

Qwest
421 SW Oak Street
Room 810
Portland, OR 97204
Telephone: 503-242-5623
Facsimile: 503-242-8589
Email: Alex.Duarte@qwest.com



Alex M. Duarte
Corporate Counsel

VIA EMAIL AND U. S. MAIL

February 16, 2005

Mr. Lee Sparling
Director, Utility Program
Public Utility Commission of Oregon
P. O. Box 2148
Salem, OR 97308-2148

Re: Qwest's Comments to Staff's White Paper on Income Taxes and Utility Ratemaking

Dear Mr. Sparling:

With respect to the February 2005 White Paper that Commission Staff prepared for the Oregon Legislative Assembly on the treatment of income taxes in ratemaking, Qwest supports Option 1, which is to calculate income taxes based on the utility's stand-alone results.

At the outset, Qwest notes that it is no longer under rate-of-return regulation. This is so because in December 1999, Qwest opted into price cap regulation under Senate Bill 622 (now codified as ORS 759.400, et seq.). Specifically, ORS 759.410(2) provides that companies subject to price regulation "shall not be subject to any other retail regulation, including but not limited to any form of earnings-based, rate-based or rate of return regulation." Given this situation, Qwest does not believe that any change in the calculation of income taxes would be applicable to Qwest. Nevertheless, for the reasons set forth below, Qwest believes that Staff's Option 1 is the most appropriate manner in which to treat income taxes on utility ratemaking.

Option 1 is the current method of calculating income tax expense for purposes of setting a utility's rates. Under Option 1, the tax effects of the utility's non-regulated operations, as well as the utility's parent and subsidiaries, are ignored for purposes of setting rates, so that rates reflect only the costs of providing utility service. Consequently, under Option 1, rates are set to reflect the costs of providing utility service.

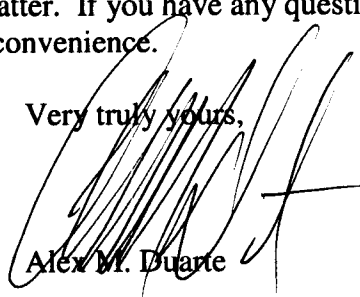
Qwest agrees with Staff's conclusion that this approach is consistent with standard utility ratemaking principles, under which regulated costs should not be affected by the results from non-regulated operations. Qwest agrees with the fundamental principle that under the cost of service approach to utility ratemaking; 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 to which they give. Thus, if utility ratepayers are held responsible for costs, they are entitled to the tax benefits associated with the costs. If, however, ratepayers do not bear the costs, they are not entitled to the tax benefits associated with the costs.

Qwest also agrees that non-utility operations involve financial risks that are different from a utility's regulated operations. When these risks are not borne by the utility's ratepayers, it is inequitable to make use of the business losses generated in those nonregulated entities to reduce the utility's cost in determining the rates to be charged for utility services. By the same token, when a parent company's nonjurisdictional activities are profitable, the utility's 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, the "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 utility ratemaking purposes.

As discussed in Attachment B of Staff's White Paper, unless the underlying revenues and costs of the parent and subsidiaries were also reflected in rates, setting rates based on consolidated tax payments is poor regulatory policy. Qwest believes regulators should reflect tax benefits in rates to the same extent that customers bear the expenses creating those benefits. There is no economic rationale for a regulatory body to pick and choose which non-utility revenues and expenses—including tax savings—to include for purposes of setting utility rates in Oregon.

Thank you for your attention to this matter. If you have any questions about these comments, please feel free to call me at your convenience.

Very truly yours,

A handwritten signature in black ink, appearing to read "Alex M. Duarte", is written over the typed name. The signature is stylized and somewhat cursive.

Alex M. Duarte