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March 3, 2008

Via Electronic and US Mail

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

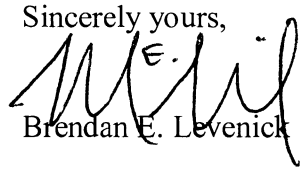
Re: In the Matter of OREGON PUBLIC UTILITY STAFF Requesting the Commission direct PORTLAND GENERAL ELECTRIC COMPANY to file tariffs establishing automatic adjustment clauses under the terms of SB 408. **Docket No. UE 178**

Dear Filing Center:

Enclosed please find the original and five (5) copies of the Industrial Customers of Northwest Utilities' Opening Brief in the above-referenced matter.

Thank you for your assistance.

Sincerely yours,



Brendan E. Levenick

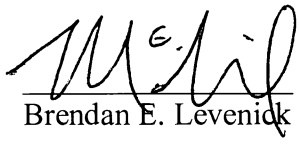
Enclosures

cc: Service List

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing Opening Brief on behalf of the Industrial Customers of Northwest Utilities upon the parties, shown below, on the official service list by causing the foregoing document to be deposited, postage-prepaid, in the U.S. Mail, or by service via electronic mail to those parties who waived paper service.

Dated at Portland, Oregon, this 3rd day of March, 2008.



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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 178

In the Matter of OREGON PUBLIC UTILITY STAFF Requesting the Commission Direct PORTLAND GENERAL ELECTRIC COMPANY to File Tariffs Establishing Automatic Adjustment Clauses Under the Terms of SB 408.	)	OPENING BRIEF OF THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

Pursuant to the Prehearing Conference Memorandum issued on November 7, 2007, the Industrial Customers of Northwest Utilities ("ICNU") submits this Opening Brief to the Oregon Public Utility Commission ("OPUC" or the "Commission"). ICNU, the Citizens' Utility Board ("CUB"), Staff, and Portland General Electric Company ("PGE") have settled the outstanding issues related to PGE's tax report for the 2006 tax year and agreed to a net refund amount of $37.2 million for federal, state, and local taxes. ICNU disagrees, however, with PGE's proposal to amortize the net refund amount over a two-year period, and urges the Commission to order PGE to amortize the refund amount over one year. In addition, PGE has stated its intention to raise constitutional arguments similar to the arguments raised in UM 1271 regarding the operation of SB 408 with respect to the sale of non-utility assets. Any argument PGE may raise with respect to the constitutionality of SB 408 is baseless and should be rejected by the Commission.

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I. BACKGROUND

In 2005, the Oregon Legislature passed SB 408, requiring public utilities to file tax reports with the Commission for the preceding tax year on October 15 of each year. ORS § 757.268(1). The tax reports filed by the utilities must compare taxes collected in rates to taxes actually paid to governmental authorities, and the difference, whether a surcharge or credit, must be trued up through an automatic adjustment clause. ORS § 757.268(4). As required by SB 408, PGE filed its tax report for the 2006 tax year on October 15, 2007, reflecting a credit of $37.1 million.

A prehearing conference was held on November 5, 2007. At the prehearing conference, PGE stated its intent to raise constitutional arguments regarding the tax effect of the sale of non-utility assets at a loss, which reduced the amount of taxes PGE paid to governmental authorities. PGE raised constitutional arguments regarding the operation of SB 408 with respect to the sale of non-utility assets in Docket No. UM 1271, in which PGE's application for deferral of the tax effect was rejected by the Commission as being contrary to the requirements of SB 408. Re PGE, Docket No. UM 1271, Order No. 07-421 at 7 (Sep. 26, 2007). The Commission did not, however, address PGE's constitutional arguments. Instead, the Commission held that those arguments were not ripe until an actual rate change was ordered. Id. at 8. At the prehearing conference, PGE submitted an Expedited Motion to Take Official Notice, asking the Commission to take official notice of the facts contained in Order No. 07-421 in order to avoid the need for redevelopment of a factual record. No party objected to PGE's motion, which was granted on November 8, 2007.

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PGE filed Opening Testimony on December 3, 2007. PGE's Opening Testimony addressed only the $4.9 million tax benefit from the sale of the non-utility assets. On December 19, 2007, ICNU filed an issues list and Staff filed initial findings regarding PGE's 2006 tax report. After settlement discussions on January 7, 2008 and January 17, 2008, PGE, ICNU, Staff, and CUB reached agreement on the outstanding issues regarding PGE's 2006 tax report. The Stipulation, along with the Joint Testimony in support of the Stipulation, was filed with the Commission on February 1, 2008. No objections to the Stipulation were filed.

In the Stipulation, the parties agreed to a net refund amount of $37.2 million for state, federal, and local taxes. The Stipulation, however, specifically did not resolve two issues: 1) whether PGE's proposed two-year amortization schedule is appropriate; and 2) whether the operation of SB 408, with respect to the non-utility assets, is constitutional. The parties to the stipulation agreed to address these issues in briefing.

II. ARGUMENT

A. PGE's Proposal to Amortize the Refund Over Two Years should be Rejected

OAR § 860-022-0041(8)(c) requires the difference between taxes paid and taxes collected to be amortized "over a period authorized by the Commission." In PGE's October 15, 2007 filing, PGE proposed to amortize the rate credit resulting from the operation of SB 408 over a two-year period "in order to reduce the impact to customers of an expected change to rates in June 2009 due to the application of SB 408 to 2007

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results." ICNU disagrees with PGE's proposal, and urges the Commission to amortize the refund over a one-year period.

The SB 408 balancing account is a deferred account, and should be treated as such. One goal of deferred accounting is to "match appropriately the costs borne by and benefits received by ratepayers." ORS § 757.259(2)(e). In this case, the appropriate matching is achieved by amortizing the refund amount to customers over the same time period over which those amounts were collected. Since ratepayers bore the burden of the overcharges for PGE's tax expense over a one-year period (the 2006 tax year), the refund of this amount should also occur over a one-year period. See Re PGE, Docket No. UM 1234, Order No. 07-049 at 9 (Feb. 12, 2007) (shorter time period of rate impact better aligns benefits and costs).

Should the Commission accept PGE's proposal to amortize the SB 408 refund amount over two years, customers should get the benefit of the time value of money. Spreading the refund amount over a two-year period gives PGE the benefit of time that customers were not similarly afforded. If the Commission elects to refund the money over two years, then it should apply an appropriate interest rate to the unamortized balance.

B. The Operation of SB 408 is Constitutional

In UM 1271, PGE raised several arguments regarding whether the operation of SB 408 violates provisions of the state and federal constitutions. PGE's arguments revolved around an LM 6000 Gas Turbine Generator and associated transformer that was purchased in May 2001 for the Port Morrow gas generating project.

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PGE used shareholder equity to purchase both assets, and the costs were recorded in non-utility accounts. PGE sold the turbine and generator for $6.1 million in July 2006, creating a $12.3 million tax loss, and decreasing PGE's consolidated tax liability in 2006 by approximately $4.9 million. Re PGE, Docket No. UM 1271, Order No. 07-421 at 2-3.

It was not necessary, however, for the Commission to reach PGE's constitutional arguments because the Commission found that those arguments were not ripe for adjudication until a rate adjustment is ordered. Re PGE, Docket No. UM 1271, Order No. 07-421 at 8 (Sep. 26, 2007). As this Docket involves a rate adjustment that includes the tax effect of the sale of the non-utility assets at issue in UM 1271, PGE may properly raise its constitutional issues in this Docket. Nevertheless, these arguments have no more validity than they did in UM 1271. PGE has expressed its intention to raise only the same constitutional arguments as it did in UM 1271. ICNU, therefore, will address the merits of the arguments that PGE raised in UM 1271 in this Opening Brief. ICNU reserves the right, however, to address any new arguments in its Reply Brief.

1. The Operation of SB 408 will not Result in an Unconstitutional Taking

The tax benefit related to the sale at a loss of the non-utility assets are required to be accounted for under SB 408 and will not result in an unconstitutional taking, as PGE asserted in UM 1271. Docket No. UM 1271, PGE Opening Brief at 12. Any suggestion to the contrary fails for two reasons: 1) there is no property interest involved that can be taken; and 2) the United States Supreme Court has squarely rejected such an argument.

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a. PGE does not have a Property Interest in "Phantom" Taxes

Bodies of government are constitutionally prohibited from taking property without just compensation. U.S. Const. amend. V; Or Const., Art. I, § 18. The fundamental flaw in PGE's argument is that there is no property interest in which SB 408 deprives the Company. Property interests are not created by the Constitution, but "are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law . . . ." Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 161 (1980) (internal quotation marks omitted).

First, in UM 1271, PGE mischaracterized the effect of SB 408. SB 408 does not deprive PGE of the tax benefit related to the sale of the non-utility assets. There is no dispute that PGE received the tax benefit to which it is entitled, resulting in a reduction to PGE's consolidated tax liability, or taxes paid to governmental authorities. PGE's argument, therefore, is more properly characterized as asserting a property interest in the monies collected from ratepayers and not actually paid to governmental authorities as taxes, not as a property interest in the actual tax benefit.

Second, no independent source of law grants PGE a property interest in these "phantom" taxes. To the contrary, SB 408 requires the opposite conclusion. SB 408 specifically provides that "[u]tility rates that include amounts for taxes should reflect the taxes that are paid to units of government to be considered fair, just and reasonable." ORS § 757.267(f). SB 408 requires that ratepayers only be charged in rates for actual taxes paid by a utility. PGE, therefore, does not have a property interest in monies paid

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by customers for "phantom" taxes under Oregon law. Without such a property interest, there is no basis for a claim that the operation of SB 408 results in an unconstitutional taking.

Most of PGE's argument in UM 1271 focused on the matching of benefits and burdens. PGE's argument seems to be that these regulatory principles create a constitutionally protected property interest in "phantom" taxes. PGE fails to recognize, however, that the Commission "is a legislative agency and has only those powers granted it by the legislature." Advanced TV & Video v. Qwest Corp., Docket No. UC 454, Order No. 00-572 at 5 (Sep. 19, 2000). The Legislature's direction to the Commission in passing SB 408 is clear; rates that include "phantom" taxes are not fair, just and reasonable. ORS § 757.267. After all, "[i]t cannot be seriously contended that the Constitution prevents state legislatures from giving specific instructions to their utility commission." Duquesne Light Co. v. Barash, 488 U.S. 299, 313 (1989).

b. The United States Supreme Court has Already Rejected a Similar Argument

The United States Supreme Court has long since rejected an argument similar to PGE's argument in this Docket. In Fed. Power Comm'n v. United Gas Pipe Line Co., 386 U.S. 237 (1967), the United States Supreme Court rejected an argument that the tax benefits resulting from a consolidated tax filing belong solely to shareholders. In rejecting the argument that the tax savings from a consolidated filing should *never* be shared with the consolidated group, the Court stated:

> Rates fixed on this basis would give the [utility] and its stockholders not only the fair return to which they are

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> entitled but also the full amount of an expense never in fact incurred. In such circumstances, the Commission could properly disallow the hypothetical tax expense and hold that rates based on such an unreal cost of service would not be just and reasonable.

Id. at 244.

The operation of SB 408 in this case is indistinguishable from the situation in United Gas. PGE's sale of the turbine at a loss reduces PGE's tax expense so that PGE is collecting from ratepayers "the full amount of an expense never in fact incurred." Id. Under United Gas, the OPUC has the discretion, and in this case is required by law, to true-up the amount PGE collected from ratepayers for taxes to the amount PGE actually paid to governmental authorities.

In its Reply Brief in UM 1271, PGE asserted that United Gas did not involve a constitutional challenge. UM 1271, PGE Reply Brief at 3. PGE is correct that, on its face, United Gas did not involve a constitutional challenge. As stated before, however, PGE cannot assert a takings claim without identifying a property interest of which it is being deprived. In United Gas, the United States Supreme Court stated that, while the non-regulated members of a consolidated group should not be required to pay the tax liability of the regulated utility, neither should the regulated utility pay the tax liability of the non-regulated members. 386 U.S. at 243. United Gas, therefore, squarely rejects PGE's argument that it has a property interest in "phantom" taxes. Without a property interest, PGE's takings claim has no basis.

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2. The Operation of SB 408 will not result in Confiscatory Rates

Rates must be set to allow a utility to "operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risk assumed...." Fed. Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 605 (1944). A party challenging rates based on the premise that the rates set are confiscatory "carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences." Id. at 602. Such a burden cannot be met in this case.

When challenging rates based on confiscation, the court looks at the overall effect of the rate order, not the methodology used to set rates and certainly not *one very small component of a utility's revenue requirement*. Hope Natural Gas, 310 U.S. at 602 (emphasis added). The operation of SB 408 affects only taxes, which is only one small part of PGE's revenue requirement. If PGE is in fact underearning, which PGE produced no evidence of in UM 1271, it will not be the sole result of SB 408. Rather, PGE would have to show how a rate order affects PGE's revenue requirement as a whole, such as in the context of a general rate case.

Based on the arguments raised by PGE in UM 1271, PGE is unable to meet the "heavy burden" required for a claim based on confiscatory rates. Hope Natural Gas, 320 U.S. at 602. In UM 1271, PGE provided no argument or evidence regarding what impact the operation of SB 408 will have on PGE's earnings. See Duquesne Light, 488 U.S. at 312 ("No argument has been made that these slightly reduced rates jeopardize the financial integrity of the companies, either by leaving them insufficient operating

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capital or by impeding their ability to raise future capital.") Instead, PGE simply stated the applicable standards without any analysis or evidence. UM 1271, PGE Opening Brief at 14. Without more, PGE simply cannot make a showing of confiscatory rates.

3. Any Suggestion that the Legislature's Decision to Pass SB 408 is "Arbitrary and Opportunistic" is Baseless

In UM 1271, PGE argued that the operation of SB 408 would result in an "arbitrary and opportunistic change in regulation." UM 1271, PGE Opening Brief at 15. PGE cited, in isolation, one statement from Duquesne Light in which the Court stated that "a State's decision to arbitrarily switch back and forth between methodologies in a way which required investors to bear the risk of bad investments at some times while denying them the benefit of good investments at others would raise serious constitutional questions." 488 U.S. at 315. Seizing on this quote, PGE incorrectly concludes that the Commission is prohibited from applying SB 408. UM 1271, PGE Opening Brief at 15.

The concern from Duquesne Light is not implicated in this case. In Duquesne Light, the issue was whether the Pennsylvania legislature acted unconstitutionally in requiring the Pennsylvania Utility Commission ("PUC") to apply a "used and useful" standard that the PUC never used before in setting rates. Duquesne Light, 488 U.S. at 313. In upholding the Pennsylvania legislature's actions, the Court specifically stated that the case did not present the question of whether the rate orders involved implicate the issue of whether Pennsylvania was arbitrarily switching back and forth between methods. Id.

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In this case, the legislature adopted SB 408, ordering the Commission to depart from the stand-alone method of determining the amount of taxes to include in rates. Similar to the legislation in Duquesne Light, SB 408 mandates *only one method* of determining the amount of taxes included in rates going forward, whether the result is a credit or surcharge for customers, and does not require the Commission to choose which method to apply depending on the result. PGE's argument equates to a constitutional rule that, once the Commission utilizes a method of setting rates, that method cannot be changed without violating the Constitution. Such a result is simply absurd.

In addition, the foregoing quote is purely dicta, as the Court did not pass on the question in Duquesne Light and has not had occasion to pass on the question since Duquesne Light. PGE, however, mistakenly amounts this dicta to a "constitutional rule." UM 1271, PGE Reply Brief at 5. ICNU is unaware of any instance where the United States Supreme Court announced a "constitutional rule" *carte blanche*.

4. Enforcement of SB 408 will not result in the Impairment of Contract

PGE asserted in UM 1271 that the operation of SB 408 violates the Contract Clauses of the United States and Oregon Constitutions. PGE's argument was based on the "ring fencing" provisions imposed by the stipulation approving the merger between PGE and Enron (the "Enron Stipulation"). According to PGE, because the "ring fencing" provisions imposed conditions designed to insulate utility customers from the risks involved with unregulated activities, those provisions impliedly guaranteed shareholders the entire tax effect of the losses incurred by unregulated activities. UM 1271, PGE Opening Brief at 15-16. The "ring fencing" provisions provide no such

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guarantee. As a party to the Enron ORS § 757.511 proceeding, ICNU can ensure the Commission that, not only is this argument missing from the stipulation or any Commission orders, the argument was never made by PGE or Enron at the time the ring fencing provisions were drafted.

The ultimate inquiry in a Contract Clause challenge is "whether the change in state law has operated as a substantial impairment of a contractual relationship." General Motors Corp. v. Romein, 503 U.S. 181, 186 (1992) (internal quotation marks omitted); see also, State v. Willingham, 206 Or. App. 156, 165 n.2 (2006) (impairment of contract occurs under the Oregon Constitution when "by operation of law, there is an elimination of an obligation under which performance is required"). That inquiry involves three parts: 1) whether there is a contractual relationship; 2) whether a change in law impairs that contractual relationship; and 3) whether the impairment is substantial. General Motors, 503 U.S. at 186. PGE's argument fails because there is no contractual relationship regarding income taxes that SB 408 could impair.

The provisions referenced by PGE required Enron to ensure: 1) that the allowed return on common equity and other costs of capital would not rise as a result of the merger; 2) that customers would be held harmless if the merger resulted in a higher revenue requirement; and 3) that Enron would not subsidize its activities by allocating or directly charging PGE for expenses not authorized by the Commission. Re Enron Corp., Docket No. UM 814, Order No. 97-196 at App. A, pp. 2-4, ¶¶ 7, 10, 14 (June 4, 1997).

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PGE's reliance on these provisions is misplaced. First, these provisions are obligations specific to Enron as a condition of Commission-approval of the merger. These provisions do not place any obligations on the Commission. Second, there is no agreement with the Commission regarding income taxes, other than enforcement of the provisions. In its UM 1271 Reply Brief, PGE argues that the Enron Stipulation could be interpreted as including income taxes. UM 1271, PGE Reply Brief at 5. Contracts, however, are interpreted according to the "four corners" of the document and the court is not to insert what has been omitted. Yogman v. Parrott, 325 Or. 358, 361 (1997). By the plain language of the Enron Stipulation, there was no obligation regarding income taxes, nor were these provisions adopted with tax issues in mind. See, e.g., General Motors, 503 U.S. at 188-90. (change in workers' compensation laws did not impair employment agreements because the parties to the agreements did not manifest an intent to address workers' compensation, nor did the change in law affect the legal enforceability of the employment agreements). Because there is no contractual relationship regarding the allocation of income taxes in the Enron Stipulation, SB 408 cannot impair any legal obligations.

5. Principles of Federal Preemption are Inapplicable to this Docket

In UM 1271, PGE argued that the federal tax laws somehow guarantee that shareholders get to keep the tax benefit associated with the turbine sale. UM 1271, PGE Opening Brief at 17. PGE's argument fails to recognize, however, that SB 408 is not a tax law, and that the United States Supreme Court has squarely rejected such an argument.

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In United Gas, the Supreme Court characterized the argument that regulated activities should never share in the tax benefits on a consolidated basis as "untenable." 386 U.S. at 243-44. After all, without the gains from regulated activities to offset, the losses from unregulated activities in the consolidated group are worthless. See City of Charlottesville v. FERC, 774 F.2d 1205, 1221 (D.C. Cir. 1985). SB 408 does not affect in any way PGE's ability to take advantage of the federal income tax laws. The federal income tax laws do not guarantee that PGE will be able to keep "phantom taxes." SB 408, however, prohibits the OPUC from authorizing PGE to keep these amounts. The operation of SB 408 does not prevent PGE from using losses to offset gains in a consolidated tax filing; it affects the amount PGE is able to recover in rates.

6. The Equal Protection Clause is not Violated by SB 408

SB 408 applies only to "[a] regulated investor-owned utility that provided electric or natural gas service to an average of 50,000 or more customers in Oregon in 2003." ORS § 757.268(13)(b)(A). In UM 1271, based on this provision, PGE argued that SB 408 arbitrarily creates two classes of utilities subject to different tax treatments in violation of Article I, section 32 and Article IX, section 1 of the Oregon Constitution, the Privileges and Immunities Clause of the Oregon Constitution, and the Equal Protection Clause of the United States Constitution. UM 1271, PGE Opening Brief at 17. PGE's argument again ignores the fact that SB 408 is not a tax law, and that the legislative history reveals a legitimate purpose in creating such a distinction.

First, SB 408 addresses how utility rates are set, not how utilities pay income taxes. Therefore, the premise of PGE's argument of disparate tax treatment is

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fundamentally flawed, as SB 408 does not subject utilities to differing income tax treatment. Second, even if SB 408 could be construed as a tax law, "[t]he law is well settled that 'the States have a very wide discretion in the laying of their taxes.'" Weissinger v. White, 733 F.2d 802, 805 (11th Cir. 1984) (quoting Allied Stores v. Bowers, 358 U.S. 522, 526 (1959)). As a result, state tax laws are subject to a "minimal level of scrutiny" when challenged on equal protection grounds, and will be upheld as long as the differing tax treatment "rests upon some ground of difference having a fair and substantial relation to the object of the legislation." Id. at 806 (internal quotation marks omitted). In Weissinger, the court upheld the State of Alabama's property tax, which applied different methods of calculating the tax for different types of property based on Alabama's special interest in preserving farm and timberland. Id. at 806-07.

SB 408 is simply not a tax law; however, SB 408 satisfies the minimal level of scrutiny applied to tax laws. The line was drawn at investor-owned utilities with more than 50,000 customers in 2003 due to the cost of complying with SB 408. House State and Federal Affairs Committee, SB 408 Work Session, Tr. at 9, July 15, 2005 (Statement of Rep. Tom Butler). Due to the small size of an investor-owned utility that serves less than 50,000 customers, any tax adjustment would be outweighed by the cost to the utility of complying and the administrative burden placed on the Commission to oversee compliance. Id.

III. CONCLUSION

For the foregoing reasons, the Commission should reject PGE's amortization proposal for the SB 408 refund in this Docket and order amortization over a

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one-year period. In addition, the Commission should reject PGE's challenges to SB 408 based on the federal and state constitutional arguments.

Dated this 3rd day of March, 2008.

Respectfully submitted,

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