



February 16, 2005

Sent via E-Mail (PUC.TAXWHITEPAPER@STATE.OR.US)

Commission Chair Lee Beyer
Commissioner Ray Baum
Commissioner John Savage
Public Utility Commission of Oregon
PO Box 2148
Salem, OR 97308-2148

Dear Commissioners:

I am attaching the comments PacifiCorp prepared on the Commission's draft White Paper "Treatment of Income Taxes in Utility Ratemaking." This issue is important to PacifiCorp and we appreciate the opportunity to provide comments in this manner and at the public meeting on February 23, 2005. As we note in our comments, changes in the Commission's approach to utility income taxation could negatively impact PacifiCorp, its customers and the public interest.

Sincerely,

A handwritten signature in black ink, appearing to be "DF", with a long horizontal line extending to the right.

Don Furman
Senior Vice President
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DF/rcn



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Commission Chair Lee Beyer
Commissioner Ray Baum
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Public Utility Commission of Oregon
PO Box 2148
Salem, OR 97308-2148

**Re: DRAFT WHITE PAPER ON THE TREATMENT OF INCOME TAXES IN
UTILITY RATEMAKING**

Dear Commissioners:

PacifiCorp appreciates this opportunity to submit comments on the Oregon Public Utility Commission's (Commission) draft White Paper titled "The Treatment of Income Taxes in Utility Ratemaking." PacifiCorp's comments begin with general observations, followed by comments proposing specific revisions or additions to aspects of the White Paper.

I. The White Paper Is an Excellent Primer on Utility Income Taxes and Serves the Important Function of Correcting Inaccurate Information on the Issue.

The manner in which income taxes are collected and paid by utilities is not a simple matter. In Oregon, utilities currently calculate income tax liability for ratemaking purposes on a standalone basis whether or not they file income taxes on a consolidated basis. This means that utilities' rates include projected expenses for income taxes calculated assuming a separate return basis—*i.e.*, considering only the costs and profits of the regulated utility and ignoring the costs and profits (and resulting tax savings or liabilities) of nonregulated affiliated businesses (*e.g.*, parent companies or subsidiaries). The White Paper recognizes that although alternatives to the current standalone method of reporting and calculating income taxes exist, each has significant limitations and potential negative consequences. In contrast, the Commission's current approach is theoretically and practically sound, protecting ratepayers and the public generally.

There are a number of common misunderstandings about the current standalone method that the White Paper corrects and clarifies. Most fundamentally, the White Paper makes clear that the standalone method is designed to protect customers, not hurt them. The only way to fully

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Idaho



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insulate customers from the costs and risks of nonregulated business activities of utilities' affiliates is to maintain a careful separation between the respective businesses. The standalone method is one aspect of this barrier. Without it, both utility taxes and utility costs could be higher, depending on the activities of the nonregulated company. Likewise, without this barrier between regulated and nonregulated companies, utility rates are virtually certain to be more volatile.

The White Paper also corrects the popular misconception that the standalone method is unique to Oregon and is a function of lack of sufficient regulatory oversight of utility costs or tax collection. The White Paper indicates that the standalone method is the majority approach, consistent with fundamental principles of basing utility rates on utility costs and revenues and prohibiting cross-subsidization between utility and non-utility operations. The current method aligns savings and liabilities for utility customers with the benefits and risks associated with regulated activities. To the extent that tax savings are realized by the nonregulated parent's use of tax benefits designed to foster investment and economic growth, this suggests a proper application of tax law and policy, not the contrary. This is an approach that has spurred investment in renewable energy companies consistent with state and federal energy policy.

Finally, the White Paper points out the incompatibility of an "actual taxes paid" approach with basic ratemaking practices. Costs reflected in utility rates are forecasted and normalized; they rarely reflect "actual costs paid," which vary upward and downward from the costs set in rates. For this reason, in reviewing the fairness of utility rates, the focus is generally on the utility's overall earnings, not whether the rate level for a particular item exceeds actual costs. The current tax debate focuses on the past several years; during this period electric utilities in Oregon have suffered significant underearnings, suggesting that overall rate levels are lower than "actual costs paid," not the opposite. The standalone method has not resulted in rates that overcharge Oregon customers for the service they receive.

II. The White Paper Should Include Certain Additional Points to Add to its Overall Helpfulness.

A. The White Paper Should Include Citations Demonstrating That the Weight of Legal Authority Supports the Commission's Current Approach to Utility Income Tax.

A majority of utility commissions, including the Oregon and California Commissions and the Federal Energy Regulatory Commission (FERC), follow the current standalone method. *See, e.g., Columbia Gulf Transmission Co.*, 23 F.E.R.C. ¶ 61,396, at 61,850-53 (1983); OAR 860-



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027-0048 (requiring standalone reporting for ratemaking purposes); *In re PacifiCorp, Application for Approval of a Cross Charge Contract with ScottishPower UK plc*, UI 221, Order No. 03-726 (Or. Pub. Util. Comm'n Dec. 12, 2003); *In re Mountain States Tel. & Telegraph Co.*, Report and Order, Docket No. 88-049-07 (Utah Pub. Serv. Comm'n Oct. 18, 1989); *Re Southwestern Telephone Co.*, Decision No. 60741, 1998 WL 265335 (Ariz. Corp. Comm'n Mar. 26, 1998) (concluding that ratepayers should not bear the burden of a higher tax rate resulting from the company's decision to file a consolidated tax return); *Re Utils., Inc. of Md.*, Order No. 73482, 1997 WL 1015905, at *15 (Md. Pub. Serv. Comm'n May 28, 1997) (recognizing "general principle" that expenses for a utility "should be based upon utility operations and not related to other factors"); *Re Potomac Elec. Power Co.*, 150 P.U.R.4th 528 (abstract, full text in Westlaw), 1994 WL 109204 (D.C. Pub. Serv. Comm'n 1994); *Re Or. Exch. Carrier Ass'n*, Order No. 93-325, 1993 WL 117620, at *5 (Mar. 12, 1993) (the Commission's policy is to "calculate tax liability on a stand alone basis") *recons. denied*, Order No. 93-879, 1993 WL 390953 (Or. Pub. Util. Comm'n June 28, 1993); *Re Delmarva Power & Light Co.*, Order No. 3389, 1992 WL 465021, at *18 (Del. Pub. Serv. Comm'n Mar. 31, 1992) (true-up methods are "'short-sighted[]' and . . . violate[] the 'fundamental' ratemaking principle that a utility's costs and revenues should be kept separate from those of its non-regulated subsidiaries" (citation omitted)); *Re Midwest Gas*, 133 P.U.R.4th 380, 396-97 (Iowa Utils. Bd. 1992); *Re Iowa Elec. Light & Power Co.*, 135 P.U.R.4th 522 (Iowa Utils. Bd. 1992).

The current standalone method is consistent with the fundamental ratemaking principal that regulated utility operations must be separated from nonregulated operations. *Panhandle E. Pipe Line Co. v. Fed. Power Comm'n*, 324 U.S. 635, 641-42 (1945) ("[T]he Commission must make a separation of the regulated and nonregulated business when it fixes . . . rates of a company whose activities embrace both. Otherwise the profits or losses, as the case may be, of the unregulated business would be assigned to the regulated business . . ."); *Columbia Gulf Transmission Co.*, 23 F.E.R.C. at 61,850-53 ("Taxes are no different from other expenses included in the cost of service. . . . [T]he test is whether the expenses that generate the deduction are used to determine the jurisdictional service's rates. Put more simply, the test is whether the expenses are included in the relevant cost of service." (footnote omitted)). Indeed, "[t]he *only* approach that is consistent with standard ratemaking principles that prohibit cross-subsidization between utility and non-utility activities is to put the regulated operation on a 'stand-alone' basis and to assign the full tax burden to the taxable gain source and [the] full tax benefit to the tax loss source." *Accounting for Public Utilities* § 7.08[3] (LexisNexis 2003) (emphasis added).



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B. The White Paper Should Note the Commission’s Recent Codification of the Standalone Approach to Electric Utility Income Tax.

The draft White Paper discusses five approaches to utility income taxes: continue the current standalone method (Option 1), require an annual full true-up of income taxes collected from customers and actual tax liability related to utility operations (Option 2), require an annual partial true-up of income taxes collected from customers and actual tax liability related to utility operations (Option 3), require utilities to reflect consolidated income tax effects in rates (Option 4), and require utilities to file Oregon taxes on a deconsolidated basis (Option 5).

The White Paper should recognize that any method that allocates consolidated tax savings to utilities (Options 2-4) would reverse long-standing Commission policy and recent Commission action, designed to mandate careful separation of utilities and nonregulated affiliates. *See In re Util. Reform Project*, Order No. 03-214, App. A at 2 (Or. Pub. Util. Comm’n Apr. 10, 2003) (ratemaking on a standalone basis is “[c]onsistent with long-standing OPUC policy,” which “protect[s] [utility] customers, competitors, and the public generally” (citation omitted)). Just over one year ago, the Commission adopted a rule that requires electric utilities in Oregon to calculate and report income taxes on a standalone basis for regulatory and ratemaking purposes, even if those taxes are paid on a consolidated basis. OAR 860-027-0048, adopted in December 2003, provides in pertinent part:

(3) The energy utility shall use the following cost allocation methods when transferring assets or supplies, or providing or receiving services between regulated and nonregulated activities:

.....

(g) Income taxes shall be calculated for the regulated activity on a standalone basis for both ratemaking purposes and regulatory reporting. When income taxes are determined on a consolidated basis, the regulated activity shall record income tax expense as if it were determined for the regulated activity separately for all time periods.

(4) The energy utility shall use the following cost allocation methods when transferring assets or supplies or providing or receiving services involving its affiliates:



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.....

(h) Income taxes shall be calculated for the energy utility on a standalone basis for both ratemaking purposes and regulatory reporting. When income taxes are determined on a consolidated basis, the energy utility shall record income tax expense as if it were determined for the energy utility separately for all time periods.

The purpose of the rule is to prevent cross-subsidization between regulated utilities and nonregulated affiliates. *Re Affiliated Transactions for Energy Utils.*, Order No. 03-691, 2003 WL 23305011, at *1 (Or. Pub. Util. Comm'n Dec. 1, 2003); *In re PacifiCorp*, Order No. 03-726, App. A at 5 (requiring use by PacifiCorp of the standalone method to prevent "any cross-subsidization of [ScottishPower UK plc] operations by PacifiCorp's regulated operations").

C. The White Paper Should More Fully Explain the Benefits of the Commission's Current Standalone Approach.¹

Of the various alternatives discussed in the draft White Paper, only the current standalone approach ensures continuation of the following benefits:

- Prevents cross-subsidization between regulated operations and nonregulated operations.

See In re PacifiCorp, Order No. 03-726, App. at 5 (standalone method prevents "cross-subsidization"); *Re Midwest Gas*, 133 P.U.R.4th at 396-97 ("If the Board allowed the benefits of [nonregulated affiliate] losses to go to the ratepayers, stockholders would be forced to subsidize the utility cost of service."); *Columbia Gulf Transmission*, 23 F.E.R.C. ¶ 61,396, at 61,858 ("Once a normalization policy is adopted for dealing with tax and ratemaking timing differences, a policy on consolidated taxes that ignores the source of the loss makes no sense.").

¹ Likewise, if the Commission chooses to retain the table summarizing the pros and cons of each alternative, the table should summarize more fully the costs and benefits of the various approaches.



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- Matches the regulatory treatment of benefits with the underlying expense items that give rise to the benefits.

Under the current method, ratepayers are responsible for the expenses associated with the cost to serve them and are not entitled to the tax benefits associated with expenses for which they are not responsible. *In re Util. Reform Project*, Order No. 03-214, App. A at 2 (denying petition for investigation of Portland General Electric (PGE) income tax rates; “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.”).

- Supports growth and diversification of utility businesses, which can attract capital at favorable rates, while shielding utility customers from the financial risks of nonregulated businesses.

See id. (“Calculating [the utility]’s costs, including income taxes, for ratemaking on a stand-alone basis protects [the utility]’s customers from the financial difficulties experienced by [the parent]’s other subsidiaries.”); *Re Questar Gas Co.*, 203 P.U.R.4th 356, 371 (Utah Pub. Serv. Comm’n 2000) (standalone method “prevents ratepayers from paying additional taxes arising as a result of affiliate earnings”).

- Stimulates investment in activities that policy makers encourage through incentives in the tax code.

Lawmakers frequently use tax credits and other tax benefits to encourage investment in activities such as development of renewable resources. *See, e.g.*, ORS 469.190 (business energy tax credit encourages use of renewable resources); Oregon Dep’t of Energy, Second Draft: Renewable Action Plan at 1 (2004) (“We can make Oregon the national leader in renewable energy and renewable product manufacturing. . . . Development of renewable energy will lessen our reliance on fossil fuels, protect Oregon’s clean air and create jobs.”), quoting Governor Kulongoski (2003).² Any approach that limited the effectiveness of these tax

² The draft Renewable Action Plan is available at <http://www.energy.state.or.us/renew/RenewPlan.htm>.



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credits or otherwise discouraged investment in renewable energy would be contrary to state and federal energy policy. *See Re Nat'l Rates for Natural Gas*, 4 P.U.R.4th 401 (Fed. Power Comm'n 1974) (“[T]o reduce the rates of a regulated pipeline because of . . . [tax losses resulting from] affiliated exploration and development activities would be discouraging to the very enterprise we now want to encourage.” (citation omitted)).

- Is consistent with sound ratemaking principles.

The standalone method is used so that the taxes in utility rates are based on the costs of providing the regulated utility service and not on the utility's nonregulated operations or operations of the utility's parent and subsidiaries. *See Re Delmarva Power & Light Co.*, 1992 WL 465021, at *18 (true-up methods are “short-sighted[] and . . . violate[] the ‘fundamental’ ratemaking principle that a utility's costs and revenues should be kept separate from those of its non-regulated subsidiaries” (citation omitted)).

- Promotes tax equity among the states and between multi-state businesses and in-state businesses.

The current method also promotes tax equity among the states and between multi-state businesses and in-state businesses. When combined reporting is used consistently in all the affected states, it results in neither double taxation nor “nowhere income.” Purely in-state taxpayers obtain no benefit from the creation of multiple entities because all income, whether realized in one entity or several, is subject to the state's taxes. Thus, the current system reduces unhealthy tax competition between and among the states. Or. Dep't of Revenue, *Separate Accounting vs. Combined Reporting* at 2 (Nov. 23, 2004), citing Multistate Tax Comm'n, *Corporate Income Tax Sheltering Work Group Report* (June 2004).

- Insures rate stability.

The Oregon Department of Revenue has noted that the current method increases rate stability. *Id.* Although the Commission has no jurisdiction to review the prudence or reasonableness of nonregulated entities' investments, the expenditures of those entities would affect rates under any approach that allocates the benefits (or costs) of nonregulated tax losses (or liabilities) to utilities. The result would be potentially extreme rate fluctuations without any change in how



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services were provided to ratepayers or in the expense of services provided to ratepayers.

D. The White Paper Should Capture the Full Range of Risks Presented by the Alternative Options.

Deconsolidation through true-up mechanisms (Options 2-4) or a change in tax law (Option 5) could have perverse unintended consequences—including increased risk for ratepayers and shareholders, distorted price signals to consumers, decreased investment in utilities, decreased investment in environmental and socially valuable programs, depressed utility earnings, violation of the Internal Revenue Code (IRC) normalization requirements and, ultimately, increased electricity rates. *See Re Delmarva Power & Light Co.*, 1992 WL 465021, at *18 (“[B]reaching the wall between regulated and unregulated activities is fraught with a potential for mischief which once released may do more harm to ratepayers in the long-term than any short-term benefit that they may otherwise receive.” (citation omitted)).

- Increases risk for ratepayers *and* shareholders.

“Actual taxes paid” approaches (Options 2-4) mismatch cost incurrence and cost recovery. They attempt to estimate the utility’s “share”³ of the consolidated tax and to either give refunds to customers or lower rates in order to reflect consolidated tax savings. Under these methods, ratepayers would subsidize nonregulated investments whenever utility affiliates reported earnings.⁴ *See Re Midwest Gas*, 133 P.U.R.4th at 396-97 (“The decision whether to cross the line between utility service and affiliate companies should not be determined by

³ Determining the utility’s share of actual taxes paid will be complicated whenever the consolidated group has taxable income. When the consolidated group has taxable income, *all* tax is paid by the U.S. parent company—the utility itself never pays more than an annual minimum state tax (in Oregon, \$10).

⁴ This situation is not far-fetched. The Commission has already denied a utility’s request for a “true-up” to offset affiliate gains. *See Or. Exch. Carrier Ass’n*, 1993 WL 117620, at *5; *see also Re Southwestern Tel. Co.*, 1998 WL 265335, at *11 (concluding that ratepayers should not bear the burden of a higher tax rate resulting from the company’s decision to file a consolidated tax return); *Re Utils., Inc. of Md.*, 1997 WL 1015905, at *14-16 (using the standalone method, which resulted in a *lower* tax rate for the utility than if the effective rate for the consolidated entity had been used).



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whether it is beneficial to ratepayers.”); *Accounting for Public Utilities* § 17.04[2] (“The shifting of the tax savings to the regulated company . . . creates an unwarranted and unfair financial detriment to the investor.”).

Similarly, in the case of a nonregulated parent company’s or nonregulated affiliate’s bankruptcy, any approach that breached the boundary between regulated and nonregulated operations (Options 2-4) could expose ratepayers to claims by the nonregulated operation’s creditors.

State deconsolidation (Option 5) would also increase risk to ratepayers from nonregulated investments. Consolidation allows investors to keep the regulated utility business separate from the nonregulated business ventures without adverse tax consequences. A deconsolidated approach would encourage investors to make nonregulated investments within the utility corporation. If such investments were to fail, assets of the regulated utility would be subject to creditors’ claims. The effects on investment would probably not be limited to utilities. State deconsolidation would send a signal to other large businesses in Oregon that their industry group may be next.

Additionally, payments for tax settlements—*e.g.*, adjustments of prior taxes in response to an audit—are not currently reflected in rates in Oregon. Under an “actual taxes paid” approach, the risk of any incremental adjustment to taxes as a result of an audit would shift to ratepayers.

- Distorts price signals.

Ratepayers would get a refund (Options 2-3) or rate reduction (Option 4) when nonregulated affiliates suffer tax losses and would pay increased rates when those entities have tax gains. *See Re Potomac Elec. Power Co.*, 150 P.U.R.4th 528, 1994 WL 109204 (“[R]elating District of Columbia utility customers’ cost of service to factors alien to utility operations distorts the true costs of electric service.”); *Accounting for Public Utilities* § 17.04[2] (allocation of consolidated tax savings to ratepayers would “create a windfall benefit to the utility customer by transferring to the customer the benefit of the tax relief intended for the owners of the losing subsidiary”).



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- Jeopardizes certain tax benefits.

Any approach to utility taxation or rate regulation that flows through to ratepayers the tax benefit of deductions or losses from utilities' nonregulated affiliates would harm ratepayers by jeopardizing federal income tax benefits that are available only to companies that follow "normalization" accounting rules.⁵ Under the normalization rules, the investment tax credit and accelerated depreciation are available to companies that operate utilities only if there is no flow through (*i.e.*, via refund or rate adjustment) of federal tax benefits.⁶

⁵ In order to use a normalization method of accounting, the utility must treat assets consistently in ratemaking and tax accounting. I.R.C. §168(i)(9)(A)(i) (requiring utility in computing its tax expense for purposes of establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account to use a method of depreciation for property that is the same as, and a depreciation period that is no shorter than, the method and period used to compute the property's depreciation for ratemaking purposes). The IRC normalization conditions are not satisfied if the utility uses any procedure or adjustment for ratemaking purposes that uses an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes unless such estimate or projection is also used for ratemaking purposes. I.R.C. § 168(i)(9)(B). The consequence of violating the IRC normalization requirements is severe: the utility (or filing entity) would lose the right to claim accelerated depreciation on its federal tax returns. I.R.C. § 168(f) (depreciation deduction determined under section 168 shall not apply to any public utility property if the taxpayer does not use a normalization method of accounting). This consequence may be permanent with respect to any utility property existing at the time of the violation. *See id.* The loss of accelerated depreciation would probably cause decreased investment in utilities and their affiliates, decreased diversification of utilities, and, ultimately, increased rates and prices in all jurisdictions in which the affected utilities and affiliates do business.

⁶ Throughout the 1980s, the IRS consistently ruled that use of flow-through mechanisms for companies that file consolidated federal returns violates the normalization requirements. *See, e.g.*, Rev. Rul. 81-16, 1981-1 C.B. 17; Priv. Ltr. Rul. 90-45-014 (Aug. 9, 1990); Priv. Ltr. Rul. 88-01-041 (Oct. 10, 1987); Priv. Ltr. Rul. 87-11-050 (Dec. 15, 1986); Priv. Ltr. Rul. 86-43-052 (July 29, 1986). In 1990, the Treasury issued a notice of proposed rulemaking that would have effectively compelled states to follow the standalone approach in order for utilities to be eligible to receive certain tax benefits such as accelerated depreciation deductions. 55 F.R. ¶ 49294, 1990-2 C.B. 869 (Nov. 27, 1990). The Treasury eventually withdrew the proposed regulations.



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that presently reduce the federal tax burden on both regulated and nonregulated businesses.

Although the draft White Paper claims that the partial true-up method (Option 3) would avoid violating IRC normalization requirements, this may not be true. *Any* method that flows through tax savings from consolidated federal filing to utility ratepayers may violate IRC normalization requirements. This is because the use of taxes expenses determined on a consolidated basis for rate-setting purposes is inconsistent with normalization tax accounting principles and frustrates tax policy by shifting to ratepayers the benefits of congressionally endorsed tax incentives to encourage investment, even though ratepayers do not bear the risks of investment.

I.R.S. Notice 91-16, 1991-1 C.B. 319 (June 3, 1991); *see also* Priv. Ltr. Rul. 92-01-032 (Feb. 14, 1992) (holding that adjustment of regulatory tax expense to reflect investment of a parent in a utility with which it files a consolidated return does not violate normalization requirements). Some courts and state commissions have concluded that withdrawal of the proposed regulations indicated that standalone tax treatment was no longer required for a utility to take advantage of the tax code's normalization provisions. *See, e.g., Re GTE South, Inc.*, No. 90-522-T-42T, 1992 WL 510679, at *5-6 (W. Va. Pub. Serv. Comm'n Mar 30, 1992). Many other jurisdictions, however, decline to interpret the withdrawal as approval of flow-through accounting for utilities. *See, e.g., Re Sierra Pacific Power Co.*, 129 P.U.R.4th 470 (Nev. Pub. Serv. Comm'n 1992) (recognizing inconsistent pronouncements on normalization rules and stating that "the Commission would not consider acceptance of this [flow-through] adjustment without first placing a requirement on the Applicant to seek a private letter ruling from the IRS . . . [to] assure the Commission that the Applicant could avoid the grave consequences associated with non-compliance with the IRS"); *Re Delmarva Power & Light Co.*, 1992 WL 465021, at *19 (noting that IRC normalization rule is "in 'a state of flux'" and opting to continue requiring standalone method (citation omitted)); *Re Potomac Elec. Power Co.*, 150 P.U.R.4th 528, 1994 WL 109204 (noting witness testimony regarding withdrawal of regulations and opting to continue requiring standalone method). Continued recognition of the rule against flow-through accounting is consistent with the IRS' most recent pronouncement on the issue. *See* Priv. Ltr. Rul. 2004-18-001 (Apr. 30, 2004). There, the IRS ruled that a utility's maintenance of an accumulated deferred federal income tax reserve associated with property that was excluded from the utility's regulated books of account would violate the consistency requirement of section 168(i)(9)(B) and the normalization rules, because the utility's rate base, tax expense, and depreciation expense for ratemaking purposes would be determined without the cost of the excluded property.



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An appreciable risk exists that flow-through mechanisms would violate IRC normalization requirements, resulting in substantial increases in federal tax liability for utilities doing business in Oregon and their affiliates, parents and subsidiaries. Thus, for a utility like PacifiCorp with customers in six states, ratepayers and consumers in each of these states could suffer increased rates and higher prices if Oregon legislation or regulation causes the company to violate normalization requirements.

Because the alternative approaches may violate the normalization requirements, utilities would need to request a private letter ruling from the Internal Revenue Service (IRS) before implementing an alternative approach. The process of obtaining a private letter ruling may take a year or more.

- Decreases investment.

By reducing the value of tax incentives, Options 2-5 would stifle investment in environmental and socially valuable programs. Tax credits, such as the Oregon business energy tax credit, pollution control credit, and credit for installing fish-screening devices, motivate companies to invest in “green” energy projects, install pollution-control devices, and undertake other socially beneficial projects. The value of such credits is often captured through consolidated tax filing. Allocating the tax benefits of participation in these ventures to entities that do not take the risk of investment would decrease or eliminate the economic value of these tax incentives. This would also put nonregulated affiliates that invest in these ventures at a competitive disadvantage to other businesses in the industry that are not subject to the reallocation of benefits. If Oregon’s tax policies are structured in such a way as to impede affiliates’ ability to compete, utilities will lose the incentive to diversify into core-related energy businesses.

- Increases electric rates.

Options 2-5 would diminish equity investment in utility companies themselves because investors would rather invest in a group that could take full advantage of the investment benefits the tax code has to offer. Utilities that lose equity investors must take on more debt, which drives up the cost of borrowing. *See Utility Tax Benefits in Jeopardy*, Creditweek, Sept. 17, 1990 at 28 (“[R]ate cuts due to tax consolidation can only be viewed as a negative to utility credit quality, no matter how modest As a precaution, bond holders should be aware of



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utilities or utility parents that incur meaningful tax losses from nonutility ventures.”).

E. The White Paper Should Outline the Legal Impediments to the Alternative Options.

Subsidization of ratepayers *or* shareholders through ill-advised approaches to utility income tax is not only inequitable and economically irrational, it is also unlawful. Allocating tax liabilities resulting from nonregulated operations to ratepayers “is contrary to the Commission’s statutory obligation to prevent subsidization by the ratepayers of unregulated activities.” *Re Or. Exch. Carrier Ass’n*, 1993 WL 117620, at *6.

Deconsolidation approaches would also improperly expand the purview of the Commission’s regulatory oversight to non-jurisdictional entities. Adopting a method that attempts to deconsolidate the benefits and/or losses of consolidated tax filings would put the Commission in the business of investigating affiliate and parent tax issues and the reasonableness of their business decisions, an area outside of its regulatory jurisdiction.

The alternatives discussed in the draft White Paper also implicate numerous state and federal constitutional concerns. For example, any approach that bases rates on nonregulated operations would likely violate constitutional prohibitions against confiscatory ratemaking. *In re Util. Reform Project*, Order No. 03-214, App. A at 2-3 (allocation of tax benefits to utility “may lead to confiscatory rates”); U.S. Const. amends. V, XIV. Likewise, allocating tax benefits from nonregulated investments to ratepayers would likely constitute an unconstitutional taking. *See Re Potomac Elec. Power Co.*, 150 P.U.R.4th 528, 1994 WL 109204; *Iowa Elec. Light & Power Co.*, 135 P.U.R.4th at 527 (“The affiliates’ financial losses which create the tax savings exist only because of the investment and expenses borne by the stockholders. It is clear the losses which created the tax savings belong to the affiliates . . .”). Any income tax method that treats electric utilities differently than other businesses also raises constitutional concerns. Or. Const. art. I, § 32 (requiring uniform taxation among same class of subjects); Or. Const. art. IX, § 9 (prohibiting unreasonable classifications); Or. Const. art. I, § 20 (prohibiting unreasonable classifications among taxpayers); *Mathias v. Dep’t of Revenue*, 312 Or. 50, 817 P.2d 272 (Or. 1991) (holding that statute violated uniformity requirements of state constitution); U.S. Const. amends. V, XIV. Any state law that makes it impossible for intended beneficiaries of the tax code to take advantage of its provisions raises concerns under the Supremacy, Equal Protection and Due Process Clauses of the U.S. Constitution. Finally, a state pricing scheme that negatively impacts interstate commerce raises concerns under the Commerce Clause. These constitutional



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concerns should be researched before the Commission adopts or recommends any alternative approaches.

F. The White Paper Should Recommend Continuation of the Standalone Approach.

The White Paper should recommend continuation of the current standalone method because:

- Ratemaking on a standalone basis is consistent with long-standing Commission policy that protects utility customers, competitors and the public generally.
- The current approach has not resulted in over-earning by Oregon's electric utilities.
- The weight of authority supports the current approach.
- The Commission's current approach implements Oregon law prohibiting cross-subsidization.
- The current approach implements Congress's goal of promoting investment.
- Alternative methods would entail significant economic risk for Oregon businesses and consumers.

Thank you for this opportunity to comment on the draft White Paper. If you have questions about these comments, please contact Katherine McDowell at (503) 294-9602 or Robert Manicke at (503) 294-9664.

Very truly yours,

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