BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1271

	)
In the Matter of	)
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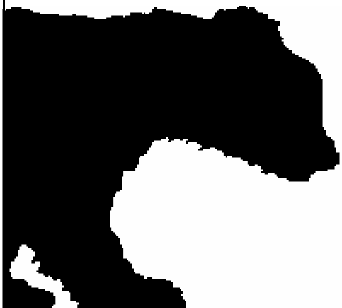
PORTLAND GENERAL ELECTRIC,	)
	)
Deferred Accounting Authorization for	)
Expenses/Refunds Associated with SB 408.	)
	)

REPLY BRIEF

OF THE

CITIZENS' UTILITY BOARD OF OREGON

May 18, 2007



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I. Introduction

In CUB's Opening Brief, we address the illegality of PGE's request in this case, the subsidization of shareholders' unregulated investment that would result from granting PGE's request, and the inapplicability to this situation of ORS 757.259(2)(e) under which the Company filed its request. We do not readdress those arguments here, and instead turn to the legal and constitutional arguments made in PGE's Opening Brief. These Company arguments are neither appropriate nor correct, and the Commission should dismiss them.

II. Argument

We did not address any constitutional arguments in our Opening Brief because we do not believe those arguments are appropriate in this docket.

A. Constitutional Arguments Are Not Appropriate In This Case

Even were PGE's request for a deferred account denied, PGE's constitutional rights would not be implicated here. It could be argued that, if the Company's request were denied, PGE would be adversely affected and could seek judicial review of that order. While PGE could complain to the courts of a faulty Commission reasoning concerning the appropriateness of PGE's Application under ORS 757.259(2)(e), it seems to us that constitutional arguments would be dismissed as not ripe. Denial of the deferred account would not cause the utility to lose anything of substance, and, therefore, there would be no adverse affect to the utility. Actually, PGE recognizes this when it says that denial of the application "will likely lead" to a difficult decision down the road. PGE Op. Br. at 11.

On or before October 15th of each year, a utility must file a tax report with the Commission outlining the rule-defined amounts of taxes paid to the federal, state, and local taxing authorities, the amounts that are properly attributed to the regulated operations of the utility, and the amounts that were authorized to be collected in rates. The Commission will then determine if, for any of the three preceding years, the amounts collected in rates differ by $100,000 or more from the amounts paid to taxing authorities that are properly attributed to the regulated operations of the utility. If so, for the preceding year the Commission will determine the differences between the amounts paid to taxing authorities and the amounts collected in rates, at which point the utility must file tariffs, effective each June 1st, establishing balancing accounts and tariffs establishing automatic adjustment clauses to recover or refund those Commission-determined differences in state, federal, and local tax collections and payments.

At the point when the automatic adjustment clause could affect amounts collected in rates, the utility can test the constitutionality of that rate adjustment.

> At any time, a utility may file a claim that a rate adjustment under the automatic adjustment clause violates ORS 756.040 or other applicable law. In making a determination regarding a potential violation of ORS 756.040, the Commission will perform an earnings review using the utility's results of operations report for the applicable tax year.

OAR 860-022-0041(10).

Until we get to the rate-adjustment stage in the process, the Commission should refrain from engaging in extracurricular constitutional arguments. The Commission, in this filing, should limit itself to the issues that all the parties but PGE limited themselves to: whether this deferred account application satisfies the standards in ORS 757.259(2), and whether the Commission should violate the law in order to grant PGE's application.

B. Constitutional Requirements

Having determined that constitutional arguments are not relevant to this case, we offer the following counter-arguments to the extracurricular arguments in PGE's Opening Brief.

i. Hope: Takings

PGE argues that denial of the deferred account application constitutes an unconstitutional taking of property under the Fifth Amendment of the United States Constitution. PGE Op. Br. 12-14.

The starting place for identifying utility takings issues is *Federal Power Comm. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). *Hope* tells us that, while ratemaking may be a subtle balancing act, the Court's constitutional review is a simple threshold question.

"If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry … is at an end." *Hope* at 602.

Hope does give us some parameters to judge when a rate order departs from just and reasonable, and sinks to the level of a confiscatory taking. In reviewing a rate order, it is not the method employed to determine rates that is controlling, it is the result. The Commission is "not bound to the use of any single formula;" it is not the "theory but the impact of the rate order which counts;" the order is "viewed in its entirety;" and even if the method employed contains "infirmities," the only subject of the inquiry is the result. *Ibid*. In short, from a takings point of view, the Supreme Court does not care what tax approach the Commission uses as long as rates, as a whole, are reasonable.

In examining the reasonableness of the rates, a court may look at whether the allowed return is "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." *Id.* at 603. However, the Court says "[t]he conditions under which more or less might be allowed are not important here." *Ibid*. As the Supreme Court summarized the *Hope* standard in *Duquesne Light v. Barasch*, 488 U.S. 299, 310, these questions have constitutional overtones "at the margin."

PGE has made no showing that the issue here implicates anything remotely approaching a constitutional taking as defined by *Hope*. There is no evidence here, nor is it likely given the small size of the economic effect, that a Constitutional taking is implicated.

ii. Duquesne: Switching Back And Forth

Another potential constitutional issue raised by PGE is the arbitrary switching back and forth between methodologies. PGE cites the *Duquesne* decision as the basis of the Supreme Court's prohibition of a regulator's decision to "arbitrarily switch back and forth between methodologies" in a way that imposes risks on investors at times and denies benefits at other times. *Duquesne* at 315. It should be noted that, technically, this pronouncement is dicta, not a holding of the case, because the issue was not presented to the court. Nevertheless, rejection of PGE's deferral and the Company's request for unique treatment of the turbine at issue here will be a consistent regulatory methodology under SB 408. In granting PGE's request, the Commission would be switching methodologies back and forth.

PGE is confused about what consistency means. PGE states:

> [A]bsent a deferral and corresponding rate adjustment to reflect the costs and risks associated with the Turbine investment, the application of SB 408, in particular section 12 (ORS 757.268(12)), would force the Commission to arbitrarily switch back and forth in how it apportions tax effects.

PGE Op. Br. at 15.

Actually, absent such a deferral, the Commission's apportionment methodology is consistent. Under the apportionment method, the Commission starts with the actual tax liability of the tax filing entity, and, based on the totality of the tax liability, the methodology apportions a reasonable share as customers' responsibility. In contrast, PGE proposes that a utility can, on the basis of "fairness" or the history of a particular investment, ask the Commission to switch the methodology to identify the costs or benefits of a particular tax effect and treat that tax effect outside of the totality of the tax

liability. It is PGE's proposal that skews the consistency of the Commission's methodology.

iii. Federal Preemption

PGE makes a half-hearted effort to argue a federal preemption flaw in SB 408. PGE Op. Br. at 16-17. Without any citation, PGE indicates what it thinks the federal government meant to do for shareholders under the federal tax code. SB 408 has little to do with the federal tax code, and a lot to do with how the Commission sets rates. SB 408 tells the Commission to set rates while simultaneously recognizing the treatment of losses under the federal tax code and the state's interest to make sure that customers of utilities only pay as much in taxes as actually goes to taxing authorities. There is no direct or indirect conflict.

Charlottesville v. FERC, 774 F2d 1205, 1217 (DC Cir 1985), cannot be dispositive on this issue, because it does not concern a state statute, however the underlying facts help illustrate an important point: the courts don't care about the regulatory treatment of costs until there is a confiscatory taking. An overlooked aspect of *Charlottesville* is that the appellant is challenging the Federal Energy Regulatory Commission's change <u>from a consolidated to a stand-alone approach</u> to regulation. Far from the question of whether a regulator has to use a stand-alone approach, the legal questions in *Charlottesville* were, can, and did, the FERC appropriately adopt the stand-alone approach. State regulatory agencies cannot act in conflict with the federal tax code, but neither can federal regulatory agencies. *Charlottesville* implicitly showed that a consolidated regulatory approach passed muster, and explicitly showed that a stand-alone regulatory approach passed muster. As will be discussed further below, the court did not

concern itself with the particularities of the various possible regulatory approaches, only whether they exceeded rational (not tax code) limits.

C. The Benefit/Burden Test

In broad terms, SB 408 requires a true-up between taxes collected from customers and the taxes paid to the government which are properly attributed to regulated utility operations. ORS 757.268(4). A utility must adjust rates accordingly if the difference between these amounts is more than $100,000. Taxes paid reflects the "amounts received by units of government from the utility or from the affiliated group of which the utility is a member, whichever is applicable…" ORS 757.268(13)(f).

In its application, PGE has not charged that the Commission's interpretation of SB 408 is beyond the legislated authority. Nevertheless, PGE, citing *City of Charlottesville v. FERC*, 774 F2d 1205, 1217 (DC Cir 1985), implies that the Commission should use the benefit/burden test. PGE Op. Br. at 6-8.

First, it is firmly established in Oregon that, while the Commission's authority is limited by the Federal and State constitutions and by other legislative limits, the regulation of public utilities constitutes a legislative function. *Pacific Northwest Bell v. Sabin*, 21 Or App 200, 213. This leads courts in Oregon to conclude that where the Commission "has been granted broad legislative authority [the Commission] is not obligated to employ any single formula or combination of formulas to determine what are in each case 'just and reasonable' rates." *Id.* at 224.

Second, *Charlottesville* does not require a benefit/burden test. We see the benefit/burden test as the test that the FERC applied in its cases, and the D.C. Circuit Court was determining whether the test itself and it's application were reasonable. "It

remains to be considered whether the Commission's methodology for allocating tax deductions for stand-alone purpose is reasonable, and whether it has been applied correctly to the facts of this case. The methodology in question is the so-called benefits/burdens test…" *Charlottesville* at 1217. The D.C. court did not say one must, or should, use a benefit/burden test, only that the FERC's test was rational. Had the FERC applied a differently methodology, the court would have applied the same reasonableness test to see if it fit within rational limits.

The precise holding of *Charlottesville* is that there is a range of tax approaches that can be employed by regulators, and that the courts will not second guess the approach as long as the approach is within certain rational limits.

> The object of the present exercise is not theoretically accurate assignment of causality for the tax advantages of consolidated filing, but estimation of the tax liability attributable to operations of a regulated company that happens to be an affiliate. There are a number of plausible ways to make that estimation – ranging, perhaps, from an approach that would give the utility's ratepayers the benefit of all tax deductions of the consolidated group offset against the utility's income (since the deductions would have been worthless without the income) to an approach that would give ratepayers the benefit of none of them (since the utility would have had no deduction on its own). Within certain rational limits that have clearly not been exceeded here, which approach to choose is more a matter of regulatory policy than of logic.

Id. at 1221.

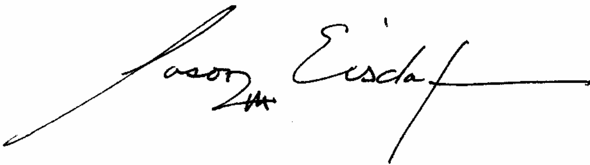
In fact, were the court to require a particular test or theory, it would fly in the face of the standard set out in *Hope,* where the Supreme Court repeatedly hammered on the point that the courts were not to tell the regulators how to regulate. Again, *Hope* was very clear when it said a regulator is "not bound to the use of any single formula" and it is not the "theory but the impact of the rate order which counts." *Hope* at 602. *Pacific Northwest Bell* echoed exactly the same reasoning. We believe that the language used in

Charlottesville, “within certain rational limits,” is a recognition of the policy outlined in *Hope* and that the court does not require or necessarily suggest a particular test such as the benefit/burden test.

III. Conclusion

As PGE’s application for a deferred account would require the Commission to violate ORS 757.268, and because PGE’s application does not satisfy the required justification for a valid deferred account under ORS 757.259(2)(e), the Commission should deny PGE’s application.

Respectfully Submitted,
May 18, 2007



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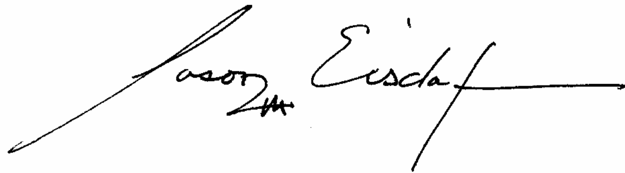
CERTIFICATE OF SERVICE

I hereby certify that on this 18th day of May, 2007, I served the foregoing Reply Brief of the Citizens' Utility Board of Oregon in docket UM 1271 upon each party listed below, by email and, where paper service is not waived, by U.S. mail, postage prepaid, and upon the Commission by email and by sending 6 copies by U.S. mail, postage prepaid, to the Commission's Salem offices.

Respectfully submitted,



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