

ORDER NO. 03-214

ENTERED APR 10 2003

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**BEFORE THE PUBLIC UTILITY COMMISSION**

**OF OREGON**

UM 1074

In the Matter of	)	
	)	
UTILITY REFORM PROJECT	)	
	)	
Petition for an accounting of the Federal, State	)	ORDER
and Local Income Tax Payments of	)	
PORTLAND GENERAL ELECTRIC CO.,	)	
since its acquisition by ENRON Corp., and	)	
Appropriate Rate Adjustments and Refunds.	)	

**DISPOSITION: PETITION FOR INVESTIGATION DENIED**

On March 7, 2003, the Utility Reform Project (URP) filed a petition to open an investigation along with a complaint.<sup>1</sup> The Public Utility Commission (PUC) assigned Docket No. UM 1074 to this filing. URP's petition asks the Commission to commence an investigation to determine the amount that Portland General Electric (PGE) has paid in income taxes since 1997, and order PGE to refund to ratepayers, with interest, funds collected for paying income taxes that were not used for that purpose.

URP's petition is styled as both a request for an investigation under ORS 756.515 and a complaint under ORS 756.500. Staff's recommendation in this matter addresses only the request for investigation under 756.515.

At its public meeting on March 31, 2003, the Commission adopted Staff's recommendation to deny URP's petition to open an investigation regarding PGE's income taxes. Staff's recommendation is attached as Appendix A and is incorporated by reference.

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<sup>1</sup> URP's Complaint that accompanied this petition has been docketed as UCB 13, and will be processed by the Administrative Hearings Division.

ORDER NO. 03-214

**ORDER**

IT IS ORDERED THAT Utility Reform Project's request to open an investigation is denied.

Made, entered and effective \_\_\_\_\_.

BY THE COMMISSION:

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**Becky Beier**  
Commission Secretary

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A party may appeal this order to a court pursuant to ORS 756.580.

**PUBLIC UTILITY COMMISSION OF OREGON  
STAFF REPORT  
PUBLIC MEETING DATE: March 31, 2003**

REGULAR  X  CONSENT \_\_\_\_\_ EFFECTIVE DATE \_\_\_\_\_ NA \_\_\_\_\_

**DATE:** March 24, 2003

**TO:** John Savage through Lee Sparling

**FROM:** Ed Busch

**SUBJECT:** UTILITY REFORM PROJECT: (Docket No. UM 1074) Requests Commission to open an investigation and order Portland General Electric to refund funds collected to pay income tax.

**STAFF RECOMMENDATION:**

I recommend the Commission deny URP's request to open an investigation regarding PGE's income taxes.

**DISCUSSION:**

On March 7, 2003, the Utility Reform Project (URP) filed a petition to open an investigation along with a complaint. The filing was docketed as UM 1074. URP's petition asks the Commission to commence an investigation to determine the amount that Portland General Electric (PGE) has paid in income taxes since 1997 and order PGE to refund to ratepayers, with interest, funds collected for paying income taxes that were not used for that purpose.

URP's petition is styled as both a request for an investigation under ORS 756.515 and a complaint under ORS 756.500. Staff's recommendation in this matter addresses only the request for investigation under 756.515.

In its petition, URP states that Enron Corp. (Enron), the parent company of PGE, has paid little or no federal, state or local income taxes since 1997 despite collecting over \$400 million from PGE for that purpose. URP also states that "Substantial evidence exists that Enron/PGE engaged in a pattern of fraud and deceit upon the agency when it provided "proof" in rate proceedings that it would incur such tax liabilities but in fact had put in place numerous schemes for the avoidance and evasion of income tax liabilities. . ." URP's petition includes several figures that it believes were amounts

included in customer rates for payment of income taxes that were not used for that purpose. According to the petition, PGE's rates "are based on fraud and misrepresentation by PGE."

### Background

By Order 97-196 (Docket UM 814), the Commission approved Enron's application to exercise influence over PGE. The Internal Revenue Code allows a parent corporation to elect to file a consolidated federal income tax return that reports the combined income and expense items of the consolidated group. From 1997 until May 2001, Enron filed consolidated tax returns that included PGE's income and expenses. During that period, PGE calculated its federal and state income tax liability on its results of operations and forwarded to Enron those amounts. From May 2001 through 2002, while Enron was unconsolidated, PGE made its income tax payments directly to the taxing authorities

For ratemaking purposes, the Commission sets PGE's rates to reflect the costs of the company's regulated operations. That is, in a rate proceeding, PGE's rates are set based on its own revenues, costs and rate base for a given test year. Income taxes are calculated using PGE's net operating income. The tax effects of Enron's other operations are ignored for purposes of setting rates. This is consistent with standard ratemaking principles.<sup>2</sup>

Calculating PGE's costs, including income taxes, for ratemaking on a stand-alone basis protects PGE's customers from the financial difficulties experienced by Enron's other subsidiaries. When the Commission approved Enron's acquisition of PGE, it had the option of incorporating the effects of Enron's non-utility operations in PGE rates or treating PGE as a stand-alone entity. Consistent with long-standing OPUC policy, the Commission chose the latter approach. In adopting the stipulation in Docket UM 814, the Commission created a wall between PGE's operations and Enron's other subsidiaries. As stated by Order No. 97-196: "These conditions and commitments provide important measures and requirements, beyond those provided by the Commission's statutory authority and existing rules, to protect PGE's customers, competitors, and the public generally."

If PGE's rates were set in a manner that captured some of Enron's tax losses, PGE's rates would also have needed to reflect the expenses that created those tax savings, and customers would be worse off. Staff's counsel advised that it would be difficult for

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<sup>2</sup> See Attachment to this staff report containing excerpts from Accounting for Public Utilities.

the OPUC to justify picking and choosing which of Enron's revenues and expenses—including tax savings—to include for purposes of setting Oregon customers' rates. Moreover, such an approach may lead to confiscatory rates.

### Issues

URP's petition raises two main issues relating to whether ratepayers are entitled to a refund. First, did PGE make "false or misleading representations" regarding the amount of income taxes that should be included in its customers' rates? Second, did PGE collect funds from its customers to pay taxes that were not used for that purpose?

The answer to the first question is clear. URP's petition contains no evidence that PGE made false representations in calculating the amount of income taxes that should be included in customer rates. As described above, PGE's rates that were in effect in 1997 and subsequent years were set on a "stand alone" basis in Docket UE 100 (effective December 1, 1996). Staff believes that income taxes were accurately calculated in that rate case using PGE's test year revenues, expenses and rate base.

As to the second question, it also is clear that PGE made its federal and state income tax payments to Enron while on a consolidated basis, and directly to the proper taxing authorities while on an unconsolidated basis. As reported in the company's annual report, FERC Form 1, from 1997 through 2001, PGE paid a total of \$463.4 million in federal and state income taxes, of which \$445.1 million related to its electric operations. In fact, this is more than the amount of income taxes that customers' rates were set to collect over this period, a total of \$430.5 million. Hence, there is no substance to the argument that PGE collected amounts for payment of income taxes that it did not use for that purpose.

Even if PGE had paid out less for income taxes than it collected from customers, there would be no issue for an investigation. Rates are set based upon a utility's revenues and expenses (including income taxes) for a particular test period; actual results in subsequent years are almost certain to be higher or lower than estimated for the test period. In this case, PGE paid out more in income taxes than the amount calculated in the most recent rate case.

Staff certainly does not condone tax evasion by Enron, if that were proved to be the case. However, the OPUC does not have jurisdiction over whether or not Enron as a corporation appropriately paid its income taxes during the period Enron elected to file its

taxes on a consolidated basis. Federal and state taxing authorities are responsible for ensuring that Enron paid the income taxes it owed.<sup>3</sup>

In short, staff believes that income taxes were properly included in PGE's revenue requirement and customer rates, and that PGE properly paid its income tax liability to its parent or to the taxing authorities, as appropriate. Whether or not Enron properly paid its income taxes to the IRS and the State of Oregon is beyond the purview of the OPUC. Any underpayments by Enron would be owed to those taxing authorities and their constituents, not to ratepayers.

### Alternatives

The Commission can approve URP's application to open an investigation or it can deny the application. PGE has indicated that prior to this public meeting it will provide records that will enable the Commission to verify that PGE did, in fact, make its income tax payments reported in the company's FERC Form 1 for 1997 through 2001 either to Enron or directly to the taxing authorities. Regardless, URP's petition asks the Commission to take action in an area (possible underpayment of income taxes) in which the OPUC does not have jurisdiction. What the OPUC does have jurisdiction over is whether PGE's rates were set properly to include the company's income tax liability on a stand-alone basis. Staff finds that to be the case. Therefore, staff believes there is no reason for the Commission to open an investigation.

As noted above, URP's filing is also a complaint by URP against PGE under ORS 756.500. Staff's counsel advises that URP is still free to pursue that complaint. It may serve the complaint on PGE, if it hasn't already done so, and it may, at a hearing, present whatever evidence it chooses to support its complaint and its request for refunds.

### **PROPOSED COMMISSION MOTION:**

Utility Reform Project's request to open an investigation be denied.

UM 1074  
Attachment

APPENDIX A

PAGE 4 OF 5

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<sup>3</sup> As stated in Accounting for Public Utilities (section 17.04[1]): "The election to file a consolidated tax return makes the parent corporation the agent of all corporations included in the affiliated group. This agency relationship includes, but is not limited to, the duties to file proper and timely consolidated tax returns, to receive deficiency notices, to file refund claims, to execute waivers of the statute of limitations, to respond to Internal Revenue Service audits, and to conduct proceedings in the courts."

**Attachment**

**Excerpts from Accounting for Public Utilities  
(Publication 016, Release 19, November 2002)**

Section 7.08[3]:

“It is not uncommon for a regulated utility to have subsidiary operations that produce tax losses which, on a consolidated tax return, offset taxable income from utility operations. . . The only approach that is consistent with standard ratemaking principles that prohibit cross-subsidization between utility and non-utility activities is to put the regulation operations on a ‘stand-alone’ basis and to assign the full tax burden to the taxable gain source and a tax benefit to the tax loss source. The basic theory is that the regulated costs should not be affected by the results from nonregulated operations.”

Section 17.04[3]:

“Income tax normalization is consistent with a fundamental principle of the cost of service approach to ratemaking; the principle that consumers should bear only costs for which they are responsible. Under this principle, there is a well-reasoned, and widely recognized, postulate that taxes follow the events they give rise to. Thus, if ratepayers are held responsible for costs, they are entitled to the tax benefits associated with the costs. If ratepayers do not bear the costs, they are not entitled to the tax benefits associated with the costs.

“Regulators have long used a ratemaking procedure that explicitly embraces this principle. The procedure is to identify utility activities (revenues and costs) and compute taxes directly related to the utility activities.

“Non-utility operations involve financial risks that are different from a utility’s regulated operations. When these risks are not borne by the ratepayers, it is unfair to make use of the business losses generated in those nonregulated entities to reduced the utility’s cost in determining the rates to be charged for utility services. By the same token, when a company’s nonjurisdictional activities are profitable, the ratepayers have no right to share in those profits, but neither are they required to pay any of the income taxes that arise as a result of those profits. Thus, a “stand alone” method (as opposed to a consolidated effective tax rate method) for computing the income tax expense component of cost of service is the proper and equitable method to be followed for ratemaking purposes.”