ORDER NO. 09-177

ENTERED 05/20/09

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 177

In the Matter of PACIFICORP, dba PACIFIC POWER SB 408 Tax Report for Calendar Year 2006	ORDER ON RECONSIDERATION

DISPOSITION: ORDER NO. 08-201 SUPPLEMENTED AND AFFIRMED

In Order No. 08-201, we reviewed the 2006 income tax liability for PacifiCorp, dba Pacific Power (Pacific Power), as mandated by Senate Bill 408 (SB 408). Applying SB 408 and OAR 860-022-0041, the rule we adopted to implement the legislation, we found that Pacific Power had paid $34.5 million more in taxes that it had collected in rates. We authorized the utility to surcharge customers for that additional tax liability.

The Industrial Customers of Northwest Utilities (ICNU) appealed Order No. 08-201. After the filing of ICNU's brief with the Court of Appeals, we withdrew our order under ORS 183.482(6) to address ICNU's assertion that OAR 860-022-0041 is invalid because it conflicts with SB 408. In this order on reconsideration, we conclude that OAR 860-022-0041 is valid, and supplement and affirm Order No. 08-201.

I. BACKGROUND

SB 408, primarily codified at ORS 757.267 and 757.268, requires certain utilities to adjust customer rates to account for any differences between income taxes authorized to be collected in rates and income taxes paid to units of government that are "properly attributed" to utilities' regulated operations.[1] Utilities must make annual tax filings reporting these amounts on October 15 of each year. If amounts collected and amounts paid differ by $100,000 or more, the Commission must order the utility to establish an automatic adjustment clause to account for the difference, with a rate adjustment effective June 1 of each year.[2]

On October 15, 2007, Pacific Power filed its annual tax report for calendar year 2006 (2006 Tax Report). Pacific Power reported that it had paid $87 million in taxes properly

[1] ORS 757.268(4).
[2] *See* ORS 757.268(4), (6); OAR 860-022-0041(8).

attributed to its regulated Oregon operations, but had only collected $54.4 million in rates. Pacific Power sought authority under ORS 757.268 to surcharge customers for this difference.

We opened this docket to review Pacific Power's 2006 Tax Report for compliance with ORS 757.268 and OAR 860-022-0041. The Industrial Customers of Northwest Utilities (ICNU) intervened and signed a protective order giving it access to the highly confidential tax information contained in the report.[3]

On January 22, 2008, ICNU filed direct testimony opposing any customer surcharge.[4] As relevant here, ICNU alleged that OAR 860-022-0041 was invalid because it failed to properly implement ORS 757.267 and 757.268. ICNU alleged there was no legal basis to support a customer surcharge because the amounts contained in Pacific Power's 2006 Tax Report were based on the invalid rule.

Pacific Power filed rebuttal testimony on February 12, 2008, and sought to strike portions of ICNU's testimony. An administrative law judge (ALJ) granted Pacific Power's motion to strike, agreeing that ICNU's challenge to the validity of OAR 860-022-0041 was beyond the scope of the proceeding and more appropriately addressed in a separate rulemaking proceeding.[5] We upheld the ALJ's ruling in Order No. 08-176.

Following evidentiary hearings and briefing, we completed our review of Pacific Power's 2006 Tax Report in Order No. 08-201. We adopted two adjustments to the report recommended by our regulatory staff (Staff) that increased the amount of taxes Pacific Power was deemed to have paid by $1.9 million.[6] With the adjustments, we concluded that Pacific Power's revised 2006 Tax Report complied with SB 408 and OAR 860-022-0041. We authorized Pacific Power to surcharge customers $34.5 million, plus interest, to account for the difference between federal, state, and local income taxes paid by Pacific Power to taxing authorities and taxes collected in rates.[7]

ICNU appealed Order No. 08-201 to the Court of Appeals arguing in part that the Commission failed to consider the substance of ICNU's challenge to the validity of OAR 860-022-0041. We subsequently withdrew the order for reconsideration under ORS 183.482(6) and conducted additional proceedings to address ICNU's arguments regarding OAR 860-022-0041. On April 13, 2009, ICNU filed an opening brief. On April 23, 2009,

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[3] After signing the protective order (Order No. 06-033), ICNU complained that the terms were too restrictive and sought to amend it. Specifically, ICNU alleged that the provisions limiting review of highly confidential information to a "safe-room" precluded its ability to participate in the proceeding. We denied ICNU's request in Order No. 08-002 and do not revisit that decision here.

[4] ICNU/100 and 101.

[5] ALJ Ruling at 5 (Mar 3, 2008.

[6] Order No. 08-201 at 6.

[7] Pacific Power's under-collection of taxes in 2006 was caused, in large part, by its change of ownership. At that time, Pacific Power's rates included a lower tax expense to recognize a tax deduction arising from its ownership by Scottish Power. *See In the Matter of PacifiCorp, dba Pacific Power, Request for General Rate Increase*, Order No. 05-1050 at 13-19 (Sept 28, 2005). That deduction was eliminated in early 2006, however, when MidAmerican Energy Holdings Company acquired Pacific Power. *See In the Matter of MidAmerican Energy Holdings Company Application for Authorization to Acquire PacifiCorp*, Order No. 06-082 (Feb 24, 2006).

Pacific Power and Staff each filed a response brief. On April 30, 2009, ICNU filed a reply brief.

II. PROCEDURAL ISSUE

Before we consider the merits of ICNU's challenge to OAR 860-022-0041, we must address a procedural issue related to testimony filed in this docket. As noted above, in Order No. 08-176 we upheld the ALJ's ruling to strike certain direct testimony filed by ICNU. Specifically, the ALJ struck testimony sponsored by Ellen Blumenthal, a tax consultant, addressing (1) the validity of OAR 860-022-0041; (2) the authority of the Commission to waive OAR 860-022-0041; and (3) the reasonableness of the safe-room discovery mechanism. Because that testimony was not admitted into the record, Pacific Power did not seek to admit portions of its rebuttal testimony sponsored by Douglas Larson and Ryan Fuller responding to the Blumenthal testimony on those three issues.

On reconsideration, we modify Order No. 08-176 and consider the testimony of Blumenthal relating to the validity of OAR 860-022-0041. Because this testimony consists of legal argument and does not address any disputed fact, however, we consider the testimony as comment rather than factual evidence. Accordingly, Order No. 08-176 is modified to include as part of the record ICNU/100, Blumenthal/3, lines 3-13; ICNU/100, Blumenthal/5, lines 1-16; ICNU/100, Blumenthal/6, line 23 though Blumenthal/7, line 2; ICNU/100, Blumenthal/9, line 3 through Blumenthal/12, line 4; and ICNU/100, Blumenthal/14, line 19 through Blumenthal/15, line 9. The remainder of Order No. 08-176 is unchanged.

Similarly, we admit into the record the rebuttal testimony Pacific Power filed, but did not offer as evidence, which addresses Blumenthal's arguments concerning the viability of OAR 860-022-0041. That testimony is PPL/100, Larson/7, line 1-13; PPL/100, Larson/7, line 17 through Larson/9, line 12; PPL/103; PPL/104; PPL/200, Fuller/5, line 10 through Fuller/7, line 14; PPL/200, Fuller/8, line 15 through Fuller/9, line 10; PPL/204; and PPL/205. Because this testimony, like the Blumenthal testimony, consists of legal argument and does not address any disputed fact, we consider the testimony as comment rather than factual evidence. We believe this treatment of ICNU's and Pacific Power's testimony allows us to fully consider and address the issues raised in the testimony and does not prejudice any party.

In its briefs, ICNU contends this reconsideration proceeding is flawed because the identified testimony of Blumenthal, Larson, and Fuller has not been properly admitted into the record. It argues that, under ORS 756.558(1), no additional evidence may be admitted without an opportunity to cross-examine witnesses.[8] ICNU's reliance on that statute is misplaced. Even though ICNU and Pacific Power presented these arguments on

[8] Despite these arguments, ICNU's brief included information not contained in the record from Pacific Power's 10-K filed with the Securities and Exchange Commission. *See* Opening Brief on Reconsideration of ICNU at 21-22 (Apr 13, 2009). ICNU alleges this information shows that our rules do not comply with SB 408. For the reasons cited by ICNU under ORS 756.558(1), we neither admit nor rely on the 10-K information. Moreover, in addition to these procedural restrictions, we note that any analysis using that information would potentially include revenues and expenses attributable to the unregulated operations of the utility or, potentially, revenues and expenses attributable to operations outside of Oregon.

the validity of OAR 860-022-0041 in testimony rather than briefing, the testimony is still legal argument, not evidence. Therefore, cross-examination is not appropriate.

III. DISCUSSION

ICNU complains that OAR 860-022-0041 circumvents SB 408's requirement that a utility may collect in rates only amounts for taxes "actually paid" to units of government.[9] According to ICNU, SB 408 is designed to ensure that the amounts the utilities *actually* pay in taxes match what the utilities collect in taxes from ratepayers. ICNU argues that, despite these provisions, the rule matches *hypothetical* amounts of taxes paid instead of *actual* taxes paid. Because the methodologies prescribed by OAR 860-022-0041 do not ensure that the amounts for taxes collected in rates reflect taxes actually paid to taxing authorities, ICNU claims the rule does not ensure rates that are "fair, just, and reasonable."[10]

To determine whether OAR 860-022-0041 departs from the standards imposed by SB 408, we begin with a review of the legislation itself. To determine legislative intent, we examine the text and context of the act, giving words of common usage their plain and ordinary meaning.[11] Once we identify the legislative intent, we then turn to OAR 860-022-0041 and address ICNU's claims that the rule violates SB 408.

A. SB 408

As part of the ordinary process of setting rates for electric utilities, the Commission estimates the amount of income tax liability the utility will incur as a result of its regulated operations. This estimated liability is included as a reasonable operating expense that the utility is allowed an opportunity to recover through customer rates.

To calculate this amount, the Commission determines the utility's tax liability based on the regulated revenues and operating costs of the utility itself, without regard to the utility's unregulated activities or the operations of its parent and other affiliated companies. The method is used so that the taxes in utility rates are based solely on the costs of providing the regulated utility service.

This methodology, though well established and widely used by regulatory agencies for utility rate setting, came under criticism due to the potential mismatch between amounts collected from ratepayers to pay taxes and the actual amount of taxes paid to the taxing authorities. Because tax laws allow a utility's corporate holding company to file consolidated tax returns reflecting its full span of operations, losses in some operations can offset profits in others. Thus, consolidated tax reporting may allow amounts collected for taxes in a utility's rates to exceed the taxes the parent company actually pays to taxing authorities. For example, under Enron's ownership of Portland General Electric Company

[9] Opening Brief on Reconsideration of ICNU at 17 (Apr 13, 2009). Because we consider the substance of ICNU's arguments regarding the validity of OAR 860-022-0041 in this order, we find that ICNU's claim that we erred in failing to address this challenge in Order No. 08-201 is moot, and we therefore decline to address that claim in this order.

[10] Citing ORS 757.267(1)(f).

[11] *Portland Gen. Elect. Co. v Bureau of Labor and Ind.*, 317 Or 606, 859 P2d 1143 (1993).

(PGE), Enron's tax losses completely offset PGE's tax liability on a consolidated basis. Thus, while PGE's rates included income tax expense as if PGE filed a separate return, Enron itself paid no taxes with its consolidated tax return.

To respond to that criticism, the 2005 Legislative Assembly enacted SB 408. The legislature created a process designed to "true up" the difference between the amounts of taxes collected in rates and those paid to units of government. The first step of the process requires certain utilities to file an annual tax report containing:

> (a) The amount of taxes that was paid by the utility in the three preceding years, or that was paid by the affiliated group and that is properly attributed to the regulated operations of the utility, determined without regard to the tax year for which the taxes were paid; and
>
> (b) The amount of taxes authorized to be collected in rates for the three preceding years.[12]

The Commission must then review the tax report and determine whether "the amount of taxes assumed in rates or otherwise collected from ratepayers * * * differed by $100,000 or more from the amount of taxes paid to units of government by the public utility, or by the affiliated group and properly attributed to the regulated operations of the utility* * *."[13] If so, the Commission must order the utility to establish an automatic adjustment clause to account for the difference.[14]

The legislature recognized that, because federal and state tax laws allow a corporate entity to file a consolidated return, the amount of taxes a utility pays to units of government "is affected by the operations or tax attributes of the parent company or other affiliates of the utility."[15] Accordingly, the legislature required any adjustment to the utility's rates to be based on the amounts the utility or its affiliated group[16] paid in taxes that are "properly attributed to the regulated operations of the utility" rather than the total amount of taxes actually paid to units of government, which can vary widely based on corporate structures. As explained in ORS 757.268(6):

> The automatic adjustment clause shall account for all taxes paid to units of government by the public utility that are properly attributed to the regulated operations of the utility, or by the affiliated group that are properly attributed to the regulated operations of the utility, and all taxes that are

[12] ORS 757.268(1).
[13] ORS 757.268(4).
[14] *Id*.
[15] ORS 757.267(1)(b).
[16] ORS 757.268(13)(a) defines "affiliated group" as the "group of corporations of which the public utility is a member and that files a consolidated federal income tax return."

> authorized to be collected through rates, so that ratepayers are not charged for more tax than:
>
> (a) The utility pays to units of government and that is properly attributed to the regulated operations of the utility; or
>
> (b) In the case of an affiliated group, the affiliated group pays to units of government and that is properly attributed to the regulated operations of the utility.

The legislature did not define the term "properly attributed." It did, however, place a limit on the amount of taxes paid to units of government that could be properly attributed to the regulated operations of the utility, thus capping the amount of tax liability that may be included in utility rates. ORS 757.268(12) provides:

> For purposes of this section, taxes paid that are properly attributed to the regulated operations of the public utility may not exceed the lesser of:
>
> (a) That portion of the total taxes paid that is incurred as a result of income generated by the regulated operations of the utility; or
>
> (b) The total amount of taxes paid to units of government by the utility or by the affiliated group, whichever applies.

B. OAR 860-022-0041

Shortly after the passage of SB 408, we initiated a rulemaking to implement the tax true-up mechanism. All the affected utilities and several consumer groups, including ICNU, participated in the rulemaking. Comments from the rulemaking participants primarily focused on how to define "properly attributed."

To assist our rulemaking, we asked the Attorney General how the Commission should apply the "properly attributed" standard. The Attorney General concluded that "properly attributed" was a delegative term that must be interpreted and applied by the Commission, consistent with the limits imposed by ORS 757.268(12):

> The Commission has discretion to define and implement the phrase "properly attributed," subject to the general policy and specific limits expressed in [SB 408]. The general policy of [SB 408] is to more closely align taxes collected by a regulated utility from its ratepayers with taxes received by units of government. The specific limits include a cap on the maximum amount of taxes paid that the Commission may properly attribute to regulated operations of public utilities. In any event, the

> Commission's actions in "properly attributing" taxes paid must result in rates that are fair, just, and reasonable.[17]

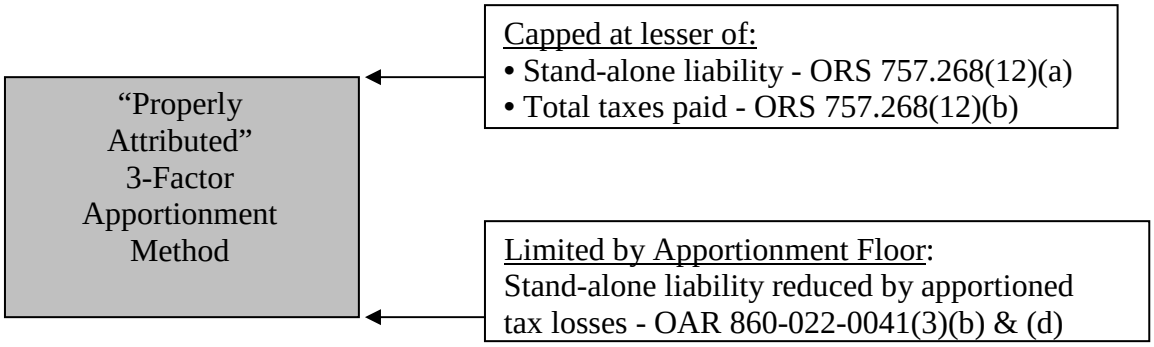
Much of our rulemaking proceeding focused on determining what factors should be used to properly isolate the taxes of a regulated utility from other corporate entities included in the consolidated tax return. To help formulate an appropriate mechanism, we concluded that any such methodology must balance the interests of the utility and ratepayers. We also determined that the methodology must begin with the actual amounts of taxes paid to units of government, should be easy to administer and apply, and should be flexible enough to apply to the variety of corporate structures used by the utilities' affiliated groups.[18]

After consideration of several recommendations made by utilities, customer groups, and our Staff, we ultimately adopted a methodology similar to that used by Oregon and other states to determine the state tax liability for multistate corporations.[19] This methodology, which we called the Apportionment Method, starts with the amount of taxes actually paid to units of government and apportions those tax payments by calculating the utility's amounts of payroll, property, and sales compared to the consolidated group's amounts for the same items. A combination of the three ratios is multiplied by the amount of taxes paid by the affiliated group to units of government, yielding the utility's attributed portion of the taxes paid by the consolidated group.[20]

We also imposed limits on the amount of taxes paid by the consolidated group that could be properly attributed to the regulated utility. First, to implement the statutory caps in ORS 757.268(12)(a) and (b), the amount calculated under the Apportionment Method is capped at the lesser of the utility's stand-alone tax liability or the total amount paid by the consolidated group.[21] Second, to ensure that ratepayers do not receive more than 100 percent of the tax benefits derived from losses within the utility's affiliated group, the amount calculated under the Apportionment Method is limited by a floor derived from the utility's stand-alone tax liability.[22] Thus, the range of amounts "properly attributed" to the regulated

[17] Letter of Advice dated Dec 27, 2005, to Chairman Lee Beyer, at 2.
[18] Order No. 06-400 at 5.
[19] *See* Orders No. 06-532 and 06-400. For a general discussion of the apportionment methodology used by the Oregon Department of Revenue, *see Fisher Broadcasting, Inc., v. Dept. of Rev.*, 321 Or 341, 351, 898 P2d 1333 (1995).
[20] Order No. 06-532 at 2. In comments to the rulemaking, ICNU supported use of the Apportionment Method. Reply Comments of the Industrial Customers of Northwest Utilities on Proposed Rules, Docket AR 499 at 1 (Aug 14, 2006) ("ICNU supports the application of the Apportionment Method and believes that the Commission has thoughtfully resolved a thoroughly debated and complex issue.").
[21] *See* OAR 860-022-0041(4)(d).
[22] *See* OAR 860-022-0041(3)(b) and (d). For further discussion of the need for the floor, *see* Order No. 06-532 at 8-9.

utility under OAR 860-022-0041 is bounded by a statutorily imposed ceiling and a pragmatic floor. This range is depicted below:



Put in practice, the determination of taxes paid that are properly attributed to the utility's regulated operations is established by the lowest amount of three alternative calculations. One calculation is the stand-alone tax liability of the utility, which assures that the amount of taxes included in utility rates is properly limited by the cap imposed by ORS 757.268(12)(a). The second calculation is the total tax liability of the consolidated group to which the utility belongs, which assures that the amount of taxes included in rates is properly limited by the cap imposed by ORS 757.268(12)(b). The third calculation uses the total tax liability of the affiliated group adjusted under the Apportionment Method to calculate the amount of taxes paid that are properly attributed to regulated operations.[23] These three calculations are often referred to as the Stand-Alone Method, the Consolidated Method, and the Apportionment Method. The lowest of these three calculations is used by the Commission as the amount of taxes properly attributed to the regulated utility for purposes of SB 408. To the extent the utility actually collected in rates an amount that varies from this number by $100,000 or more, the utility must implement a customer refund or surcharge to "true up" the amount of taxes included in rates.[24]

C. Challenge to OAR 860-022-0041

With this background, we turn to ICNU's objections. In resolving ICNU's challenge, our task is to determine whether we exceeded our statutory authority in adopting OAR 860-022-0041. We consider our role to be similar to that of the Court of Appeals in determining the validity of a rule under ORS 183.400. We therefore examine whether any provision of OAR 860-022-0041 departs from the legal standard expressed or implied in SB 408.[25]

[23] In all three methods, the utility's tax liability is adjusted to remove the benefits of accelerated depreciation and benefits related to the Investment Tax Credit, as allowed by ORS 757.268(8).
[24] ORS 757.268(4) and (6).
[25] *See Beaver Creek Coop. Telephone Co. v PUC*, 182 Or App 559, 50 P3d 1231 (2002).

ICNU primarily challenges the methodologies prescribed by OAR 860-022-0041 for calculating results under the Apportionment Method and the Stand-Alone Method. ICNU contends that the methodologies do not provide results that are consistent with SB 408. We address each primary challenge separately.

1. Apportionment Method

a. ICNU's Position

ICNU contends that we exceeded our statutory authority by adopting an overly expansive definition for the term "properly attributed." ICNU places great emphasis on the legislature's use of two conjunctive clauses in ORS 757.268(6) to limit the amount ratepayers may be charged for taxes. ICNU explains that the statute only permits ratepayers to be charged for taxes that the utility or its affiliate "pays to units of government *and* that is properly attributed to the regulated operations of the utility."[26] Despite this limitation, ICNU contends that the Apportionment Method could produce "properly attributed" amounts that exceed actual tax payments. ICNU concludes that:

> To construe the "properly attributed" clause as allowing ratepayers to be charged for hypothetical tax calculations that exceed amounts actually received by units of government makes a mockery of the defined terms of SB 408. Such a construction ignores the context of SB 408 and is invalid.[27]

ICNU does not clearly articulate the basis for its assertion that the Apportionment Method permits ratepayers to be charged for amounts that exceed those received by units of government. On its face, the assertion is easily dismissed, because the Apportionment Methodology—which compares the utility's payroll, property, and sales taxes to those same factors for all other affiliates included in the consolidated tax return—will always attribute an amount to the regulated utility that is lower than the total amount of taxes paid to units of government by an affiliated group.

Upon closer examination of other arguments raised by ICNU, we believe the assertion is directed at how the rule identifies the amount of taxes the utility or its affiliate pays to units of government. Although ICNU acknowledges that every utility subject to SB 408 currently pays taxes as part of an affiliated group, ICNU seems to contend that the Apportionment Method is impermissibly based on the amount of taxes paid by the affiliated group. ICNU evidently contends the rule should focus only on the taxes paid by the utility itself. ICNU asserts that a utility itself pays taxes, even when the utility is part of a group that files a consolidated tax return:

> Subsidiaries certainly pay actual taxes, they just do it through their parent company. In fact, Oregon ratepayers

[26] Opening Brief on Reconsideration of ICNU at 11 (Apr 13, 2009), citing ORS 757.268(6) (emphasis added).
[27] *Id.* at 13.

> are charged a sum of money in their rates for PacifiCorp's income taxes. As each and every subsidiary corporation prepares an actual tax return in order for the parent company to prepare and file a consolidated return, the actual taxes paid by a subsidiary utility can be computed by multiplying its taxable income by the statutory rate * * *.[28]

Thus, we surmise that ICNU believes there is some number that represents a utility's actual tax liability or tax payment that should be attributed to the utility's regulated operations under our rule, even when that utility files taxes as part of an affiliated group. ICNU also suggests that this utility-specific tax amount should be calculated based on the utility's taxable income for its regulated operations, arguing that "the actual taxes paid by a subsidiary utility can be computed by multiplying its taxable income [for its regulated operations] by the statutory rate" and concluding that "taxable income," rather than the Apportionment Method, should therefore be the "basis for apportioning the total taxes paid to units of government" under SB 408.[29]

b. Resolution

We are not persuaded by ICNU's challenge to how OAR 860-022-0041 interprets and applies the term "properly attributed." SB 408 does not require us to determine the amount of "actual taxes paid" by a regulated utility, as ICNU argues. Rather, as discussed above, ORS 757.268(6) requires us to determine the amount taxes paid to units of government by the public utility or its affiliated group that are *properly attributed to the regulated operations* of the utility.

ICNU's suggestion that the term "taxes paid" in SB 408 refers to those amounts paid by the regulated utility itself ignores the plain language of the statute. ORS 757.268(13)(f) defines "taxes paid" as "amounts *received by units of government* from the utility *or from the affiliated group of which the utility is a member* * * *." (Emphasis added.) Although a utility may be required, via an intra-company tax sharing agreement, to remit income tax payments to its parent company, any such payment is received by the parent, not units of government.[30] In other words, any tax payment "made" by a utility is received by its parent, not taxing authorities. The parent then files a consolidated return based on the tax liability and losses for the entire affiliated group. That consolidated tax payment represents the amount of "taxes paid" to units of government that must be divided up, with a portion properly attributed to the regulated utility under SB 408.

The language of ORS 757.268(6), which requires us to determine the amount of taxes paid to units of government by the public utility or its affiliated group that are properly

[28] Reply Brief on Reconsideration of ICNU at 15 (Apr 30, 2009).
[29] *Id.;* Opening Brief on Reconsideration of ICNU at 23 (Apr 13, 2009).
[30] We note that any attempt to base a utility's tax liability on intra-company tax sharing or other agreements would be a challenge, given the companies' ability to draft such agreements at their discretion. In any case, doing so is unnecessary since SB 408 focuses on the verifiable touchstone of tax payments made to units of government, rather than any possible moving target set forth in intra-company agreements.

attributed to the regulated operations of the utility, reflects the reality that utilities may not, and in this instance do not, file their own tax returns. As a result, there is no amount of "actual taxes paid" by a regulated utility reflected in either the affiliated group's tax return or any individual tax document.[31] Thus, the statute requires us to exercise our judgment to "properly attribute" to the regulated utility an amount of the affiliated group's total tax payment. In short, ICNU's use of the phrase "actual taxes paid" does not comport with either the statute or with the reality of utility tax filings.

Moreover, ICNU's apparent interpretation of "taxes paid" is also inconsistent with its own testimony before the legislature in support of SB 408. As the principal witness on the version of SB 408 that was ultimately enacted, Michael Early, Executive Director for ICNU, testified that, to implement the bill, the Commission would need to make certain judgments to identify what portion of the taxes paid by the corporate parent are properly attributed to the regulated operations of the utility:

> *The starting point in our bill is [the Commission] looks at, for the parent, it says how much tax did the parent pay and you look at the check. And then the Commission asks itself how much of that tax is attributable to a regulated operation of the utility and that's the job of the Commission*. That is the sort of decisions it makes and, as you point out, it is fact specific and not something that can be dealt with legislatively in any detail. So, that is a decision for the Commission to make and after it makes that decision, then it compares that number, you know, the amount of the $500 million attributable to the utility with the amount of tax that was collected in the same year through rates. And then its makes the adjustment up or down to the rates depending on whether it under-collected or over-collected.[32]

Thus, given the manner in which utilities pay taxes, ICNU itself recognized that any methodology adopted by the Commission to determine amounts "properly attributed" would begin with the amount of taxes actually paid *by the affiliated group*.

We are also not persuaded by ICNU's apparent suggestion that SB 408 mandates the use of taxable income for purposes of attributing amounts paid to the regulated operations of the utility. Because the amount of "taxes paid" received by units of government includes the tax attributes of the corporate parent and other entities of the affiliated group, the legislature delegated the Commission the responsibility to develop a mechanism to properly attribute these consolidated tax payments. In his letter of advice, the Attorney General clarified that the expression "properly attributed" unambiguously delegated

[31] Any tax return prepared by the utility used by the parent for a consolidated return would reflect the utility's regulated and unregulated operations.

[32] Testimony of Michael Early, House State and Federal Affairs Committee (SB 408B), July 26, 2005, tape 47, side B at 179-194 (emphasis added).

to the Commission the responsibility for making judgments about how best to implement the legislative goal, and that the Commission had discretion in making those judgments within the bounds of its legislatively delegated authority.[33]

To demonstrate the range of authority delegated to the Commission in defining the term "properly attributed," the Attorney General provided examples of how we might exercise our discretion. First, he explained that the Commission could decide to attribute to a utility's regulated operations the maximum amount permitted under ORS 757.268(12). He explained:

> Under such an approach, the Commission would not reduce rates if an affiliated group that includes the utility pays more income taxes than the Commission had assumed in the utility's rates. In other words, if $100 million of taxes are assumed in the utility's rates, $100 million in taxes paid are the result of the utility's regulated operations, and the consolidated group as a whole pays $101 million in taxes, then there would be no reduction of rates.[34]

The Attorney General also explained that the Commission could decide to follow an approach once used by the Pennsylvania Public Utility Commission. Under that "modified effective tax rate method," the Pennsylvania PUC takes tax losses from other non-regulated members of the consolidated group and allocates a share of those tax savings to all members having positive tax income.[35] The Attorney General concluded that, while both approaches were permissible, neither was required, and that the Commission was required to "craft a 'properly attributed' method that is equal to or lesser than the cap as determined by the calculation set forth in [ORS 757.268(12)]."[36]

Ultimately, we adopted the Apportionment Method to determine what amounts of taxes paid are properly attributed to the regulated operations of the utility. We concluded that the Apportionment Method, as limited by the caps imposed by ORS 757.268(12), fell within our delegated authority. Although ICNU's proposed use of taxable income to allocate taxes might also be a *permissible* methodology to implement "properly attributed," there is nothing in SB 408 to *mandate* its use.[37]

Because all utilities subject to SB 408 pay taxes through an affiliated group, the Apportionment Method and other calculations required by the rule are properly based on the total taxes paid by the consolidated taxpayer. The Apportionment Method, with the caps imposed by ORS 757.268(12), is permitted under the authority delegated to this Commission to define "properly attributed." We conclude that OAR 860-022-0041 properly attributes to a

[33] Letter of Advice dated Dec 27, 2005, to Chairman Lee Beyer, at 18.
[34] *Id.* at 17.
[35] *See Barasch v. Pennsylvania Public Utility Commission*, 548 A2d 1310, 1312-1215 (1988).
[36] Letter of Advice at 13-14.
[37] We note ICNU's proposed "taxable income" methodology might prove unworkable, as it may require the auditing of all affiliate operations. That task would be extremely burdensome, particularly because Pacific Power is part of the Berkshire Hathaway consolidated federal tax return, which includes hundreds of affiliates.

regulated utility the amount of taxes actually paid to units of government and is consistent with the plain language of SB 408 and its legislative history.

Stand-Alone Method

a. ICNU's Position

ICNU also contends that the method adopted in OAR 860-022-0041 to calculate a utility's stand-alone tax liability (the Stand-Alone Method) circumvents SB 408. A utility's stand-alone tax liability is used for two purposes under the rule. First, it is directly used to establish the cap of taxes paid and properly attributed under ORS 757.268(12)(a). Second, it is used as the starting point to calculate the Apportionment Method floor under OAR 860-022-0041(3)(b) and (d). The rule defines "stand-alone tax liability" as:

> [T]he amount of income tax liability calculated using a pro forma tax return and revenues and expenses in the utility's results of operations report for the year, except using zero depreciation expense for public utility property, excluding any tax effects from investment tax credits, and calculating interest expense in the manner used by the Commission in establishing rates.[38]

ICNU contends the Stand-Alone Method violates SB 408 in four ways. First, ICNU objects to the fact that a pro forma tax return is based on hypothetical, not actual, tax figures. For that reason, ICNU contends the pro forma return does not produce the result ICNU contends is mandated by SB 408: a calculation of actual taxes paid by the regulated utility.

Second, ICNU objects to the requirement in the rule that interest expense be calculated in the manner used by the Commission in establishing rates. ICNU contends that this method, known as the interest synchronization method, is not used by the utilities to calculate the interest deduction on their actual tax returns, so it should not be used to calculate the stand-alone liability for purposes of SB 408.

Third, ICNU contends the elimination of any depreciation expense in the Stand-Alone Method is improper. ICNU acknowledges the need to remove accelerated tax depreciation expenses to avoid a normalization violation, but contends that straight line depreciation on public utility property must be added back into the calculation so that the stand-alone calculation more accurately represents actual taxes paid by the utility.

Finally, ICNU contends the Stand-Alone Method fails to reflect any consolidated tax savings that might be realized by the utility's affiliated group. ICNU contends that customers must receive a share of these tax benefits in order to fulfill the goal and purpose of SB 408.

[38] OAR 860-022-0041(2)(p).

b. Resolution

We reject ICNU's assertion that the Stand-Alone Method violates the standards imposed by SB 408 because it uses *hypothetical* tax figures. Again, given the manner in which utility's pay taxes, there is no *actual* tax return reflecting solely the regulated operations of the utility. Moreover, contrary to ICNU's implied assertion, the Stand-Alone Method uses, to the greatest extent possible, actual tax data to reasonably approximate "that portion of taxes paid that is incurred as a result of income generated by the regulated operations of the utility."[39] The pro forma return is created using actual revenues and expenses for a utility's regulated activities, as reported in the annual results of operations report filed with the Commission. This provides the most accurate information available on what taxes the regulated operations of the utility would pay if it were to pay taxes as a separate and fully regulated company, the very definition of stand-alone tax liability.

Similarly, the use of the interest synchronization method to calculate interest expense in the Stand-Alone Method is appropriate under SB 408. Again, because a utility's tax payments are consolidated with its corporate parent and unregulated affiliates, no tax data exists for the utility's "actual" interest expense. In fact, it is difficult to isolate a utility's deductible interest expense for SB 408 purposes for two reasons. First, any tax data reported by the utility to its parent would include results from both its regulated and unregulated operations. Second, as Staff notes, all but one utility subject to SB 408 operates in more than one state. As a result, any interest expense for debt attributable to the utility's rate base would be based on the utility's entire system, not just its regulated operations here in Oregon.

Due to this lack of information, the Stand-Alone Method requires the utility to calculate its interest expense using what Staff refers to as the interest synchronization method. Simply explained, this method calculates deductible interest expense by applying the utility's average weighted cost of debt to its rate base.[40] For example, Pacific Power's interest expense for 2006 was calculated using its annualized weighted cost of debt for 2006 applied to its actual rate base allocated to its Oregon operations.[41] This method, based on actual data, establishes a reasonable proxy for the deductible interest used to determine a utility's stand-alone tax liability.

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[39] ORS 757.268(12).

[40] The term "rate base" refers to the amounts that a utility prudently invests in capital assets to service its customers. ORS 756.040(1) requires rates to provide adequate revenue for both operating expenses and a rate of return which reflects the cost of debt on rate base.

[41] The calculation of Pacific Power's 2006 interest expense was complicated by the fact that it had two owners during the year. Scottish Power owned it during the first quarter; MidAmerican Energy Holdings Company owned it during the last three quarters. *See* Order No. 06-082. Thus, interest expense was calculated on an annual basis for each owner and then weighted accordingly.

1st Quarter - 2006A (annualized)	Last three quarters - 2006B (annualized)
Weighted Cost of Debt: 3.08%	Weighted Cost of Debt: 3.04%
Average Rate Base: $2,190,135,787	Average Rate Base: $2,296,324,698
Interest Expense: $67,456,182	Interest Expense: $69,808,271

Next, contrary to ICNU's assertions, OAR 860-022-0041 provides customers the tax benefits of depreciation on public utility property. As Staff explains, under the initial calculation of "taxes paid" under the Stand-Alone Method, Consolidated Method, and Apportionment Method, tax benefits related to depreciation of public utility property are excluded.[42] In the second phase of these calculations, however, those depreciation benefits related only to Oregon regulated operations—on a straight-line basis—are added back.[43] The purpose of this two-step treatment is to ensure that no benefits from accelerated depreciation are passed through to Oregon customers, which would cause a normalization violation under federal tax rules.

Finally, there is no basis to support ICNU's claim that the stand-alone tax calculation must include consolidated tax savings. As previously explained, the legislature, in enacting ORS 757.268(12)(a), identified the utility's stand-alone tax liability as a cap to the amount of taxes paid that may be properly attributed to the regulated operations of the utility. There is nothing in that section mandating that the stand-alone cap reflect tax savings caused by losses in the corporate operations of the utility's parent or affiliates.

This conclusion is confirmed by the Attorney General's letter of advice. There, the Attorney General noted that ORS 757.268(12)(a) addresses the amount of taxes paid that is incurred "as a result of income generated by the regulated operations of the utility." Based on the plain, natural, and ordinary meaning of that phrase, the Attorney General concluded:

> [T]he phrase "as a result of income" appears to mean something that directly occurs or is caused by the income from regulated operations. Therefore, paragraph 3(12)(a) addresses those taxes that would not have been received by units of government "but for" the existence of the regulated operations. The amount specified in paragraph 3(12)(a) cannot include taxes reaching units of government as a result of profits earned by a utility from unregulated business operations; only the "portion" of taxes paid on the utility's regulated operations is counted for purposes of subparagraph 3(12)(a).[44]

Because the cap established in ORS 757.268(12)(a) may not reflect any profits earned from unregulated operations, it follows that the cap may not similarly reflect any losses incurred from unregulated operations.

[42] *See* OAR 860-022-0041(2)(p), (3)(a)(A)(i), (3)(c)(A)(i), (3)(e)(A)(i), and (4)(a).
[43] *See* OAR 860-022-0041(4)(d)(B) and (4)(j)(B).
[44] Letter of Advice dated Dec 27, 2005, to Chairman Lee Beyer, at 15.

Accordingly, consistent with the plain language of SB 408 and as supported by the letter of advice from the Attorney General, OAR 860-022-0041 properly calculates the utility's stand-alone tax liability for purposes of determining the cap imposed by ORS 757.268(12)(a). Because all utilities subject to SB 408 pay taxes through an affiliated group, the Stand-Alone Method uses, to the greatest extent possible, actual tax figures to reasonably approximate "that portion of taxes paid that is incurred as a result of income generated by the regulated operations of the utility."[45]

IV. CONCLUSION

SB 408 delegates to the Commission the authority to calculate how taxes paid by utilities are recovered from ratepayers in a manner that results in fair, just, and reasonable rates. OAR 860-022-0041, which interprets and implements SB 408, is a valid expression of the general policy and express limits in the legislation. The rule's use of the Apportionment Method to properly attribute taxes paid by the utility or its affiliated group to the regulated operations of the utility is consistent with the policy behind SB 408 and within the discretion delegated by the legislature. The rule's Stand-Alone Method to calculate the maximum amounts of taxes that may be properly attributed to the regulated operations of the utility is consistent with the expressed and implied legislative standards in SB 408. For these reasons, we find OAR 860-022-0041 valid.

V. ORDER

IT IS ORDERED that Order No. 08-201 is supplemented and affirmed.

Made, entered and effective MAY 20 2009.

Lee Beyer
Chairman

Ray Baum
Commissioner

John Savage
Commissioner

A party may appeal this order by filing a petition for review with the Court of Appeals in compliance with ORS 183.480-183.484.

[45] ORS 757.268(12).