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Via Electronic Mail

Chairman Lee Beyer
Commissioner Ray Baum
Commissioner John Savage
Oregon Public Utility Commission
555 Capitol St. NE #215
Salem, OR 97308-2148

Re: Oregon Department of Justice Memorandum regarding the “Legality of Setting Utility Rates Based upon the Tax Liability of its Parent”

Dear Commissioners:

Pursuant to the Oregon Public Utility Commission’s (“OPUC” or the “Commission”) notice of request for comments, the Industrial Customers of Northwest Utilities (“ICNU”) submits the following comments regarding the February 18, 2005 Oregon Department of Justice Memorandum regarding the “legality of setting utility rates based upon the tax liability of its parent” (“DOJ Memorandum”). ICNU recommended in its February 18, 2005 comments regarding Staff’s White Paper on Utility Income Taxes (“Staff White Paper”) that the Commission’s policies should remain flexible enough to address specific circumstances under which the current stand-alone policy may not produce just and reasonable rates. In addition, ICNU urged the Commission to fully examine all alternatives to the stand-alone policy. ICNU provides these comments to support ICNU’s previous recommendations and to provide a more complete discussion of the DOJ Memorandum.

ICNU agrees with the DOJ Memorandum’s ultimate conclusions that: 1) the Commission has the discretion to change its current policy of establishing rates based on the tax liability of the stand-alone utility; and 2) any policy adopted by the Commission must be rational and consistent with statutory and constitutional requirements. These are the basic requirements for any Commission action. The DOJ Memorandum criticizes, however, certain cases that discuss an “actual taxes paid” approach. The Commission should not draw the conclusion from

the discussion in the DOJ Memorandum that policies that consider the tax liability of a consolidated tax group as a whole for the purposes of setting rates are unsound or unlawful.

The DOJ Memorandum identifies Federal Power Commission v. Hope Natural Gas Pipeline, 320 U.S. 591 (1944) and Duquesne Light Company v. Barasch, 488 U.S. 299 (1989) as two U.S. Supreme Court cases that are relevant to consideration of the Commission's income tax policy. Other Supreme Court cases are relevant as well. In Federal Power Commission v. United Gas Pipeline Company, the Court upheld the Federal Power Commission's ("FPC") policy of establishing natural gas rates that included amounts for taxes calculated on a consolidated basis. The Court found that the FPC's discretion to determine just and reasonable rates allowed it to include taxes in rates based on consideration of the total tax liability of a consolidated tax group; however, the Court did not find that the FPC was required to apply this method. Fed. Power Comm'n v. United Gas Pipeline Co., 386 U.S. 237, 243-245 (1967). This rationale applies in the context of the OPUC's discretion to establish a tax policy to determine just and reasonable rates as well.

Subsequent to the United Gas Pipeline decision, FERC determined that it will apply the stand-alone policy rather than a methodology that considers consolidated tax liability, and the courts have upheld the decisions applying that policy as well. Florida Gas Transmission Co., 47 F.P.C. 341 (1972); City of Charlottesville v. FERC, 774 F.2d 1205, 1207-1212, 1216 (D.C. Cir. 1985). FERC's policy determination to apply a stand-alone policy, however, does not impact the OPUC's discretion to articulate and adopt a different policy. Indeed, the fundamental point regarding the legality of utility income tax policies is that regulators have considerable discretion to determine what policies will result in just and reasonable rates under different situations. The federal courts have upheld and struck down different methodologies under different circumstances.^{1/} The DOJ Memorandum should not be interpreted otherwise.

The DOJ Memorandum refers generally to all policies that would consider the tax liability of a consolidated tax group as the "actual taxes paid" doctrine and discusses this doctrine as the minority approach. DOJ Memorandum at n.1, 4. The use of the term "actual taxes paid" to describe all policies other than the stand-alone policy is unfortunate, however, because the strict application of that term has been criticized in decisions such as City of Charlottesville v. FERC, which the DOJ Memorandum discusses. Id. at 6-7. The "actual taxes paid" policy does not reflect all the potential alternatives to the stand-alone method. Indeed, the Staff White Paper acknowledges that other methods exist. Staff White Paper at 11. Furthermore, the DOJ Memorandum discusses cases in which a litigant argued that a regulator could "only" consider the "actual taxes paid" by a consolidated tax group to establish rates because those rates would otherwise include a hypothetical amount for taxes. City of Charlottesville, 774 F. 2d at 1213; Barasch v. Penn. Pub. Util. Comm'n, 548 A.2d 1310 (1988). Arguments that a regulator is *required* to establish rates based on a particular approach are

^{1/} The D.C. Circuit recently vacated FERC's inclusion of taxes in rates based on the stand-alone policy in the case of a regulated gas pipeline operated by a limited partnership that was exempt from corporate taxation. BP West Coast Products v. FERC, 374 F.3d 1263, 1293 (D.C. Cir. 2004). The court concluded that the partnership was "entitled to no allowance for the phantom income taxes it did not pay." Id. at 1288.

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inconsistent with the judicial determinations that regulators have discretion to adopt different policies to determine just and reasonable rates. Thus, the Commission should not conclude that the criticisms of the “actual taxes paid” approach in the DOJ Memorandum extend to all alternative methodologies.

The primary consideration for development of a policy that includes taxes in rates according to the liability of a consolidated tax group is the methodology by which the Commission would allocate the appropriate portion of the total liability to the regulated utility. The DOJ Memorandum suggests that the benefits/burdens approach described in City of Charlottesville is reasonable, but that is only one possible method for the OPUC to consider. Neither the DOJ Memorandum nor the Staff White Paper demonstrate that there has been a thorough and careful examination of all potential alternatives to the stand-alone policy. Both documents point out alternative methodologies that have been subject to criticism in other circumstances, but provide no detail about potentially workable policies.^{2/} ICNU urges the Commission to study the alternative methodologies in detail prior to determining whether the OPUC will continue to follow the stand-alone policy and to ensure that the Commission’s policies remain flexible enough to address this issue on a case-by-case basis.

At some point, including in rates taxes that are consistently not paid to the appropriate authorities will result in rates that are unjust and unreasonable. It has been reported that PGE collected from ratepayers over \$400 million in income taxes that ultimately was never paid by Enron. The Commission’s policies should remain flexible enough to address this situation to ensure just and reasonable rates for customers. ICNU appreciates the opportunity to comment on the DOJ Memorandum.

Sincerely yours,

/s/ Melinda J. Davison

Melinda J. Davison

^{2/} Staff’s White Paper states that Staff conducted an “informal survey” of other states regarding the methodologies used and briefly describes the “actual taxes paid” approach discussed above. Staff White Paper at 11. This important issue warrants a more detailed review of alternative methodologies prior to any OPUC policy determination.