

# McDowell & Associates PC

• • • • •

SARAH J. ADAMS LIEN  
Direct (503) 595-3927  
sarah@mcd-law.com

May 19, 2006

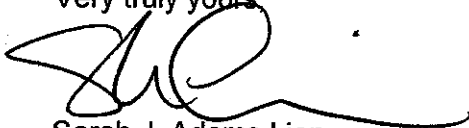
## VIA ELECTRONIC FILING

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

**Re: Docket AR 499**

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

Very truly yours



Sarah J. Adams Lien

Enclosures

cc: Service List

1                                   **BEFORE THE PUBLIC UTILITY COMMISSION**  
2                                   **OF OREGON**

3                                   **AR 499**

4 In the Matter of the Adoption of Permanent  
5 Rules to Implement SB 408, Relating to  
6 Matching Utility Taxes Paid with Taxes  
7 Collected

**PACIFICORP'S REPLY COMMENTS ON  
STRAW PROPOSALS**

8           PacifiCorp respectfully submits the following Reply Comments on the AR 499 Straw  
9 Proposals.

10                                   **I. KEY POLICY PRINCIPLES**

11           A review of the parties' divergent Opening Comments confirms that adherence to  
12 objective and indisputable principles is the only means to a fair outcome in this proceeding.  
13 In its Opening Comments, PacifiCorp suggested a list of key policies and principles to guide  
14 Commission decision-making in this docket: (1) fairness and rationality, which cannot be  
15 obtained without adherence to the matching principle; (2) authenticity with legislative intent;  
16 (3) consistency with general Commission policies; (4) practicality of implementation; and  
17 (5) sustainability.

18           Like PacifiCorp, Portland General Electric ("PGE") also proposed that the  
19 Commission test its interpretation and implementation of SB 408 against objective and  
20 indisputable principles that are the foundation of sound regulatory policy. See PGE Opening  
21 Comments at 2-3 (discussing application of SB 408 within the context of Commission  
22 regulatory obligations). The principles that PGE identified are: (1) the matching principle –  
23 *i.e.*, aligning benefits and burdens; (2) transparency – *i.e.*, making rules that are  
24 understandable by utilities, customers, the financial community, and other constituents; and  
25 (3) rationality – *i.e.*, making rules that can be applied in a non-arbitrary fashion. *Id.*

26           Similarly, in its comments on the straw proposals, Staff relied on the "fundamental  
principle of basing utility rates on utility costs and revenues, and prohibiting cross-

1 subsidization between utility and non-utility operations." See Staff Opening Comments at 2.  
2 Staff also relied on the matching principle, noting that "[i]f ratepayers are responsible for  
3 costs, they should receive the tax benefits associated with the costs; if they do not bear the  
4 costs, they should not get the related tax benefit." *Id.*

5 The Citizens' Utility Board of Oregon ("CUB") also identified the matching principle as  
6 a key principle that should guide the Commission's interpretation and application of SB 408.  
7 See CUB Opening Comments at 11 (proposing to "align the benefits of the interest tax  
8 deduction with the sources of payment for the debt"); *id.* at 4 (criticizing proposals for  
9 purportedly failing to "pass the benefit/burden test").

10 The Industrial Customers of Northwest Utilities and Northwest Industrial Gas Users  
11 ("ICNU/NWIGU") discuss a set of key policy principles in its opening comments.  
12 ICNU/NWIGU's second principle is the matching principle, albeit stated in an entirely one-  
13 sided manner. ICNU/NWIGU Opening Comments at 6 ("Principle 2: Tax benefits supported  
14 by utility revenues belong to ratepayers"). To restate this principle symmetrically: tax  
15 benefits belong to the entity that supports them. In other words, the entity that bears the  
16 burden of a deductible expense should receive the tax benefit of that expense.

17 It is not surprising that Staff, customers and utilities alike identified the matching  
18 principle as a core regulatory principle that must guide the Commission's decisions in this  
19 docket. Matching is a principle that benefits both customers and utilities, and adherence to  
20 the matching principle is necessary to preserve the balance between customer and utility  
21 interests necessary to provide rates that are fair, just and reasonable. See Commission  
22 White Paper at 12 (utility tax approaches that violate the matching principle "would be  
23 considered poor regulatory policy"); see *also* Memorandum to the Commission from  
24 Assistant Attorney General Jason Jones, p. 3 (Mar. 22, 2005) ("it is clear that regulators  
25 have discretion to use different methods of calculating tax allowances, but it is also true that  
26

1 whichever method is chosen it should be applied in a way that matches benefits and  
2 burdens”).

3       The matching principle is particularly important in the interpretation and application of  
4 SB 408, which has at its core the goal of aligning – *i.e.*, matching – taxes collected and  
5 taxes paid. See Formal Opinion Letter from Attorney General Hardy Meyers to Lee Beyer,  
6 Chair, Oregon Public Utility Commission re Oregon Laws 2005, Chapter 845, pp. 2, 11 (Dec.  
7 27, 2005) (“Op Atty Gen”) (The Commission must construe the phrase “properly attributed”  
8 in accordance with the general policy of SB 408, which is to “more closely align taxes  
9 collected by a regulated utility from its ratepayers with taxes received by units of  
10 government.”).

11       Specifically, SB 408 implicates the matching principle in the following respects:

- 12       • At its core, SB 408 requires the Commission to match taxes collected and  
13       taxes paid.
- 14       • SB 408 requires the Commission to measure taxes paid by looking at actual  
15       tax data for a particular tax year. Thus, to achieve the matching of taxes paid  
16       and collected mandated by SB 408, the measurement of taxes collected must  
17       also be based on actual data for the same period.
- 18       • SB 408 requires the Commission to consider the standalone tax liability of the  
19       utility’s regulated operations, excluding below the line items and Commission  
20       disallowances. To achieve proper matching, the measurement of taxes  
21       collected must also exclude these non-regulated items. Similarly, the  
22       Commission should define properly attributed to determine what taxes paid  
23       are properly attributed to the utility’s regulated operations only.
- 24       • The matching principle should govern the definition of properly attributed.  
25       The Attorney General’s opinion made clear that the legislative delegation to  
26       the Commission to determine what taxes are “proper” to attribute to the utility  
27       allows for continued adherence to the matching principle in the interpretation  
28       and application of SB 408. See Op Atty Gen at 7-9 (concluding that “properly  
29       attributed” is a delegative term because the word “properly” implicates  
30       concepts of fairness and reasonableness traditionally left up to an agency to  
31       define). Thus, the Commission should attribute tax benefits to customers  
32       only to the extent that customers bear the costs (*i.e.* burdens) associated with  
33       these benefits.

34       The matching principle is directly implicated by SB 408 and its consistent application  
35 in the law’s implementation is required to achieve a fair outcome in this rulemaking. A

1 decision supported by the matching principle insulates the result from charges that it was  
2 improperly politically- or influence-driven and contributes to its durability. Additionally, as  
3 PGE correctly observes, administrative rules that adhere to time-tested regulatory principles  
4 minimize the possibility that new unintended consequences will result from implementation  
5 of this complex legislation. For all of these reasons, to the extent the Commission ultimately  
6 determines that SB 408 requires a departure from the matching principle, the Commission  
7 should specifically identify the statutory provision that prevents adherence to the matching  
8 principle.

9 Applying a policy-based approach, the Commission should disregard "principles"  
10 suggested by parties that are really statements of desired outcomes, especially when they  
11 are in direct conflict with the matching principle. See ICNU/NWIGU Opening Comments at 6  
12 (Principles 3-4: "the OPUC must allocate to the Oregon utility some portion of the tax losses  
13 of the unregulated businesses within the consolidated group"; ratepayers "should pay only  
14 their proportionate share of each dollar of the consolidated income tax."). The Commission  
15 should not test the proposals in this proceeding based on whether they will result in a rate  
16 reduction for a particular utility. SB 408 does not mandate rate reductions. Instead, SB 408  
17 directs the Commission to use an automatic adjustment clause mechanism to align taxes  
18 authorized to be collected in rates with actual taxes paid and properly attributed to the  
19 regulated operations of the utility. To the extent that these amounts are already aligned, the  
20 bill does not require, or even authorize, a rate reduction.

21 The Commission should also reject suggested principles that are plainly  
22 inconsistent with SB 408's basic framework, such as ICNU/NWIGU's principle that  
23 implementation of SB 408 rules must be fact-specific. *Id.* at 14 (Principle 6 states that  
24 implementation of SB 408 should not be mechanical, but instead should involve a factual  
25 inquiry and determination by the Commission). SB 408 gives the Commission only 180  
26 days each year in which to set the automatic adjustment clauses for the four utilities subject

1 to SB 408, making factually specific implementation of the rules, such as that required by  
2 ICNU's 9-part test for defining a taxes paid subgroup, a practical impossibility.

3 PacifiCorp urges the Commission to develop implementation rules for SB 408 that  
4 align with the following combined list of principles developed from the parties' opening  
5 comments:

- 6 (1) Fairness and rationality, which cannot be obtained without adherence to the  
7 matching principle. This principle is identified as a key principle by  
PacifiCorp, PGE, Staff, CUB and ICNU/NWIGU.
- 8 (2) Authenticity with legislative intent. To sustain potential legal and political  
9 challenges, the rules adopted must be consistent with the stated intent of the  
Oregon legislature.
- 10 (3) Consistency with general Commission policies. Inconsistency with  
11 established ratemaking principles will likely result in misinterpretation and  
variances in the implementation of the rules by the utilities and the Staff.
- 12 (4) Practicality of implementation. Overly complex implementing rules will lead to  
13 confusion and could be difficult or impossible to administer within SB 408  
strict timelines.
- 14 (5) Sustainability. For the rules to stand the test of time, they must be balanced  
15 and take into account the importance of maintaining the financial integrity of  
Oregon's investor-owned utilities.
- 16 (6) Transparency. The rules must be clear and concise so that any observer of  
17 the process can understand the result and assess whether the rules comply  
with the legislation and the legislature's intent.

## 18 II. PACIFICORP'S PROPOSALS

### 19 A. **PacifiCorp's "Lesser Of" and "With and Without" Straw Proposals Reflect the 20 Intent of the Legislature to Meaningfully Change the Way Tax Expenses Are Passed on to Utility Customers.**

21 CUB's argument that "Lesser Of" is not consistent with legislative intent ignores the  
22 Attorney General's opinion to the contrary. See CUB's Opening Comments at 6. In his  
23 December 27, 2005, formal opinion letter, the Attorney General advised the Commission  
24 that it could adopt the "Lesser Of" approach because that approach is consistent with the  
25 legislature's intent. Op Atty Gen at 17.

26

1 PacifiCorp's "Lesser Of" proposal precisely reflects the reform described during the  
 2 SB 408 legislative debates and reflected in the SB 408 legislative record. See Opening  
 3 Comments of PacifiCorp at 3-6 (citing legislative history showing that SB 408 was designed  
 4 to fix the Enron problem or the offsetting of utility tax liability with unregulated losses). As  
 5 this chart from ICNU's legislative testimony in support of SB 408 demonstrates, ICNU's  
 6 position in the legislature based the tax adjustment on the "Lesser Of" the actual  
 7 consolidated and standalone taxes, without any suggestion of loss allocation, selective debt  
 8 attribution or financial impact on investors when, as in ICNU's scenarios 1, 2 and 4,  
 9 consolidated taxes paid are higher than what the utility collected in rates:

SB 408 ICNU Amendments (dollars in millions) <sup>1</sup>				
Year	1	2	3	4
Parent	N/A	\$500	\$(50)	\$450
(1) Taxes Collected in Rates	\$100	\$100	\$100	\$100
Taxes Paid to Governmental Units	\$100	\$600	\$50	\$550
Taxes Paid to Governmental Units and Attributed to Regulated Operations of the Utility	\$100	\$100	\$50	\$100
(2) <b>Adjustment to Rates</b>	<b>\$0</b>	<b>\$0</b>	<b>\$(50)</b>	<b>\$0</b>
Impact on Investors	Neutral	Neutral	Neutral	Neutral

18 The legislative reform that is embodied in the "Lesser Of" proposal, constitutes a  
 19 significant departure from past ratemaking practices. Under the "Lesser Of" proposal, unlike  
 20 under the previous standalone method, the clear boundary between regulated and  
 21 unregulated operations is no longer maintained. Thus, unlike under the traditional  
 22 standalone approach, under "Lesser Of," the Commission looks beyond the utility's  
 23 regulated operations to the taxes actually paid by the consolidated group and decreases  
 24 rates if the consolidated group paid less tax than the utility collected in rates. This difference

25 \_\_\_\_\_  
 26 <sup>1</sup> Table copied from Testimony of Michael Early on behalf of ICNU before the House  
 Committee on State and Federal Affairs work group on SB 408, p. 6 (June 30, 2005).

1 is illustrated in the ICNU table above, where Line (1) is the tax expense in rates based on  
2 the standalone method and Line (2) is the adjustment to rates based on the "Lesser Of"  
3 method. As the table illustrates, PacifiCorp's "Lesser Of" proposal would implement a cap  
4 that would prevent the kind of offsets about which CUB and ICNU complained during the  
5 legislative session. It is therefore disingenuous for the customer groups to now claim that  
6 "Lesser Of" would not "yield any meaningful tax reform." See Staff Report, AR 498 at 2  
7 (OPUC Dec. 7, 2005) ("Lesser Of" attribution approach would remedy the Enron-type  
8 situation that the proponents of the bill cited.).

9 **B. PacifiCorp's "With and Without" Proposal Attributes Even More Tax Benefits**  
10 **to Customers than Its "Lesser Of" Proposal.**

11 Throughout this rulemaking proceeding, PacifiCorp has engaged with Staff, customer  
12 groups, and other interested parties to develop a principled compromise proposal between  
13 the two so-called "bookend" approaches (the "Lesser Of" and Temporary Rule approaches).  
14 Specifically to address customers' concerns that SB 408 allocate to utility customers the tax  
15 benefits that the regulated operations of the utility bring to the consolidated group,  
16 PacifiCorp developed its "With and Without" proposal. See CUB Opening Comments at 3  
17 (arguing that "properly attributed" methodology should allocate to customers "tax benefits  
18 associated with [the utility] being a member of a conglomerate"). The proposal also  
19 addresses other concerns raised in the rulemaking proceeding about financial integrity of  
20 Oregon utility owners, encouraging financially sound owners and discouraging potentially  
21 imprudent financially leveraged owners.

22 PacifiCorp first presented its "With and Without" concept at the March 6, 2006  
23 AR 499 public workshop. The proposal subsequently evolved in direct response to  
24 concerns raised by Staff, CUB and ICNU, to make it applicable irrespective of the level of  
25 taxes collected in rates, and to track Staff's proposed "three pronged" approach to

26



1 determining taxes paid (*i.e.*, taxes paid is the lowest of (1) standalone, (2) consolidated and  
2 (3) the properly attributed amount).

3 PacifiCorp's "With and Without" proposal adds a third test to the "Lesser Of"  
4 calculation. Under its "With and Without" proposal, the amount of taxes paid and properly  
5 attributed is the lowest of three tests: (1) the standalone tax expense of the utility's  
6 regulated operations; (2) the actual tax payment of the utility's consolidated group which  
7 includes the utility; and, (3) the tax benefits caused by inclusion in the consolidated group of  
8 the utility's regulated operations (measured by comparing taxes paid by the consolidated  
9 group with and without the tax attributes of the regulated operations of the utility). The "With  
10 and Without" proposal quantifies the tax benefits the utility's regulated operations bring to  
11 the consolidated group by considering *all* entities in the utility's consolidated tax group and  
12 *all* tax attributes of the utility's regulated operations.

13 Because the "With and Without" proposal provides more tax benefits to customers  
14 than the "Lesser Of" proposal, CUB's and ICNU/NWIGU's characterization of the two  
15 proposals as substantively identical in every case fails to appreciate that the "With and  
16 Without" proposal is incremental – *i.e.*, it encompasses "Lesser Of" and adds to it. See CUB  
17 Opening Comments at 12-16; ICNU Opening Comments at 15.

18 CUB's numeric examples, which show both proposals always reaching identical  
19 outcomes, are fundamentally flawed. Given that CUB builds into its equation the  
20 assumption that the proposals are the same, it is no wonder the equation produces that  
21 result. See CUB Opening Comments at 13-14 (assuming that "without" amount equals the  
22 consolidated group tax liability minus the utility standalone tax liability; asking the  
23 Commission to consider the differences between "With and Without" and "Lesser Of" by  
24 "put[ting] aside complexities such as the alternative minimum tax, accelerated depreciation,  
25 etc."). Alternative minimum tax and accelerated depreciation are examples of the tax  
26 benefits that consolidated groups can reap by including the tax attributes of a utility's

1 regulated operations on the consolidated return. And it is precisely these tax benefits that  
2 will be captured by the "With and Without" approach. In essence, CUB is asking the  
3 Commission to compare the two proposals by first disregarding the factors that would make  
4 the proposals different.

5       The standalone tax liability is different from the "With and Without" amount because  
6 the "With and Without" amount takes into account *consolidated* tax adjustments (including  
7 net operating losses, alternative minimum tax computations, credits, limitations, etc.). The  
8 standalone amount, by its very definition, does not take into consideration any consolidated  
9 tax adjustments. Instead, the standalone amount is computed by considering the taxable  
10 attributes from regulated operations only, without regard to their effect on the consolidated  
11 group. In contrast, the "With and Without" amount captures both the standalone amount  
12 and the effect of the regulated operations of the utility on the consolidated group. The  
13 differences between the standalone amount and the "With and Without" amount are  
14 therefore the differences between the standalone liability caused by the utility's regulated  
15 operations and the consolidated liability caused by the utility's regulated operations.

16       These differences are directly related to actual tax return numbers including all of the  
17 tax attributes of the utility's regulated operations. Thus, when the tax return shows that the  
18 consolidated group reaped a benefit from inclusion of the utility's regulated operations on  
19 the consolidated return, an SB 408 rate reduction is appropriate. When it does not show  
20 such a benefit, then an SB 408 rate reduction is not appropriate (unless it is required by the  
21 first or second prong of the test).

22       ICNU's argument that the "With and Without" proposal does not meet the  
23 requirements of SB 408 is similarly erroneous. The Attorney General has already concluded  
24 that the "Lesser Of" approach meets the requirements of SB 408. See Op Atty Gen at 17.  
25 Given that the "With and Without" proposal will always provide customers with the same or  
26

1 more tax benefits than the "Lesser Of" proposal would, it is beyond debate that the "With  
2 and Without" proposal meets or exceeds the requirements of SB 408.

3 **C. PacifiCorp's Proposals Are Not Just "Enron Fixes."**

4 The "Lesser Of" and "With and Without" proposals provide meaningful rate relief  
5 whenever a utility or its affiliated group does not pay its taxes by offsetting net losses  
6 against utility taxable income. The "With and Without" proposal provides additional rate  
7 relief whenever a consolidated group reaps a tax benefit as a result of including an Oregon  
8 utility's regulated operations on the tax return of a consolidated group.

9 CUB complains that PacifiCorp's "Lesser Of" proposal would not result in rate  
10 reductions for PacifiCorp customers now that PacifiCorp is part of a consolidated group that  
11 generates substantial taxable income and ultimately pays significant taxes. See CUB  
12 Opening Comments at 2. While PacifiCorp cannot predict the future, based on past  
13 performance CUB is probably correct that the "Lesser Of" proposal will not affect PacifiCorp  
14 under Berkshire Hathaway ownership. This derives not from the fact that "Lesser Of" is  
15 flawed, but rather from the fact that the Berkshire Hathaway group is a financially strong,  
16 profitable owner that pays billions of dollars in taxes annually—an owner that most  
17 regulatory commissions would approve if given the opportunity and that Oregon approved  
18 when it consented to the acquisition of PacifiCorp. In other words, "Lesser Of" will likely not  
19 affect PacifiCorp under Berkshire Hathaway ownership because Berkshire Hathaway is  
20 financially strong and is not using PacifiCorp's taxable income to offset taxable losses of the  
21 consolidated group. "Lesser Of" would, however, still come to bear in situations where  
22 consolidated groups use utility taxable income to offset consolidated group losses.

23 In this way, the "Lesser Of" proposal provides the Commission with another tool to  
24 address problems related to a potentially financially unsound consolidated group. It  
25 encourages financially strong companies to own Oregon utilities while discouraging  
26 companies that are not profitable and financially strong. Because the "With and Without"

1 proposal incorporates all the benefits of the "Lesser Of" proposal, it also provides this added  
2 benefit.

3 CUB also complains that, like the "Lesser Of" proposal, the "With and Without"  
4 proposal would not affect PacifiCorp. Again, while PacifiCorp cannot predict the future tax  
5 liability of the Berkshire Hathaway group, it can safely say that, to the extent the Berkshire  
6 Hathaway group reaps a benefit as a result of including PacifiCorp's regulated operations in  
7 the consolidated group, the "With and Without" proposal will allocate these tax benefits to  
8 PacifiCorp customers.

9 As noted above, whether a proposal will result in rate reduction for a particular utility  
10 is not a valid test by which to judge the proposal. As long as taxes paid and taxes collected  
11 are matched, SB 408 does not require, or even authorize, a rate reduction.

12 **D. PacifiCorp's Proposals Do Not Negate Commission Adjustments to the Utility's**  
13 **Standalone Liability.**

14 CUB argues that PacifiCorp's proposals are a step backward in Commission utility  
15 tax policy because the proposals do not include a normalizing adjustment to reflect and  
16 preserve tax disallowances made in the rate case context. Addressing the same issue, Staff  
17 suggests an addition to PacifiCorp's "With and Without" proposal so that the final "taxes  
18 paid" amount reflects and preserves tax adjustments made in the rate case context.

19 Effectively, both CUB and Staff are arguing for the need to match the taxes paid side  
20 of the SB 408 equation with the taxes collected side, a position with which PacifiCorp  
21 agrees. A change to PacifiCorp's proposals, however, is not required to achieve this  
22 matching and preserve rate case adjustments. PacifiCorp calculates its standalone utility  
23 taxes paid (i.e., the Section 3(12)(a) amount) using its Semi-Annual results of operations,  
24 with Type I adjustments. Rate case adjustments to tax expense are preserved in the  
25 standalone calculation through the Type I adjustments, which include all Commission-  
26 ordered adjustments. In part to address the issue raised by Staff and CUB, and in part to

1 ensure the use of matching calculations, PacifiCorp proposes to use this same standalone  
2 number reflecting Type I adjustments in the "With and Without" calculation as the amount  
3 that is subtracted from the consolidated group total to determine the "Without" value. In this  
4 manner, the "Lesser Of" and "With and Without" proposals both preserve rate case tax  
5 adjustments in the calculation of taxes paid.

6 On the more general issue of rate case adjustments to tax expense, PacifiCorp  
7 agrees with Staff that a rate case adjustment based on affiliate losses or parent debt must  
8 be premised upon a showing of a "burden borne by utility customers." See Staff Opening  
9 Comments at 2-3; see also February 18, 2005 Department of Justice memorandum from  
10 Assistant Attorney General Jason Jones (advising that the Commission should follow a  
11 "benefits and burdens" standard in making rate case tax adjustments). This is in contrast to  
12 the tax adjustment made in UE 170, which Staff cites as an example in its comments. The  
13 adjustment in that case was not based on a factual showing that the utility was burdened by  
14 parent debt, but instead was an attempt to forecast or estimate PacifiCorp's future taxes  
15 paid. See Order 05-1050 at 19 (adjustment designed to reduce amounts flowing through  
16 automatic adjustment clause and was admittedly imprecise). Because this tax adjustment is  
17 different in kind than that contemplated by Staff, and because the adjustment is currently on  
18 reconsideration, PacifiCorp submits that a Type I adjustment to its Semi-Annual results of  
19 operations to capture this specific adjustment is inappropriate.

20

### III. THE TEMPORARY RULE

#### 21 A. The Temporary Rule Is Unsound Policy.

22 The now-lapsed Temporary Rule arbitrarily appropriates losses from utility affiliates.  
23 It does this without regard to whether utility customers bear any burden related to the loss,  
24 in violation of the matching principle. As a result, under the Temporary Rule approach,  
25 Oregon utility customers would receive a rate reduction if they are customers of a utility that  
26 is a member of a consolidated group that includes a company that provided insurance

1 coverage to victims of Hurricane Katrina. This would be true whether or not the  
2 consolidated group paid taxes far in excess of the utility's standalone tax liability.

3 As Staff observes, the Temporary Rule also results in inequities between the four  
4 utilities. Staff Opening Comments at 3. This is because the amount of taxes paid and  
5 attributed to each utility could vary widely due only to the structure of the utilities' corporate  
6 families and financial results of individual affiliates – even if the four utilities had the same  
7 taxable income and paid the same amount of tax to units of government.

8 What this means—contrary to CUB's assertions—is that the Temporary Rule would  
9 result in reductions based entirely on corporate structure. In this way, results under the  
10 Temporary Rule would change simply depending on whether two subsidiaries were merged.  
11 Compare CUB Opening Comments at 3 (arguing that the Temporary Rule approach “does  
12 not invite corporate rearranging”). In other words, whether the approach results in a rate  
13 adjustment when a utility's consolidated group pays taxes in excess of the utility's  
14 standalone tax liability could depend entirely on whether a utility's affiliates were separate or  
15 merged companies. The following table illustrates the effect of so-called “corporate  
16 rearranging” on rate adjustments under the Temporary Rule:

			Effect of Merging Affiliates X and Y	
	Standalone Tax Expense	Temporary Rule Properly Attributed Amount	Standalone Tax Expense	Temporary Rule Properly Attributed Amount
Utility	\$130	<b>\$100</b>	\$130	<b>\$130</b>
Aff. X	\$130	<b>\$100</b>		
Aff. Y	(\$60)	<b>\$0</b>	\$70	<b>\$70</b>
Actual Consolidated Tax Payment	\$200	<b>\$200</b>	\$200	<b>\$200</b>

24 As the table illustrates, although the actual consolidated tax payment remains the  
25 same, the utility's standalone tax expense remains the same, and the amount of the  
26 unregulated affiliates' net taxable income remains the same, rates are reduced \$30 if

1 Affiliates X and Y remain separate companies and rates are not reduced at all if Affiliates X  
2 and Y merge.

3 **B. The Temporary Rule Is Also Unworkable.**

4 Additionally, any proposal that requires the Commission to consider the standalone  
5 tax liabilities of the affiliates within a utility's consolidated group, such as the Temporary  
6 Rule, will be onerous to implement. Such approaches will require the Commission, on an  
7 annual basis, to gather and audit the confidential financial information and tax records of  
8 literally hundreds of unregulated affiliates of utilities. Under the terms of SB 408, the  
9 Commission must conduct this audit for all four Oregon utilities simultaneously and must  
10 complete its review within a maximum of 180 days. As Staff points out, not only would this  
11 be onerous and costly, it is also questionable public policy to require the Commission to  
12 gather and audit the tax information of hundreds of companies over which the Commission  
13 has no regulatory authority.

14 **IV. CUB'S AND ICNU/NWIGU'S ALTERNATIVE PROPOSALS**

15 **A. Unlike "With and Without," CUB's and ICNU/NWIGU's Alternative Proposals**  
16 **Are Not Meaningful Compromises.**

17 CUB's straw proposal has two main parts:

- 18 (1) Identify all affiliates in a utility's consolidated group that have net losses and,  
19 if the utility is earning above its authorized ROE, allocate a portion of the tax  
20 benefits from that affiliate's losses to utility customers (after determining  
21 which amount of those losses are attributable to accelerated depreciation and  
22 Oregon Business Energy Tax Credits and adding back those amounts).
- 23 (2) Identify all affiliates with interest expense greater than interest income in the  
24 utility's "chain of ownership" and allocate a portion of the tax benefits from  
25 that debt to utility customers (regardless of whether the utility is earning its  
26 authorized ROE).

24 ICNU/NWIGU proposes to define as "properly attributed" the lowest of the following  
25 three amounts:

- 26 (1) Total taxes actually paid by the tax-paying entity;

- 1           (2)     The share of the taxes paid by the tax-paying entity incurred as a result of  
2                   income generated by the utility, reduced to account for tax deductions and  
3                   credits incurred by other entities within the corporate family and affiliate  
              deductions related to interest payments on debt, if the interest payments are  
              supported, directly or indirectly, by the utility; and
- 4           (3)     Either the results of the Temporary Rule or a proportionate share of the taxes  
5                   paid and attributed to a subgroup of the corporate family.

6           CUB and ICNU/NWIGU claim that these alternative proposals are a compromise  
7 from their "bookend" proposal, the Temporary Rule approach. See CUB Opening  
8 Comments at 1; Straw Proposal of ICNU/NWIGU at 1. PacifiCorp appreciates that CUB has  
9 in fact compromised in two respects: (1) by proposing that unrelated affiliate losses only be  
10 allocated to utility customers when the utility is over-earning; and (2) by proposing that  
11 affiliate losses only be allocated to utility customers to the extent the losses are not caused  
12 by the affiliates' accelerated depreciation.

13          Despite these two compromises, CUB's alternative proposal, as well as  
14 ICNU/NWIGU's, is more extreme and violative of the matching principle than the Temporary  
15 Rule. Both proposals reach further into unregulated affiliates, seeking out the tax benefits of  
16 losses, whether or not the costs and risks of those losses are borne entirely by the affiliates.  
17 See PacifiCorp Opening Comments at 12-13 (numerically illustrating how the subgroup  
18 approaches allocate more affiliate losses to utility customers by excluding positive tax-  
19 paying entities from the group). Both proposals would allocate these individual affiliate tax  
20 attributes to the utility based on the standalone tax liabilities of a subgroup of companies  
21 that does not even include the actual tax-paying entity, and the proposals would do this  
22 without reference to the actual tax return.

23          The proposals fail to satisfy the two basic requirements that the Attorney General  
24 stated must be met by any approach to "properly attributed" – (1) they do not seek to "more  
25 closely align taxes collected by the regulated utility from its ratepayers with taxes received  
26 by units of government;" and (2) they would not produce rates that are fair, just and



1 reasonable. See Op Atty Gen 11, 2. See also Department of Justice Memorandum re  
2 Legality of Setting Rates Based upon the Tax Liability of the Parent (Feb. 18, 2005)  
3 (Commission tax policy must be rational and symmetrical). The Attorney General's opinion  
4 stated that the "so-called bookends" ("Lesser Of" and the Temporary Rule) are within the  
5 discretion of the Commission, and also anything in between. The more extreme attributes of  
6 CUB's and ICNU/NWIGU's approaches would require the Commission to venture outside of  
7 the parameters of the Attorney General's opinion.

8 **B. CUB's and ICNU/NWIGU's Subgroup Approaches Are Not Based Upon Sound**  
9 **Regulatory Principles and Are Unworkable.**

10 Under CUB's subgroup proposal, utility customers would receive a rate reduction  
11 whenever a utility had in its corporate "chain of ownership" an affiliate with interest expense  
12 greater than its interest income (CUB refers to this as "net debt"). CUB's proposal starts  
13 with the utility and looks up each level of utility ownership in a stepwise fashion. At each  
14 level, it looks to see whether any affiliate at that level has net debt. If so, the proposal would  
15 allocate the tax effects of that debt to the utility based on its share of the positive taxable  
16 income of all the entities in the subgroup (the utility and the entities at and below the level of  
17 ownership where the net debt resides).

18 Under ICNU/NWIGU's subgroup proposal, losses (*i.e.*, negative taxable income)  
19 within the subgroup would be allocated to utility customers. Although it is unclear precisely  
20 what entities would be included the ICNU/NWIGU subgroup, which they define by reference  
21 to nine factors, it is clear that the ICNU/NWIGU subgroup would include entities with debt  
22 "supported," "directly or indirectly" by the utility. However, the meaning of indirect support in  
23 this context is not specified. Similarly, the subgroup would include entities engaging in  
24 indirect transactions with the utility, but the meaning of indirect transactions is not specified.

25

26

1           **1.       Rather than Aligning Taxes Collected with Taxes Paid, CUB's and**  
2           **ICNU/NWIGU's Subgroup Approaches Would Disregard Actual Tax**  
3           **Payments.**

4           Contrary to the Attorney General's Opinion and the express mandate of SB 408,  
5           CUB and ICNU/NWIGU would have the Commission disregard actual total tax payments  
6           received by units of government and instead consider the individual tax attributes of  
7           individual affiliates within a selective subgroup. Op Atty Gen 11, 2 (definition of properly  
8           attributed must conform with overarching principle of SB 408, which is to align taxes paid  
9           and taxes collected); SB 408 § 3(13)(a) (defining affiliated group as the consolidated group).  
10          The legislature did not intend "taxes paid" to be the standalone tax liabilities of an  
11          unspecified group of companies, but rather the actual amount of taxes received by  
12          government from the tax-paying entity (the utility or its affiliated group). SB 408 § 3(13)(f)  
13          (defining taxes paid as the amount of payments received by government).

14          Under CUB's and ICNU/NWIGU's subgroup approaches, the Commission would  
15          base SB 408 adjustments on the tax attributes of a selective group or groups, without regard  
16          to the entire affiliated group's actual tax payments. Indeed, CUB and ICNU/NWIGU propose  
17          that the Commission allocate the tax effects of debt held within their defined subgroups  
18          without regard to whether the subgroup or the affiliated group has net positive taxable  
19          income.

20          By focusing on the individual tax attributes of affiliates (specifically interest expense),  
21          CUB and ICNU/NWIGU are moving away from an actual-taxes-paid approach, and back  
22          toward a standalone approach (albeit based on a single tax attribute's effect on affiliate  
23          standalone liability, rather than utility standalone liability). The legislature rejected a  
24          standalone, or hypothetical tax liability, approach in SB 408 and its mandate cannot be  
25          ignored simply because doing so would result in larger rate reductions.

26

1           2.       **By Excluding from their Subgroups Numerous Affiliates with Positive**  
2                   **Taxable Income, CUB's and ICNU/NWIGU's Subgroup Approaches**  
3                   **Would Allocate to Utility Customers Even More Affiliate Tax Benefits**  
                  **than Under the Temporary Rule.**

4           CUB's and ICNU/NWIGU's proposals create an artificial subgroup over which to  
5 spread tax benefits (thereby increasing the amount spread to utility customers). The result  
6 of selectively limiting the subgroup is that affiliate tax benefits are allocated  
7 disproportionately to a smaller group of entities, which increases the amount of affiliate tax  
8 benefits allocated to utility customers. This is an extreme departure from the Temporary  
9 Rules, which spread tax effects of affiliate losses among all positive taxpaying members of  
10 the utility's affiliated group. The fact that CUB's and ICNU/NWIGU's subgroup approaches  
11 would allocate even more affiliate tax benefits to utility customers illustrates the result-  
12 oriented nature of subgroups.

13           3.       **CUB's and ICNU/NWIGU's Subgroup Approaches Are Entirely**  
14                   **Unworkable Within the Context of SB 408.**

15           CUB's and ICNU/NWIGU's subgroup approaches are unworkable in the context of  
16 SB 408. SB 408, by its terms, requires the Commission to make automatic adjustment  
17 clause ("AAC") determinations within a maximum of 180 days. The Commission must make  
18 its AAC determinations for all Oregon utilities simultaneously. CUB's and ICNU/NWIGU's  
19 subgroup approaches would both require the Commission to make factual determinations  
20 within this time frame. CUB's subgroup proposal would require the Commission to  
21 determine whether affiliates within each utility's chain of ownership held net debt (as  
22 described above). ICNU/NWIGU's proposal would require the Commission to determine  
23 which of hundreds of affiliated entities fall within the subgroup, including determining which  
24 entities have debt that is directly or indirectly supported by utility customers and which  
25 entities have had direct or indirect transactions with the utility. After the Commission makes  
26 these factual determinations, it would still need to determine the standalone tax liabilities of

1 all members of the subgroup as well as certain other individual tax attributes of individual  
2 members (e.g., the existence of net debt (CUB) or debt (ICNU/NWIGU)). These  
3 determinations would not be simple or mechanical.

4 **C. CUB's and ICNU/NWIGU's Approaches to Affiliate Debt Are Unsound and**  
5 **Unworkable.**

6 CUB would have the Commission use SB 408 to reduce rates whenever any entity in  
7 the utility's "chain of ownership" has net debt. CUB's proposal would result in a rate  
8 reduction even when the utility's affiliated group pays its taxes, the entities in the utility's  
9 chain of ownership have net taxable income, the debt is used for purposes entirely unrelated  
10 to the utility (e.g., to invest in a different business), and the Oregon utility is not servicing the  
11 debt and is not otherwise burdened by the debt.

12 ICNU/NWIGU's proposal goes even further. They would have the Commission  
13 allocate affiliate debt to utility customers, regardless of whether the affiliated group and  
14 every member within the affiliated group had net positive taxable income – that is,  
15 ICNU/NWIGU would use SB 408 to reduce rates even when no one in the utility's group had  
16 net taxable losses. Rather than encouraging good, financially strong companies to own and  
17 invest in Oregon utilities, these proposals would discourage such companies from making  
18 any investment in Oregon utilities.

19 **1. Because They Fail to Focus on Taxes Actually Paid, CUB's and**  
20 **ICNU/NWIGU's Approaches to Debt Are Completely Disconnected from**  
21 **SB 408.**

22 Had the legislature intended SB 408 to allocate the tax effects of debt, without regard  
23 to actual taxes paid, it would have been a simple matter for it to say so in the text of the bill  
24 and the legislative record. But it did not. Nor did CUB, ICNU or NWIGU advocate for a bill  
25 that would allocate the tax effects of debt, without regard to actual taxes paid. Rather, they  
26 consistently advocated for a simple change – one that looks at actual taxes paid and  
refunds or surcharges customers between that amount and the amount of tax expense

1 collected in rates. See Statement of CUB/ICNU regarding SB 408, "Utility Customers Ask  
2 for Fairness and Equity: Taxes Collected Must Align with Taxes Paid; Vote Yes on SB 408-  
3 C." CUB and ICNU did not ask the Oregon legislature to "vote yes" on a bill that would  
4 allocate the effects of individual affiliate's tax deductible expenses to Oregon ratepayers  
5 regardless of whether the affiliate, the affiliated group or the utility paid its taxes.

6           **2. Both Proposals Mistakenly Assume that Utility Customers Bear the**  
7           **Burden of Affiliate Debt.**

8           ICNU/NWIGU and CUB attempt to justify their departure from the legislative intent to  
9 align taxes collected with taxes paid by asserting that their treatment of parent debt and  
10 affiliate losses is somehow required by the matching principle. See CUB Opening  
11 Comments at 11 (stating that utility "customers' payments service parent company debt");  
12 ICNU/NWIGU Opening Comments at 6-7 (assuming that any debt within the subgroup is  
13 "supported" by utility revenues, and thus, under ICNU/NWIGU's first "principle," the tax  
14 benefits of such debt must be allocated to utility customers).

15           However, neither CUB nor ICNU/NWIGU provide a methodology for identifying how  
16 and when the matching principle actually requires an adjustment to the utility's tax expense  
17 to reflect a burden on utility customers caused by parent debt or other affiliate losses. In  
18 other words, both proposals simply assume utility revenues are supporting affiliate debt  
19 without requiring customers to prove this assumption. As PacifiCorp's Opening Comments  
20 explain, the assumption that a utility is supporting debt at an affiliate simply because that  
21 debt exists ignores reality. PacifiCorp is not even expected to pay dividends for many years  
22 to come. See PacifiCorp Opening Comments at 14-15 (stating that net cash flows from  
23 PacifiCorp to shareholders are not anticipated for six years); see *also* S&P, "Research  
24 Update: PacifiCorp's Short-Term Rating Raised to 'A-1' Following Sale to MidAmerican  
25 Energy Holdings" (Mar. 22, 2006).

26

1 CUB's argument that dividends are used to make debt payments is even more  
2 problematic because it suggests that investors should be constrained in their use of the  
3 dividends, if any, from their Oregon utility investments. Moreover, a review of how parent  
4 entities use dividends was not a part of SB 408. Furthermore, a parent company's required  
5 rate of return on an investment in a utility subsidiary is only a function of the risk  
6 characteristics of the subsidiary utility. How any investor whether an individual or a holding  
7 company, finances its investment in the utility does not change the required rate of return of  
8 the utility. An individual's use of dividends received from his or her investment in a public  
9 utility's common stock to make his or her mortgage payment is no different than a holding  
10 company using a dividend from a utility subsidiary to finance debt service. CUB's argument  
11 fails when it is taken to its logical conclusions. In any event, with respect to PacifiCorp,  
12 there is no basis for claiming that MidAmerican intends to use dividends from PacifiCorp to  
13 finance debt related to the acquisition of PacifiCorp. Moreover, dividend safeguards are  
14 already in place as part of the transaction commitments to maintain certain minimum capital  
15 structure ratios.

16 As a result of their unsupportable assumption that ratepayers support parent debt,  
17 CUB's and ICNU/NWIGU's debt proposals actually depart from the matching principle.  
18 Because they fail to adhere to the matching principle, both proposals could result in rate  
19 reductions even when affiliate debt was incurred to support entities entirely unrelated to the  
20 utility and even when the debt was secured by unregulated assets. Likewise, as PacifiCorp  
21 explained in its opening comments, CUB's and ICNU/NWIGU's debt proposals would result  
22 in rate reductions even when more money flowed in reverse from the parent to the utility  
23 rather than from the utility to its parent. Clearly, using SB 408 to give a rate reduction  
24 whenever a corporate parent or other affiliate incurs debt, regardless of the circumstances  
25 of that debt and regardless of actual-taxes-paid, is inconsistent with the Commission's key  
26

1 policy principles and the plain language of SB 408, and would completely undermine the  
2 incentive to invest in Oregon utilities.

3           **3.       The Determination of Whether Utility Customers Bear the Burden of**  
4           **Affiliate Debt Is a Rate Case Determination.**

5           CUB's and ICNU/NWIGU's omission of any principled and feasible basis for  
6 identifying when customers are burdened by (or "support") affiliate debt highlights the fact  
7 that these are complex factual inquiries. Indeed, as the record from PacifiCorp's last  
8 general rate case, Docket UE 170, reveals, assessing whether customers bear the burden  
9 of an affiliate's debt is a complex and speculative inquiry. PacifiCorp agrees with Staff that  
10 the appropriate venue for addressing whether customers bear the burden of an affiliate  
11 expense is a utility's general rate case. As discussed above, SB 408 does not authorize nor  
12 provide sufficient time for the Commission to make a selective tax adjustment related to  
13 affiliate debt.

14           **V. NW NATURAL'S AND PGE'S EARNINGS TEST PROPOSALS**

15           While PacifiCorp believes the "Lesser Of" and "With and Without" proposals are  
16 practical and principled mechanisms to implement the legislative intent of SB 408 with  
17 respect to the calculation of "taxes paid," SB 408 also presents significant implementation  
18 issues with respect to comparing "taxes paid" to "taxes collected." PacifiCorp supports the  
19 resolution proposed by NW Natural and PGE to the problem of a mismatched comparison  
20 between "taxes paid" and "taxes collected" under SB 408.

21           **A.       The Earnings Test Proposals Provide a Means for the Commission to Avoid**  
22           **Harmful Unintended Consequences.**

23           The legislature intended SB 408 to provide a true-up mechanism for aligning the tax  
24 expense collected through rates with taxes actually received from a utility or its affiliated  
25 group and properly attributed to the utility. Despite this clear intent to align actual taxes  
26 collected with actual taxes paid, as enacted, SB 408 in fact appears to instead compare

1 taxes *assumed* in rates based on the utility's last general case with taxes actually paid. See  
2 SB 408 § 3(13)(e) (defining taxes collected by reference to net-to-gross ratio determined by  
3 the Commission when establishing the utility rates); Op Atty Gen at 26-27 (interpreting  
4 SB 408 § 3(13)(e) to require use of net-to-gross ratio from utility's last general rate  
5 proceeding); *see also id.* at 27 (acknowledging concern regarding differences between  
6 estimated rate case numbers and actuals); CUB Comments at 9-10 (acknowledging problem  
7 of using rate case net-to-gross ratio to derive "taxes collected").

8       Because a utility's revenues and costs vary each year, while its rates remain  
9 unchanged, the amount a utility actually collects in rates for its tax costs will differ from the  
10 amount assumed in the utility's last general rate case. As a result, SB 408 appears to direct  
11 a true-up between the tax expense included in rates for a hypothetical period with taxes  
12 actually paid for a different and actual period. This creates a mismatch that introduces  
13 unintended consequences and perverse incentives. For example, while the utility's "taxes  
14 paid" can decrease whenever the utility experiences changes in revenues and expenses  
15 between rate cases (e.g., higher fuel prices, low hydroelectric generation, unexpected  
16 generating plant outages, mild or severe weather, additions to rate base), the utility's "taxes  
17 collected" will remain artificially inflated because they will not reflect the reality of these cost  
18 changes. Thus, because of this mismatch, SB 408 would require a rate adjustment  
19 whenever a utility's costs change *even when that utility ultimately paid to government,*  
20 *dollar-for-dollar, every actual dollar collected from ratepayers for income taxes.*

21       In addition, as the time between rate cases increases, customers would receive  
22 more and more tax benefits for resources and costs incurred to serve them, but for which  
23 they are not paying. The result is that SB 408—unless mitigated through the use of an  
24 earnings test, deferred account or some other means of addressing the mismatch—would  
25 have the additional unintended consequence of accelerating the frequency of rate cases to

26



1 assure that taxes reflected in rates are consistent with what is included in the actual tax  
2 returns.

3       This mismatch problem has been described in AR 499 workshops and comments as  
4 the "double whammy" problem, because it causes an under-earning utility to suffer twice  
5 whenever actual costs exceed test year costs. First, the utility suffers from actual lower  
6 profits. Second, under SB 408, the taxes that it actually pays will be lower since taxes are  
7 reduced due to lower profits. Even though SB 408 recognizes the lower taxes paid, it does  
8 not apparently recognize the lower taxes collected. Instead, SB 408 compares the lower  
9 taxes paid with artificially high taxes assumed in rates, requiring an additional rate decrease  
10 *because the utility suffered higher costs and lower profits*. Equally counter-intuitive is the  
11 result for customers if the utility's profits, and thus taxes, are higher than assumed in the rate  
12 case. In this circumstance, customers would be facing a rate increase *because the utility*  
13 *realized lower costs and higher profits*, meaning that it paid higher taxes than the taxes  
14 estimated in its last rate case.

15       The earnings tests proposed by NW Natural and PGE provide a possible means for  
16 mitigating the perverse effects of these unintended consequences.<sup>2</sup> Because the earnings  
17 test proposals avoid perverse unintended consequences and promote matching, they are  
18 sound policy within the Commission's discretion.

19

20

21

---

22       <sup>2</sup> Another possible means would be to use deferred accounting to track the tax  
23 effects of changes in expenses between rate cases. These deferred accounts would be  
24 used to effectively match the two sides of the SB 408 equation by truing up the difference  
25 between taxes *assumed* to be collected in rates (based on rate case estimates) with taxes  
26 *actually* collected in rates. The deferred accounts would not be used to recover the actual  
expenses themselves (e.g., higher fuel prices), only to ensure that utility investors are not  
doubly harmed by both having to bear the expense and also losing the tax benefit  
associated with it. See, e.g., *In re PacifiCorp*, Application for Deferred Accounting  
Authorization for Expenses Associated with Utility Tax Liability, UM 1240 (OPUC Jan. 6,  
2006).

1           **1.     Because these Earnings Test Proposals Address the Perverse Effects**  
2           **of the Mismatch Problem, Concerns Based on Comparisons to Pass-**  
3           **Through Mechanisms Like the Gas Company's PGA Are Unfounded.**

4           As explained above, because SB 408 compares estimated taxes collected and  
5 actual taxes paid, the utility's "taxes collected" will remain artificially inflated when the utility  
6 suffers higher costs because the taxes collected will not reflect the reality of these cost  
7 changes. Because of this mismatch, unlike other pass-through mechanisms, SB 408 does  
8 not provide a mechanism for passing through actual tax costs.

9           Additionally, true pass-through mechanisms also typically *increase* rates when the  
10 utility's costs are *higher* than expected (and earnings are correspondingly lower) and  
11 decrease rates when the utility's costs are *lower* than expected (and earnings are  
12 correspondingly higher). Thus, pass-through mechanisms typically cause an "under-  
13 earning" utility to earn more and an "over-earning" utility to earn less. However, SB 408  
14 bases its adjustments on taxes only, which increase when earnings are high and decrease  
15 when earnings are low. Thus, SB 408 adjustments will cause an "under-earning" utility to  
16 earn even less and an "over-earning" utility to earn even more. Accordingly, because  
17 SB 408, unlike typical pass-through mechanisms, actually exacerbates under- or over-  
18 earning, an earnings test is uniquely appropriate in this context.

19           Despite the fact that other pass-through mechanisms do not typically have these  
20 perverse effects on earnings, many such mechanisms nevertheless include some form of  
21 earnings test to assure the reasonableness of the automatic adjustments. *See, e.g., In re*  
22 *PGE*, Order No. 05-1261, UE 165/UM 1187 (Dec. 21, 2005) (approving earnings test for  
23 power cost adjustment mechanism); *In re PacifiCorp*, UE 173, Closing Brief of CUB, at 8  
24 (recommending use of earnings test for power cost adjustment mechanism). *See also*  
25 OAR 860-022-0070 (requiring an earnings review in the context of gas utility purchased gas  
26 cost adjustment mechanisms).

1           **2.       Nor Does it Make Any Sense to Suggest that Utilities Can Mitigate**  
2           **these Perverse Effects Through Better Management of Costs.**

3           ICNU's suggestion that the utilities' concerns about the perverse effects of the  
4 mismatch problem should be addressed with internal cost-control measures is inconsistent  
5 with the realities of volatile power markets, low water years, plant outages, and numerous  
6 other uncontrollable events. Any of these uncontrollable events can cause a utility's costs to  
7 increase unexpectedly, earnings to decrease, and tax expense to decrease. Additionally,  
8 the mismatch problem occurs even when the utility manages its cost changes. As long as  
9 the utility is making investments in utility infrastructure at a rate that exceeds depreciation,  
10 the utility will be penalized by a mismatched SB 408 formula. To mitigate that result, the  
11 utility must continually update the amount of rate base included in rates and increase the  
12 frequency of its rate cases.

13           As explained above, because the "taxes paid" side of the calculation reflects actual  
14 taxes received by government, it will reflect the lower taxes paid as a result of the  
15 uncontrollable event. But, as the "taxes collected" side of the calculation reflects rate case  
16 assumptions based on the test period as opposed to actuals based on the applicable tax  
17 year, it will not reflect the lower taxes collected as a result of the unexpected event.  
18 Consequently, SB 408 will reduce rates to account for the phantom difference between  
19 actual taxes paid and estimated taxes collected caused by the unexpected event. To  
20 compound matters, by requiring a rate reduction, SB 408 will cause the already under-  
21 earning utility to earn even less.

22           The earnings tests proposed by NW Natural and PGE provide an appropriate and  
23 workable method to avoid exacerbating these perverse implementation outcomes. Contrary  
24 to ICNU/NWIGU's suggestions, the proposed earnings tests would *not* provide a basis for  
25 the utility to recover fluctuations in costs that it would otherwise be required to bear. Rather,  
26 they would provide a simple mechanism to avoid subjecting ratepayers to higher rates when

1 a utility is over-earning and jeopardizing the financial stability and credit quality of an already  
2 under-earning utility.

3 For a utility such as PacifiCorp, which is currently earning significantly below its  
4 authorized return on equity ("ROE"), without such an earnings test, the SB 408 "double  
5 whammy" will further exacerbate the utility's downward earnings spiral. *See In re*  
6 *PacifiCorp*, Docket UE 170, Exhibit PPL/317, Williams/3 (OPUC Feb. 6, 2006) (PacifiCorp's  
7 most recent semi-annual earnings report showed its unadjusted ROE to be 7.07% and its  
8 adjusted ROE to be 6.895%). Thus, unless addressed in this rulemaking proceeding or the  
9 utilities' deferred accounting proceedings, SB 408 could severely threaten Oregon utilities'  
10 ability to continue to invest in growth, provide reliable service and earn a reasonable return.  
11 See Standard & Poor's Credit FAQ, "Mid-American's Acquisition Of PacifiCorp—Implications  
12 For PacifiCorp's Bondholders" (Mar. 21, 2006) (from bondholder perspective, one of the  
13 "difficult regulatory environments" PacifiCorp faces is that created by SB 408); FitchRatings,  
14 "PacifiCorp" (Mar. 7, 2006) (a Key Credit Concern is the adverse tax ruling based on SB  
15 408); Moody's Investors Service, "Ratings Action: PacifiCorp" (Feb. 28, 2006) (regulatory  
16 and legislative issues in Oregon which could impact future credit quality include the outcome  
17 of the permanent rulemaking implementing SB 408). While not the only possible method to  
18 avoid this outcome, the earnings tests proposed by NW Natural and PGE provide a simple  
19 and mechanical approach that could easily be applied within the tight timeframe mandated  
20 for SB 408 determinations.

21 **B. Additionally, Unless Mitigated, the Mismatch Problem Will Result in Rates that**  
22 **Violate the ORS 756.040 and 757.210 "Fair, Just and Reasonable" Rate**  
23 **Standard.**

24 The perverse effects of the mismatch or "double whammy" problem, if unmitigated,  
25 will result in rates that fail to meet the statutory "fair, just and reasonable" requirement. NW  
26 Natural's and PGE's proposed earnings tests provide a simple and mechanical way to avoid  
this statutory violation.

1 ICNU/NWIGU argue that the Oregon legislature "rejected" an earnings test proposal  
2 when it passed SB 408. ICNU/NWIGU Opening Comments at 18-19. Exactly the opposite  
3 is true. Clearly, SB 408 did not take away the Commission's authority or duty to assure that  
4 the effect of its rate orders conforms to statutory and constitutional standards. See Op Atty  
5 Gen at 16 (regardless of method for determining properly attributed rates must be "fair and  
6 reasonable" under ORS 756.040(1)); *In re PacifiCorp*, Order No. 05-1202, UE 170, at 2-3  
7 (concluding that ORS 756.040 and 757.210(1), as amended by SB 408, requires rates to  
8 meet the "fair, just and reasonable" standard); see also *Duquesne Light Co. v. Barasch*, 488  
9 US 299, 311, 109 S Ct 609, 102 L Ed 2d 646 (1989) ("[i]f the total effect of a rate order  
10 cannot be said to be reasonable, judicial inquiry \* \* \* is at an end") (quoting *FPC v. Hope*  
11 *Natural Gas Pipeline*, 302 US 591, 602 (1944)).

12 Indeed, SB 408 affirmed that there is a "downward limitation" on rates that applies to  
13 all rate orders. See Statement of Deputy Attorney General Peter Shepherd, House State  
14 and Federal Affairs Work Session on SB 408 (July 15, 2005) ("[The] PUC cannot allow the  
15 adjustment if it would result in a rate which is not fair, just and reasonable, as the terms of  
16 the total rate. So, that there would be an upward limitation, as well as a downward  
17 limitation."); Written Testimony of Deputy Attorney General Peter Shepherd submitted to  
18 House State and Federal Affairs Committee Work Session on SB 408 (June 30, 2005)  
19 (describing "fair, just and reasonable" language as providing protection against *Hope*  
20 violation); see also Statement of Rep. Robert Ackerman, House Chamber Session (July 30,  
21 2005) ("I conclude that the 'fair, just and reasonable' standard and the limited use of the  
22 automatic adjustment clause satisfies constitutional requirements. Now that is from our  
23 Legislative Council.").

24 Thus, not only *may* the Commission incorporate an earnings review into its SB 408  
25 review, it *must* consider the overall impact on a utility's earnings of any of its rate orders—  
26 including orders under SB 408.


1 Staff recommended in their opening comments that the Commission meet this  
2 requirement by providing a procedure whereby each utility, on a case by case basis, could  
3 initiate a proceeding to review the effect of an SB 408 adjustment on its financial health.  
4 Staff Opening Comments at 6. Such a procedure might work in other contexts, but here, the  
5 expedited timeframe mandated by SB 408 does not allow for a separate substantive  
6 earnings review. In contrast, the earnings tests proposed by NW Natural and PGE provide  
7 a workable means for the Commission to meet its statutory and constitutional mandates  
8 within the strict time limits of SB 408.

## 9 VI. CONCLUSION

10 For the reasons stated above and in PacifiCorp's Opening Comments on Straw  
11 Proposals, the Commission should reject the results-driven, selective and asymmetrical  
12 approaches presented in the Straw Proposals of ICNU/NWIGU and CUB. Instead, the  
13 Commission should adopt PacifiCorp's "Lesser Of" proposal to implement rules most  
14 consistent with the matching principle and other key principles underlying SB 408.  
15 Alternatively, the Commission should adopt PacifiCorp's equally straightforward "With and  
16 Without" proposal if the Commission determines that it is appropriate to allocate  
17 consolidated tax benefits beyond those already provided in the "Lesser Of" proposal. The  
18 Commission should also adopt NW Natural's or PGE's earnings test proposals, both of  
19 which adhere to the matching principle and provide a workable mechanism for avoiding  
20 otherwise perverse and unreasonable outcomes under SB 408.

21 DATED: May 19, 2006.

McDOWELL & ASSOCIATES PC

22  
23  
24   
Katherine A. McDowell  
Sarah J. Adams Lien

25  
26 Attorneys for PacifiCorp

1

## CERTIFICATE OF SERVICE

2 I hereby certify that I served a true and correct copy of the foregoing document in  
3 Docket AR 499 on the following named person(s) on the date indicated below by email and  
4 first-class mail addressed to said person(s) at his or her last-known address(es) indicated  
5 below.

6 Rates & Regulatory Affairs  
7 Portland General Electric  
8 121 SW Salmon Street, 1WTC0702  
Portland, OR 97204  
[pge.opuc.filings@pgn.com](mailto:pge.opuc.filings@pgn.com)

Gary Bauer  
Northwest Natural  
220 NW 2nd Ave  
Portland OR 97209  
[gary.bauer@nwnatural.com](mailto:gary.bauer@nwnatural.com)

9  
10 Julie Brandis  
11 Associated Oregon Industries  
12 1149 Court St NE  
Salem OR 97301-4030  
[jbrandis@aoi.org](mailto:jbrandis@aoi.org)

Lowrey R Brown  
Citizens' Utility Board of Oregon  
610 SW Broadway, Suite 308  
Portland OR 97205  
[lowrey@oregoncub.org](mailto:lowrey@oregoncub.org)

13 Ed Busch  
14 Public Utility Commission of Oregon  
15 PO Box 2148  
16 Salem OR 97308-2148  
[ed.busch@state.or.us](mailto:ed.busch@state.or.us)

R. Tom Butler  
[tom@butlert.com](mailto:tom@butlert.com)

17 Rep Tom Butler  
18 H-289 State Capitol  
19 Salem OR 97310  
[cpatom@fmtc.com](mailto:cpatom@fmtc.com)

Randall Dahlgren  
Portland General Electric  
121 SW Salmon St 1WTC 0702  
Portland OR 97204  
[randy.dahlgren@pgn.com](mailto:randy.dahlgren@pgn.com)

20  
21 Melinda J Davison  
22 Davison Van Cleve PC  
23 333 SW Taylor, Ste 400  
Portland OR 97204  
[mail@dvclaw.com](mailto:mail@dvclaw.com)

Jim Deason  
Attorney At Law  
521 SW Clay St Ste 107  
Portland OR 97201-5407  
[jimdeason@comcast.net](mailto:jimdeason@comcast.net)

24 Michael Early  
25 Industrial Customers of Northwest Utilities  
26 333 SW Taylor Ste 400  
Portland OR 97204  
[mearly@icnu.org](mailto:mearly@icnu.org)

Jason Eisdorfer  
Citizens' Utility Board of Oregon  
610 SW Broadway Ste 308  
Portland OR 97205  
[dockets@oregoncub.org](mailto:dockets@oregoncub.org)

1 Steve Evans  
2 MidAmerican Energy Holdings Company  
3 666 Grand Ave  
4 Des Moines IA 50303  
5 [srevans@midamerican.com](mailto:srevans@midamerican.com)

Don M Falkner  
Avista Utilities  
PO Box 3727  
Spokane WA 99220-3727  
[don.falkner@avistacorp.com](mailto:don.falkner@avistacorp.com)

5 Edward A Finklea  
6 Cable Huston Benedict Haagensen  
7 & Lloyd LLP  
8 1001 SW 5<sup>th</sup> Ave, Suite 2000  
9 Portland OR 97204  
10 [efinklea@chbh.com](mailto:efinklea@chbh.com)

Ann L Fisher  
AF Legal & Consulting Services  
2005 SW 71st Ave  
Portland OR 97225-3705  
[energylaw@aol.com](mailto:energylaw@aol.com)

9 Andrea Fogue  
10 League of Oregon Cities  
11 PO Box 928  
12 Salem OR 97308  
13 [afogue@orcities.org](mailto:afogue@orcities.org)

Kelly Francone  
Energy Strategies  
215 South State St Ste 200  
Salt Lake City UT 84111  
[kfrancone@energystrat.com](mailto:kfrancone@energystrat.com)

13 Paul Graham  
14 Department of Justice  
15 Regulated Utility & Business Section  
16 1162 Court St NE  
17 Salem OR 97301-4096  
18 [paul.graham@state.or.us](mailto:paul.graham@state.or.us)

Robert Jenks  
Citizens' Utility Board of Oregon  
610 SW Broadway Ste 308  
Portland OR 97205  
[bob@oregoncub.org](mailto:bob@oregoncub.org)

17 Judy Johnson  
18 Public Utility Commission  
19 PO Box 2148  
20 Salem OR 97308-2148  
21 [judy.johnson@state.or.us](mailto:judy.johnson@state.or.us)

Jason W Jones  
Department of Justice  
Regulated Utility & Business Section  
1162 Court St NE  
Salem OR 97301-4096  
[jason.w.jones@state.or.us](mailto:jason.w.jones@state.or.us)

21 Gregg Kantor  
22 Northwest Natural  
23 220 NW Second Ave  
24 Portland OR 97209  
25 [gsk@nwnatural.com](mailto:gsk@nwnatural.com)

Margaret D Kirkpatrick  
Northwest Natural  
220 NW 2nd Ave  
Portland OR 97209  
[margaret.kirkpatrick@nwnatural.com](mailto:margaret.kirkpatrick@nwnatural.com)



1	Elisa M Larson	Pamela G Lesh
2	Associate Counsel	Portland General Electric
3	NW Natural	121 SW Salmon St 1WTC 1703
4	220 NW Second Avenue	Portland OR 97204
	Portland OR 97209	<a href="mailto:pamela.lesh@pgn.com">pamela.lesh@pgn.com</a>
5	<a href="mailto:elisa.larson@nwnatural.com">elisa.larson@nwnatural.com</a>	
6	Ken Lewis	Raul Madarang
7	P.O. Box 29140	Portland General Electric
8	Portland OR 97296	121 SW Salmon, 1WTC
9	<a href="mailto:kl04@mailstation.com">kl04@mailstation.com</a>	Portland, OR 97204
10		<a href="mailto:raul.madarang@pgn.com">raul.madarang@pgn.com</a>
11	Ron McKenzie	Daniel W Meek
12	Avista Utilities	Attorney at Law
13	Po Box 3727	10949 SW 4th Ave
14	Spokane WA 99220-3727	Portland OR 97219
15	<a href="mailto:ron.mckenzie@avistacorp.com">ron.mckenzie@avistacorp.com</a>	<a href="mailto:dan@meek.net">dan@meek.net</a>
16		
17	Senator Rick Metsger	David J Meyer
18	State Capitol	Avista Corporation
19	900 Court St NE S-307	PO Box 3727
20	Salem OR 97301	Spokane WA 99220-3727
21	<a href="mailto:sen.rickmetsger@state.or.us">sen.rickmetsger@state.or.us</a>	<a href="mailto:david.meyer@avistacorp.com">david.meyer@avistacorp.com</a>
22		
23	Kelly O. Norwood	Thomas R Paine
24	Avista Utilities	Avista Corporation
25	PO Box 3727	1411 East Mission
26	Spokane, WA 99220-3727	Spokane WA 99202
	<a href="mailto:kelly.norwood@avistacorp.com">kelly.norwood@avistacorp.com</a>	<a href="mailto:tom.paine@avistacorp.com">tom.paine@avistacorp.com</a>
1		
2	Matthew W Perkins	Dan Pfeiffer
3	Davison Van Cleve PC	Idaho Public Utility Commission
4	333 SW Taylor, Ste 400	472 West Washington Street
5	Portland OR 97204	Boise ID 83720
6	<a href="mailto:mwp@dvclaw.com">mwp@dvclaw.com</a>	<a href="mailto:dan.pfeiffer@puc.idaho.gov">dan.pfeiffer@puc.idaho.gov</a>
7		
8	Paula E Pyron	Lisa F Rackner
9	Northwest Industrial Gas Users	Ater Wynne LLP
10	4113 Wolf Berry Court	222 SW Columbia St Ste 1800
11	Lake Oswego OR 97035-1827	Portland OR 97201-6618
12	<a href="mailto:ppyron@nwigu.org">ppyron@nwigu.org</a>	<a href="mailto:lfr@aterwynne.com">lfr@aterwynne.com</a>
13		

1 Dave Robertson  
2 Portland General Electric  
3 121 SW Salmon, 1WTC  
4 Portland, OR 97204  
5 dave.robertson@pgn.com

Ausey H. Robnett, III  
Paine, Hamlen, Coffin, Brooke  
& Miller LLP  
PO Box E  
Coeur D'Alene, ID 83816-0328

6 Inara Scott  
7 Portland General Electric  
8 121 SW Salmon St  
9 Portland OR 97204  
10 inara.scott@pgn.com

Bob Tamlyn  
Portland General Electric  
121 SW Salmon St  
Portland OR 97204  
bob.tamlyn@pgn.com

11 Douglas C Tingey  
12 Portland General Electric  
13 121 SW Salmon 1WTC13  
14 Portland OR 97204  
15 doug.tingey@pgn.com

Jay Tinker  
Portland General Electric Company  
121 SW Salmon Street, 1WTC 0702  
Portland OR 97204  
jay.tinker@pgn.com

16 Rick Tunning  
17 MidAmerican Energy Holdings Co  
18 666 Grand Avenue  
19 Des Moines IA 50303  
20 rtunning@midamerican.com

Senator Vicki L Walker  
State Capitol  
PO Box 10314  
Eugene OR 97440  
sen.vickiwalker@state.or.us

21 Benjamin Walters  
22 City of Portland  
23 Office of City Attorney  
24 1221 SW 4th Ave - Rm 430  
25 Portland OR 97204  
26 bwalters@ci.portland.or.us

Linda K Williams  
Kafoury & McDougal  
10266 SW Lancaster Rd  
Portland OR 97219-6305  
linda@lindawilliams.net

Marcus Wood  
Stoel Rives LLP  
900 SW 5<sup>th</sup> Avenue, Suite 2600  
Portland, OR 97204  
mwood@stoel.com

DATED: May 19, 2006.



Sarah J. Adams Lien

Of Attorneys for PacifiCorp