form of PacifiCorp's With-and-Without proposal) with "other adjustments as necessary"[8] that the Commission may make in a general rate case. First of all, if a tax adjustment is appropriate in a rate case, why would it not be appropriate in an automatic adjustment clause? If an adjustment is reasonable, then it's reasonable, whether it is made iteratively or automatically.

Second, SB 408 captures annual differences between taxes collected and taxes paid to government entities, regardless of how one defines that. In a rate case, taxes are forecast, and we certainly agree that the Commission should make adjustments as appropriate, but nothing in the rate case process reconciles the forecast to what was actually paid to government entities.

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[7] Staff Opening Comments page 4. Emphasis theirs.
[8] Staff Opening Comments, page 4.

Third, putting aside the problems associated with stand-alone attribution, Staff's reliance on general rate cases shows a lack of forethought about how the process might actually work. It is a utility's decision when to file a rate case, and it is no surprise that a utility will file when it will be in the shareholders' interest, and not when it would be in customers' interest. Not using an automatic adjustment clause just gives a utility one more factor it can use for its shareholders' benefit when timing its rate cases. The point of an annual automatic adjustment clause is that the adjustment is made every year, with or without a rate case, and automatically, so tax differences don't become a contested issue in every rate case. Which, by the way, doesn't fit so well with Staff's desire for simplicity.

Fourth, in part because of the annual purchased gas adjustment mechanism, gas utilities don't frequently file general rate cases. As gas utilities only sporadically file rate cases, tax differences that should have been captured by an automatic adjustment clause could slip through the cracks – well, the chasms – between rate cases. This also doesn't fit so well with Staff's concern about inequity between utilities in the implementation of SB 408, because tax adjustments made in rate cases would have a different impact on a utility that files frequently than on a utility that files occasionally. There are, of course, a number of reasons gas utilities may file more frequently in the future, such as net-to-gross feedback, but that remains to be seen.

Finally, Staff is quite circumspect about what adjustments the Commission might make in a general rate case. Staff mentions "factors" that affect the utility, "ratemaking adjustment[s] to income taxes such as [the Commission] made in docket UE 170," and "other adjustments as necessary."[9] Staff's defense of stand-alone attribution and their reference to their White Paper, which did not support any adjustments that originate at the consolidated company, will simply lead Staff to oppose in a rate case the adjustments that it opposes automatically including here.

IX. PacifiCorp Opening Comments

PacifiCorp's Opening Comments are littered with principles and mechanisms that the Company claims prohibit the Commission from changing its tax attribution methodology. The Company's arguments about the matching principle, cross-subsidization, and ring-fencing, all approach tax attribution from a very simplistic perspective, and appear to be the Company's attempt to obscure the fundamental question behind tax attribution that we stated earlier: when a utility is part of a consolidated group, what is the utility's fair share of the consolidated tax liability? PacifiCorp's arguments are easily turned on their heads when one looks a little more deeply at the issues involved.

A. The Matching Principle

PacifiCorp argues extensively that deviating from traditional stand-alone attribution will violate what the Company calls "the matching principle,"[10] and thereby "the cost-of-service approach to ratemaking."[11] However, if the matching principle leads to customer rates reflecting costs that either aren't real or are above the utility's reasonable share of the consolidated cost, then something is wrong. Worded another

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[9] Staff Opening Comments, page 4.
[10] PacifiCorp Opening Comments, page 2.
[11] Staff White Paper, <u>Treatment of Income Taxes in Utility Ratemaking</u>, February 2005, page 7, quoting <u>Accounting for Public Utilities</u>, Matthew Bender & Company, Inc. Publication 016, Release 21, October 2004.

way, are we matching a utility's contribution to consolidated net income with the utility's contribution to consolidated tax liability?

Please refer back to CUB's earlier discussion of cost-based ratemaking and the inherent unfairness of charging customers for a theoretical, stand-alone cost, when the actual cost to the utility as part of a conglomerate is quite different.

B. Cross-Subsidization

PacifiCorp warns the Commission that deviation from stand-alone attribution would result in cross-subsidization of the utility by unregulated affiliates. The Company goes so far as to claim that SB 408 and ORS 757.646(2)(c) have "conflicting mandates."[12]

Consider the example presented earlier: the utility with $100 million in stand-alone tax liability, Affiliate A with $100 million, and Affiliate B with - $100 million. The consolidated tax liability is $100 million, of which the utility pays $100 million and Affiliate A pays $0. So who would be cross-subsidizing who?!? SB 408 and ORS 757.646(2)(c) do not present conflicting mandates. In fact, SB 408 strengthens the mandate of ORS 757.646(2)(c), and directs the Commission to correct an inherent unfairness in the methodology that was being used to calculate taxes for customer rates.

C. Ring-Fencing

A utility's tax liability is not ring-fenced from its consolidated group. To the contrary, a utility's consolidated group files consolidated taxes that include the utility. Ring-fencing is used to isolate a utility from its corporate family. However, when taxes are filed on a consolidated basis – and include the utility – whatever theoretical isolation

[12] PacifiCorp Opening Comments, page 7.

there may have been is breached. If ring-fencing is designed to keep a utility separate from its corporate group, and a utility's taxes are consolidated with those of the corporate group, then the utility's taxes are not separate and there is no ring-fencing of taxes. The filing of a consolidated tax return obliterates any ring-fencing argument related to taxes.

D. Unfair Tax Attribution Is Not Unique To Enron

PacifiCorp has gone to great length to distance itself from the events leading up to the passage of SB 408, and to portray any abuse of customer tax payments as something unique to Enron.[13] This simply is not the case. While the tax profits that PacifiCorp's corporate parent reaps may not be as obvious as those reaped by Enron, they still exist. Enron may be the poster child for making additional profit from customer tax payments, and Enron's multitude of loss affiliates highlighted the injustice behind customer tax payments, but PacifiCorp's holding company structure under ScottishPower benefited in the same way.

As we stressed in our Opening Comments, SB 408 goes beyond simply Enron's shenanigans, and addresses the root cause behind Enron's tax windfall: stand-alone tax attribution. Even Staff acknowledges that this issue in not unique to Enron.

> [T]he issues surrounding how taxes are estimated have recently received a lot of interest primarily due to Enron's demise. However, the same issues apply to all utilities that have a holding company or unregulated subsidiaries.

UE 170 Staff/1000/Conway-Johnson/3. Footnote omitted.

If SB 408 was only intended to prevent the magnitude of abuse exemplified by Enron, a company of the past, then why did PacifiCorp fight so hard against the bill?

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[13] PacifiCorp Opening Comments, pages 4-5.

E. The Legislative History Does Not Support An Enron-Only Interpretation

PacifiCorp's claim that the customer groups only wanted SB 408 as protection from an Enron reoccurrence is absurd. As we mentioned earlier, at the same time as CUB fought in the legislature for SB 408, we were also fighting at the Commission to include PHI's interest deductions as a known and measurable change in PacifiCorp's tax forecast. Clearly, CUB's concerns about utility tax attribution were far more encompassing than simply capping taxes attributable to a utility at the level of its corporate family's consolidated tax liability. PacifiCorp's suggestions to the contrary are without merit.

PacifiCorp cites statements from SB 408's legislative history to support the Company's assertion that SB 408 was only about Enron. Unfortunately, even the quotes PacifiCorp provided[14] indicate that, though Enron was the most visible example, the problem with traditional utility tax attribution impacted customers of other utilities as well. Senator Rick Metsger qualifies his reference to Enron with "primarily," Senator Vicki Walker's quote doesn't even mention Enron, but does mention "the large electricity and gas utilities," and Michael Early also qualifies his Enron reference with "particularly," indicating that, though Enron was the epitome of the problem, it was by no means the extent of the problem. Would so many resources have been poured into SB 408 if the future were irrelevant? No, SB 408 was not only about Enron.

X. Conclusion

Enough. SB 408 was not only about Enron. Stand-alone tax attribution capped by the consolidated tax liability will not produce any meaningful reform. It is unjust to

[14] PacifiCorp Opening Comments, page 4.

require customers to pay a greater share of the consolidated tax liability than other affiliates with positive tax liabilities. The public has spoken, the legislature has spoken, and now it is time to remedy the injustice of stand-alone tax attribution.

Respectfully Submitted,
May 19, 2006

Bob Jenks
Executive Director

Lowrey R. Brown
Utility Analyst