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March 21, 2011

Via FedEx and Electronic

Public Utility Commission
Attn: Filing Center
550 Capitol St. NE #215
P.O. Box 2148
Salem OR 97308-2148

Re: In the Matter of OREGON PUBLIC UTILITY STAFF Requesting the Commission direct PACIFICORP, dba PACIFIC POWER & LIGHT COMPANY, to file tariffs establishing automatic adjustment clauses under the terms of SB 408.
Docket No. UE 177

Dear Filing Center:

Enclosed please find an original and six (6) copies of the Reply Brief of the Industrial Customers of Northwest Utilities ("ICNU") in the above-referenced docket.

Please return one file-stamped copy of the Reply Testimony in the self-addressed, stamped envelope provided.

Thank you for your assistance, and please do not hesitate to contact our office if you have any questions.

Sincerely yours,

/s/ Sarah A. Kohler
Sarah A. Kohler

Enclosure

cc: Service List

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing Reply Brief on behalf of the Industrial Customers of Northwest Utilities upon the parties, on the service list, by causing the same to be deposited in the U.S. Mail, postage-prepaid, where paper service has not been waived.

Dated at Portland, Oregon, this 21th day of March, 2011.

/s/ Sarah A. Kohler
Sarah A. Kohler

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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 177(4)

In the Matter of OREGON PUBLIC UTILITY STAFF Requesting the Commission Direct PACIFICORP (dba PACIFIC POWER & LIGHT COMPANY) To File Tariffs Establishing Automatic Adjustment Clauses Under the Terms of SB 408.	)))))))))))))	REPLY BRIEF OF THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

I. INTRODUCTION

Pursuant to the February 15, 2011 Prehearing Conference Report, the Industrial Customers of Northwest Utilities ("ICNU") submits the following reply brief urging the Oregon Public Utility Commission (the "Commission") to reject the income tax surcharge proposed by PacifiCorp (or the "Company"), Staff and the Citizens' Utility Board ("CUB") (jointly, the "Settling Parties"). The Settling Parties raise a host of arguments that do not directly address the central remaining issue in this proceeding: how to account for PacifiCorp's 2009 negative taxable income under the stand-alone method? The Settling Parties propose that PacifiCorp's parent company, Berkshire Hathaway, be allowed retain all of the benefits associated with this negative taxable income, which is inconsistent with how PacifiCorp would treat these losses if it were a stand-alone company and with how Portland General Electric Company's ("PGE")

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negative taxable income was addressed in UE 178(4). The Settling Parties' arguments in their briefs are merely distractions from this fundamental issue, because they are based primarily on erroneous factual allegations or they identify changes to Ms. Blumenthal's tax calculation that ICNU has already agreed should be made.

II. ARGUMENT

1. ICNU's Approach Is Consistent with How PGE's Tax Report Addresses Negative Taxable Income

PacifiCorp and Staff argue that ICNU's position in UE 178(4) is inconsistent with its position in this proceeding, and that ICNU's proposal is different from the methods used in the PGE tax stipulation. PacifiCorp Brief at 17-18.[1/] The Commission should reject these attempts to confuse the issues. ICNU is no longer opposing the stipulation in UE 178(4), and ICNU's previous concerns regarding the PGE stipulation did not address how negative taxable income should be considered under the stand-alone method.

PacifiCorp and Staff attempt to distinguish the PacifiCorp tax report from the PGE tax report with the simple, but misleading, argument that the PGE case was resolved under the consolidated method. Id. at 17. The use of either the consolidated or stand-alone method is not fundamental to PGE's tax calculations because PGE's taxes make up almost all of its consolidated return. In other words, PGE treats negative taxable income in virtually the same way regardless of whether it files its tax report under the consolidated or stand-alone methods.

Both PGE and PacifiCorp experienced negative taxable income in 2009, but their tax reports treat those losses very differently. PGE carries its negative taxable income back to

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2007 and 2008. This is a period in which PGE experienced positive taxable income. PGE's filing showed that it received refunds of past taxes paid because it carried the 2009 loss back. In other words, PGE monetized its 2009 tax loss by getting refunds of taxes paid in prior years. These refunds are reflected in the 2009 taxes paid in PGE's tax report. Ratepayers benefit from these tax savings regardless of whether PGE files under the consolidated or stand-alone method.

2. Berkshire Hathaway Should Not Be Allowed to Keep the Tax Benefits that PacifiCorp Would Generate if PacifiCorp were a Stand-Alone Company

In contrast, PacifiCorp cannot offset its 2009 negative taxable income with positive taxable income experienced in 2007 and 2008, because the Company is included as part of a consolidated tax return with Berkshire Hathaway's other affiliates. The Company does not carry back its negative taxable income because Berkshire Hathaway—not PacifiCorp—is the taxpaying entity. If PacifiCorp operated as a stand-alone utility (or if it filed a consolidated tax return like PGE, in which PacifiCorp represented virtually all of the income in the consolidated return), then the Company would be able to offset its 2009 negative taxable income with its actual positive taxable income from 2007 and 2008 to lower the taxes it paid. Likewise, negative taxable income could be carried forward to lower taxes in future years. The Settling Parties have not presented any evidence or even made any arguments to dispute the fact that the Company's negative taxable would be treated differently if the Company were actually a stand-alone utility and was not included in Berkshire Hathaway's tax return.

The Commission has approved an Oregon tax rule that ensures that the stand-alone method will always be used for PacifiCorp, which means for practical purposes that Oregon ratepayers will never benefit from Berkshire Hathaway's use of PacifiCorp's positive

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taxable income to offset losses and thereby lower Berkshire Hathaway's own tax liability. The stand-alone rule should not be interpreted to allow Berkshire Hathaway to use PacifiCorp's negative taxable income to lower Berkshire Hathaway's taxes, when customers would receive the benefits of those losses if PacifiCorp operated as a stand-alone utility.

Allowing Berkshire Hathaway to use PacifiCorp's tax losses to reduce its taxes, while not using Berkshire Hathaway losses to reduce tax properly attributable to PacifiCorp, results in an asymmetric treatment of the benefits of tax consolidation. In addition, such a result violates a fundamental condition of the MidAmerican Energy Holdings Company merger—that customers would not be harmed by Berkshire Hathaway's acquisition of PacifiCorp. Re MidAmerican Energy Holdings Co., Docket No. UM 1209, Order No. 06-082 at 7 (Feb. 24, 2006). Customers are harmed because PacifiCorp would be able to use the negative taxable income to lower its own taxes if PacifiCorp was not owned by Berkshire Hathaway.

The Settling Parties' briefs also do not identify any provision of Senate Bill ("SB") 408 or OAR § 860-022-0041 that requires or authorizes Berkshire Hathaway to retain these tax savings under the stand-alone method. Instead, ICNU's proposal to account for negative taxable income is consistent with the Commission's previous conclusion that PacifiCorp's stand-alone tax liability should be estimated without accounting for tax differences caused by inclusion of the Company in the corporate operations of the utility's parent or affiliates. Re PacifiCorp SB 408 Tax Report for Calendar Year 2006, Docket No. UE 177, Order No. 09-177 at 14 (May 20, 2009). The Commission should adjust the Settling Parties' tax report to include the negative taxable income as if the Company were not owned by Berkshire Hathaway, which is consistent with the purpose of the stand-alone method.

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3. The Settling Parties' Criticisms of ICNU's Proposal Are Merely Attempts to Distract the Commission From How They Account for the Company's Negative Taxable Income

The Settling Parties' briefs repeat the wide variety of arguments raised in their testimony regarding the alleged ways in which Ms. Blumenthal's proposal violates SB 408 and OAR § 860-022-0041. PacifiCorp Brief at 13-18; CUB Brief at 6-9. PacifiCorp and Staff also assert that, since Ms. Blumenthal does not provide a "bottom-line answer," the Commission should disregard all of her calculations for determining the difference between taxes collected and taxes paid. PacifiCorp Brief at 16. These arguments are irrelevant to the central issues in the proceeding and do not warrant rejecting ICNU's overall approach or Ms. Blumenthal's recommendation regarding the accounting for negative taxable income.

The Settling Parties specific arguments regarding Ms. Blumenthal's testimony primarily address changes that ICNU agrees should be made, or are based on erroneous or overblown factual claims. For example, Ms. Blumenthal agrees that the final tax report should include state and local taxes and account for any charitable contributions. Hearing Transcript ("Tr.") at 38-41. Similarly, ICNU agrees that the Oregon tax rule requires that: 1) the tax calculation include the iterative tax effect; and 2) such an adjustment (and its small impact) should be taken into account.

Similarly, as explained in ICNU's Opening Brief, Ms. Blumenthal's testimony does not include factual errors. ICNU Brief at 11-12. For example, Ms. Blumenthal included all of PacifiCorp's regulated operations, including Pacific Minerals, in her tax report calculation. Notably, the Settling Parties did not present any evidence, workpapers or other proof to support their claims that Pacific Minerals was not included in Ms. Blumenthal's calculation. Ms.

Blumenthal, in contrast, provided copies of the workpapers that she relied upon, which include Pacific Minerals. Tr. at 46-47. The Commission should not accept the Settling Parties' unsupported assertions or be distracted by this erroneous argument, because all parties agree that the final tax report in this case should include all regulated operations.

PacifiCorp and Staff's argument that the Commission should reject ICNU's proposal because it does not include a "bottom-line answer" is inconsistent with Commission practice and the restrictions imposed upon ICNU's participation in this case. If the Commission adopts such a rule, then no intervenor could ever effectively participate in these tax proceedings, since they are denied a copy of the report which is needed to calculate the "bottom line" answer. In contested rate proceedings, parties (including Staff) often recommend proposed adjustments to the utilities' filings without identifying the exact revenue requirement impact. In addition, the Commission often resolves contested issues by adopting a party's recommended methodology or overall approach, even when the Commission does not know the exact revenue requirement impact of the proposal. E.g., Re Investigation into Forecasting Forced Outage Rates for Electric Generating Units, Docket No. UM 1355, Order No. 10-414 (Oct. 22, 2010); Re PacifiCorp's 2011 Transition Adjustment Mechanism, Docket No. UE 216, Order No. 10-456 (Nov. 18, 2010) (the Commission adopted recommended forced outage methodologies without knowing the bottom-line rate impact).

ICNU's proposal to account more accurately for negative taxable income, but not include a pin point answer, is particularly reasonable given the restrictions imposed upon ICNU's review of PacifiCorp's highly confidential material. ICNU's consultant was required to travel to Portland and conduct her analysis of the Company's filing in a safe room with limited

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hours and constant monitoring by PacifiCorp. She was not permitted to type the numbers from the highly confidential tax reports into her computer, which would be needed to produce a "bottom line" answer. ICNU does not dispute that additional adjustments should be made to Ms. Blumenthal's calculation, but given these restrictions, it is virtually impossible for ICNU to calculate a bottom line result. In addition, those additional calculations were not relevant to ICNU's proposal regarding the treatment of negative taxable income.

4. The Commission's Revision of the Tax Rule to Account for Accelerated Depreciation Demonstrates that the Tax Rule Can Be Modified to Avoid Unintended Harmful Consequences to Ratepayers

ICNU's proposed treatment is consistent with the Oregon tax rule. Tr. at 64. However, if the Commission concludes otherwise, then the Commission should further amend the tax rule to properly treat negative taxable income under the stand-alone method. The stand-alone rule should not be interpreted to treat PGE's and PacifiCorp's negative taxable income in such radically different manners, nor should it allow PacifiCorp's parent company to reap the benefits of PacifiCorp's negative taxable income. The Oregon tax rule should be amended, however, if the Commission finds that these contradictory results are required by any provision of the rule.

The Commission recently modified the Oregon tax rule, as it was inconsistent with SB 408 and would have allowed PacifiCorp to charge an inappropriately excessive surcharge. <u>In the Matter of the Adoption of a Temporary Amendment to OAR 860-022-0041</u>, Docket No. AR 547, Order No. 11-064 at 2 (Feb. 22, 2011). The parties and the Commission are in agreement that the (4)(d) limitation was unnecessary for the utilities' tax reports to be consistent with the Internal Revenue Code's ("IRC") normalization rules that require "that

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ratepayers not be given the benefit of accelerated tax depreciation in the rates they pay." ICNU/100, Blumenthal/7; Joint Testimony/100, Jenks-Bird-Fuller/5-6; Docket No. AR 547, Order No. 11-064 at 2-3. However, no parties were given the opportunity to propose further changes to the rule.

The Commission's rapid amendment of the Oregon rule to eliminate the deferred tax floor demonstrates that the Oregon tax rules were not consistent with SB 408 when PacifiCorp filed its 2009 tax report and that the rule can quickly be changed to better conform with the law. PacifiCorp has argued that it is inappropriate for the Commission to consider changes to the Oregon tax rule and that the scope of the docket is only to determine whether PacifiCorp's tax report is consistent with the rule. PacifiCorp Motion to Strike at 2-3; PacifiCorp Brief at 8-9. PacifiCorp's argument is inconsistent with the Settling Parties' proposal to reduce the surcharge based on a change to OAR § 860-022-0041. The scope of this proceeding should include all parties' proposed revisions to OAR § 860-022-0041, not merely those proposed by Staff and PacifiCorp. Thus, if the Commission concludes that ICNU's recommendation is inconsistent with the Oregon tax rule, then the Commission should allow ICNU to propose a temporary rule change to treat negative taxable income more fairly under the stand-alone method.

5. The Commission Should Reject Part 2 of the Stipulation

PacifiCorp and Staff argue that the Commission should approve the portion of the Stipulation directing PacifiCorp to seek a Private Letter Ruling ("PLR") from the Internal Revenue Service ("IRS") to ascertain whether the new rule would result in a normalization violation. PacifiCorp Brief at 18-25. Neither the briefs nor the testimony submitted by

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PacifiCorp and Staff identify any specific manner in which the new rule could allegedly violate the IRS normalization requirements, nor do they recognize that normalization violations are extremely rare events. The Commission should reject this unnecessary part of the Stipulation.

As explained by Ms. Blumenthal, the elimination of the deferred tax floor does not require any additional guidance from the IRS. The normalization provisions of the IRC governing this situation "are clear and straightforward: the taxes paid by utility customers must be calculated using straight-line depreciation." ICNU/100, Blumenthal/10. In general rate cases, income tax expense is normally calculated using straight-line depreciation instead of tax depreciation, and the "IRS has not cited any of these utilities for a normalization violation." Id. Essentially, there is no credible basis to assume that switching to straight-line depreciation will produce a normalization violation.

PacifiCorp and Staff fail to acknowledge that IRS normalization violations are extremely rare. PacifiCorp and Staff did not rebut evidence in this case that the IRS has only cited one utility for a normalization violation, which occurred shortly after the normalization requirements were included in the IRC, when the requirements were not well understood by utilities. Id. The violation was easily remedied, and the utility was allowed to continue using accelerated tax depreciation for tax purposes. Id.

PacifiCorp argues that the ICNU's approach is inconsistent with its past practice in seeking PLRs regarding changes to OAR § 860-022-0041. PacifiCorp explains that the original version of the rule did not include the (4)(d) limitation, and that the Company sought a PLR when the deferred tax floor was added to the rule. PacifiCorp Brief at 22-23. In other words, PacifiCorp already has a PLR from the IRS for the Oregon tax rule with and without the

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(4)(d) limitation. This is further support for the conclusion that the Company need not seek a third PLR from the IRS to re-confirm that OAR § 860-022-0041, without the deferred tax floor, is consistent with the IRS normalization requirements.

III. CONCLUSION

The Commission should reject the Stipulation, as the Settling Parties fail to properly account for the Company's negative taxable income. If PacifiCorp operated as a stand-alone utility, then the Company (and not Berkshire Hathaway) would be able to offset this negative taxable income with positive taxable income from previous or future periods and lower PacifiCorp's overall tax liability. The proposed surcharge is based on a calculation that allows Berkshire Hathaway to reap the benefits of this negative taxable income, which is inappropriate under the stand-alone method and inconsistent with how PGE treats its tax losses.

Dated this 21st day of March, 2011.

Respectfully submitted,

/s/ Melinda J. Davison

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The Commission recently modified the Oregon tax rule, as it was inconsistent with SB 408 and would have allowed PacifiCorp to charge an inappropriately excessive surcharge. <u>In the Matter of the Adoption of a Temporary Amendment to OAR 860-022-0041</u>, Docket No. AR 547, Order No. 11-064 at 2 (Feb. 22, 2011). The parties and the Commission are in agreement that the (4)(d) limitation was unnecessary for the utilities' tax reports to be consistent with the Internal Revenue Code's ("IRC") normalization rules that require "that

ratepayers not be given the benefit of accelerated tax depreciation in the rates they pay." ICNU/100, Blumenthal/7; Joint Testimony/100, Jenks-Bird-Fuller/5-6; Docket No. AR 547, Order No. 11-064 at 2-3. However, no parties were given the opportunity to propose further changes to the rule.

The Commission's rapid amendment of the Oregon rule to eliminate the deferred tax floor demonstrates that the Oregon tax rules were not consistent with SB 408 when PacifiCorp filed its 2009 tax report and that the rule can quickly be changed to better conform with the law. PacifiCorp has argued that it is inappropriate for the Commission to consider changes to the Oregon tax rule and that the scope of the docket is only to determine whether PacifiCorp's tax report is consistent with the rule. PacifiCorp Motion to Strike at 2-3; PacifiCorp Brief at 8-9. PacifiCorp's argument is inconsistent with the Settling Parties' proposal to reduce the surcharge based on a change to OAR § 860-022-0041. The scope of this proceeding should include all parties' proposed revisions to OAR § 860-022-0041, not merely those proposed by Staff and PacifiCorp. Thus, if the Commission concludes that ICNU's recommendation is inconsistent with the Oregon tax rule, then the Commission should allow ICNU to propose a temporary rule change to treat negative taxable income more fairly under the stand-alone method.

5. The Commission Should Reject Part 2 of the Stipulation

PacifiCorp and Staff argue that the Commission should approve the portion of the Stipulation directing PacifiCorp to seek a Private Letter Ruling ("PLR") from the Internal Revenue Service ("IRS") to ascertain whether the new rule would result in a normalization violation. PacifiCorp Brief at 18-25. Neither the briefs nor the testimony submitted by

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PacifiCorp and Staff identify any specific manner in which the new rule could allegedly violate the IRS normalization requirements, nor do they recognize that normalization violations are extremely rare events. The Commission should reject this unnecessary part of the Stipulation.

As explained by Ms. Blumenthal, the elimination of the deferred tax floor does not require any additional guidance from the IRS. The normalization provisions of the IRC governing this situation "are clear and straightforward: the taxes paid by utility customers must be calculated using straight-line depreciation." ICNU/100, Blumenthal/10. In general rate cases, income tax expense is normally calculated using straight-line depreciation instead of tax depreciation, and the "IRS has not cited any of these utilities for a normalization violation." Id. Essentially, there is no credible basis to assume that switching to straight-line depreciation will produce a normalization violation.

PacifiCorp and Staff fail to acknowledge that IRS normalization violations are extremely rare. PacifiCorp and Staff did not rebut evidence in this case that the IRS has only cited one utility for a normalization violation, which occurred shortly after the normalization requirements were included in the IRC, when the requirements were not well understood by utilities. Id. The violation was easily remedied, and the utility was allowed to continue using accelerated tax depreciation for tax purposes. Id.

PacifiCorp argues that the ICNU's approach is inconsistent with its past practice in seeking PLRs regarding changes to OAR § 860-022-0041. PacifiCorp explains that the original version of the rule did not include the (4)(d) limitation, and that the Company sought a PLR when the deferred tax floor was added to the rule. PacifiCorp Brief at 22-23. In other words, PacifiCorp already has a PLR from the IRS for the Oregon tax rule with and without the

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(4)(d) limitation. This is further support for the conclusion that the Company need not seek a third PLR from the IRS to re-confirm that OAR § 860-022-0041, without the deferred tax floor, is consistent with the IRS normalization requirements.

III. CONCLUSION

The Commission should reject the Stipulation, as the Settling Parties fail to properly account for the Company's negative taxable income. If PacifiCorp operated as a stand-alone utility, then the Company (and not Berkshire Hathaway) would be able to offset this negative taxable income with positive taxable income from previous or future periods and lower PacifiCorp's overall tax liability. The proposed surcharge is based on a calculation that allows Berkshire Hathaway to reap the benefits of this negative taxable income, which is inappropriate under the stand-alone method and inconsistent with how PGE treats its tax losses.

Dated this 21st day of March, 2011.

Respectfully submitted,

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