F. ROBERT REEDER (2710)
VICKI M. BALDWIN (8532)
PARSONS BEHLE & LATIMER
Attorneys for UIEC, an Intervention Group
One Utah Center
201 South Main Street, Suite 1800
Post Office Box 45898
Salt Lake City, UT 84145-0898
Telephone: (801) 532-1234
Facsimile: (801) 536-6111

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of Excess PacifiCorp Income Tax Cost Monies Collected in Rates	DOCKET NO. 05-035-98 **PETITION OF THE UTAH INDUSTRIAL ENERGY CONSUMERS TO FILE A BRIEF IN OPPOSITION TO PACIFICORP'S MOTION TO DISMISS**

Fairchild Semiconductor, Holcim, Inc., Kennecott Utah Copper Corp., Kimberly-Clark Corp., Malt-O-Meal, Praxair, Inc., and Western Zirconium (this group of electrical power customers will be referred to hereinafter for convenience only as the "Utah Industrial Energy Consumers" or "UIEC"), hereby petition the Public Service Commission ("Commission") for leave to file the accompanying Brief in Opposition to PacifiCorp's Motion to Dismiss. The Motion to Dismiss of PacifiCorp dba Utah Power & Light Company ("PacifiCorp") has not met the legal standard of demonstrating that there are no set of facts under which the requested relief should be granted, and therefore, PacifiCorp's motion should be denied.

BRIEF

I. THE ISSUE BEFORE THE COMMISSION IS HOW TO DEAL WITH THE REFUND ORDERED BY THE SECURITIES EXCHANGE COMMISSION.

A. PacifiCorp's Motion to Dismiss Mischaracterizes the True Issue of the Committee's Request for Agency Action.

PacifiCorp's Motion to Dismiss bases its claim that the Commission lacks authority to issue a refund, in part, on the argument that the amount of money paid in taxes and included in rates was correctly determined. This is not the issue put before the Commission by the Request for Agency Action filed by the Committee of Consumer Services ("Committee"). The issue is how to deal with the refund that was ordered by the Securities Exchange Commission ("SEC") when it discovered that PacifiCorp and its affiliates were acting inconsistently with their filed tax sharing agreement and SEC rules. PacifiCorp did not include the issue of how to deal with the refund in its filing of the 2004 general rate case. Therefore, the rate case, and thus the Commission, never addressed the issue raised by the Committee's Request for Agency Action.

B. Contrary to PacifiCorp's Assertion, No Precedent Has Been Set for Claiming or Filing Taxes.

In arguing that the amount of money paid in taxes and included in rates was correctly determined, PacifiCorp relies heavily on the fact that it has utilized the stand-alone federal income tax calculation in setting rates in each general rate case since the merger of ScottishPower plc ("ScottishPower") and PacifiCorp, and that this is consistent with long-standing Commission policy. This argument is irrelevant because that is not the issue of the Request for Agency Action. It also fails to acknowledge two important facts: (1) the merger of ScottishPower with PacifiCorp was the first time a foreign company was the holding company of

a Utah utility; and (2) the issue of the treatment of upstream tax savings and costs were not addressed in the merger, but instead reserved to be determined in a future rate case.[1] The issue of upstream tax savings has never been decided. The issue has only been raised in the two latest general rate cases, but it was not resolved because they were settled by a "black box"[2] settlement, and all issues, including tax treatment, were reserved to be raised in a future proceeding.[3]

Therefore, the Commission has never had the opportunity to address how it should deal with Utah and federal income taxes, especially in light of the fact that PacifiCorp is held by a foreign company. Nevertheless, the specific issue of the treatment of the refund and its effect on PacifiCorp's capital structure is a separate, one-time issue, and is not dependent on the utilization of the stand-alone federal income tax calculation in setting rates.

---

[1] *In re Application of PacifiCorp & ScottishPower plc for an Order Approving the Issuance of PacifiCorp Common Stock*, Docket No. 98-2035-04, Report & Order [hereinafter Merger Order], III.A.B. Potential Tax Savings (Nov. 23, 1999) (adopting the applicants' proposed language: "The parties to this Docket preserve their right to raise the issue of the treatment of upstream tax savings and costs in future rate cases. All parties preserve their positions and have not waived their rights on this issue."). In fact, the treatment of taxes in the merger proceedings was very abnormal in that the hearings were closed for a period of time, counsel for PacifiCorp was excused, and no copies of any of the subject documents were produced for the record.

[2] This term refers to the fact that each settlement was for a total amount with a specified return on equity, but that no amount of the agreed upon rate was distinguished as being justified by any particular cost or expense. In addition, a broad reservation was included in each stipulation to allow any of the parties to raise any issue in a future proceeding because the amount of tax expenses was an issue not specifically resolved.

[3] When asked by the Commission about the settlement and any adjustments recognized, Mr. Gimble of the Committee responded: "I think the one issue where maybe the parties have a different opinion is the consolidated tax issue." *In re Matter of the Application of PacifiCorp for Approval of its Proposed Elect. Serv. Schedules & Elec. Serv.*, Docket No. 04-035-42, Tr. at 26 (Feb. 23, 2005).

II. PACIFICORP CANNOT BE ALLOWED TO RETAIN THE BENEFITS OF THE REFUND WITHOUT PROPERLY ACCOUNTING FOR IT.

A. PacifiCorp's Parent Company, PHI, and Its Affiliates Acted Contrary to the Terms of the Tax Sharing Agreement and in Violation of the SEC Rules.

Provisions in a tax allocation agreement between a registered holding company and its subsidiaries must comply with Section 12 of the Public Utilities Holding Company Act (the "Act") and SEC rule 45. *National Grid*, SEC Release No. 27154 (March 15, 2000). The purpose of these rules is to "prevent the milking of operating companies in the interest of the controlling holding company groups and to safeguard the working capital of the public-utility companies." *Id.* (internal quotations omitted).

Rule 45(a) of the Act generally prohibits any registered holding company or subsidiary company from, directly or indirectly, lending or in any manner extending its credit to or indemnifying, or making any donation or capital contribution to, any company in the same holding company system, except pursuant to SEC order. *Id.* A declaration under rule 45(a) is not required for filing a consolidated tax return in a registered holding company system, or for the execution or performance of a tax sharing agreement, if the consolidated tax return is filed pursuant to a tax agreement that specifically provides for allocation among associate companies of the liabilities and benefits arising from such consolidated tax return in a manner not inconsistent with the rules prescribed in rule 45(c). *Id.* Under rule 45(c), the filing of a consolidated tax return by a registered holding company and its subsidiaries under a tax allocation agreement entitles the consolidated tax to be apportioned among the members of the registered system in proportion to either every member's taxable income or separate tax return.

Id. The rule permits holding company subsidiaries to make payments to other subsidiaries in exchange for the allocation of tax losses, but not to the holding company. *Id.*

Rule 45(c)(4) provides that an allocation agreement may exclude companies not having positive corporate taxable income for the year (i.e. loss subsidiaries) from the allocation provided for under rule 45(c)(2), provided that the agreement contains an "appropriate and equitable provision for preserving to each subsidiary company so excluded the equivalent of any rights which such company would have had under the applicable tax law, had it filed a separate return to use in other years any loss or credit availed of by the group through the consolidated return."

Rule 45(c)(5) provides that a tax allocation agreement may include all members of the group in the tax allocation, recognizing negative corporate taxable income or a negative corporate tax, according to the allocation method chosen, but only subsidiary companies are paid for their negative tax allocation. Any company that does not meet the definition of subsidiary company under the rules cannot receive current payment of its corporate tax benefits without SEC approval. These SEC rules and the requirement to file any tax allocation agreement provide insurance that a foreign parent holding company will not "milk" the United States organized companies by charging excess expenses. *National Grid*, SEC Release No. 27154.

On October 6, 2000, the SEC issued notice that ScottishPower had filed an application/declaration with respect to its acquisition of PacifiCorp. *ScottishPower*, SEC Release No. 27244 (Oct. 6, 2000). The filing included, among other things, a request for approval of an amended agreement for the allocation of consolidated tax among ScottishPower and its subsidiaries and PacifiCorp and its subsidiaries. *Id.* The application specifically

requested that the applicants be ***exempt*** from the provisions of SEC ***rule 45(c)(5)***, which would have otherwise required that certain tax losses of the subsidiary companies be retained by the subsidiary companies. *Id.* Instead, ScottishPower and PacifiCorp requested that ScottishPower receive payment for certain of the tax losses of the subsidiary companies. *Id.* This "tax allocation agreement was drafted to comply with Rule 45(c)(4)." ScottishPower Form U-1, Post-Effective Amendment No. 4 to Application-Declaration Under PUHCA, File No. 70-9669, at 30 [hereinafter Amended Tax Agreement Filing]. The SEC issued its approval of the exemption from the provisions of SEC rule 45(c)(5) on December 6, 2000. SEC Release No. 27290 (Dec. 6, 2000).

Thereafter, the SEC conducted an audit of PacifiCorp. In so doing, the SEC determined that contrary to PacifiCorp's filed and approved tax sharing agreement and contrary to the SEC rules, PacifiCorp's United States parent, PacifiCorp Holdings, Inc. ("PHI"), was retaining without compensation certain tax attributes resulting from payments it had made, rather than allocating these tax benefits (i.e. losses) to the subsidiaries in the United States tax filing group. In essence, PHI charged PacifiCorp for phantom taxes that were not due under the applicable SEC rules and approved tax sharing agreement. Then, it appears that PHI used this money for its own corporate purposes. The ratepayers of Utah were paying for taxes through PacifiCorp, but that money never went to pay taxes, it went to PHI.

PHI and, as a result, PacifiCorp were not treating their taxes in conformance with rule 45(c)(4), which is how the tax agreement had been drafted and approved by the SEC.[4] As a result, the SEC ordered PHI to refund to PacifiCorp the monies PHI had charged PacifiCorp in violation of the tax sharing agreement and the SEC rules.[5] Therefore, this was not merely a minor administrative tax accounting error as PacifiCorp tries to claim, but an admonishment and order by the SEC for PHI to refund monies to PacifiCorp that PHI charged and kept in violation of the SEC holding company rules and regulations, and in violation of the tax sharing contract that had been filed and approved by the SEC.

As a result of PHI's failure to properly allocate the tax benefits to PacifiCorp,[6] up to the time that PHI was ordered by the SEC to issue a refund to PacifiCorp, PacifiCorp was likely overstating its tax expense because it was acting contrary to its filed tax sharing agreement and the SEC rules. This would lead to an understatement of its rate of return. Since the refund was ordered and exemption was granted, PacifiCorp has likely correctly stated its tax expense, but is likely overstating the equity portion of its capital structure. Therefore, there is a high likelihood

---

[4] The Commission need not decide in this proceeding the consolidated tax issue. It is separate from the treatment of the SEC-ordered refund. The Request for Agency Action is not based on what PacifiCorp ought to do in calculating and filing taxes, but in what it committed to do but failed to do in violation of its tax sharing agreement and SEC rules.

[5] In May 2004, ScottishPower and its United States affiliates, including PacifiCorp, filed with the SEC an amended tax sharing agreement. SEC Release 27808 (March 5, 2004). This tax sharing agreement was ***now intended to comply with rule 45(c)(5)*** instead of rule 45(c)(4). ScottishPower also applied to the SEC for permission for PHI to retain certain tax benefits rather than allocate these tax benefits (i.e. losses) to the profitable subsidiaries in the consolidated group without compensation. Amended Tax Agreement Filing at 31. Therefore, rather than correct their behavior to conform to the rules, ScottishPower and its affiliates, including PacifiCorp, basically changed the rules to conform to their behavior. Furthermore, this was not brought forward and presented by PacifiCorp as part of its rate case.

that PacifiCorp is over earning. This means there is a portion of its equity upon which it is not entitled to earn a return.

The Committee's Request for Agency Action is a request that the Commission determine how to treat this unaccounted-for refund. One remedy may be a refund directly to ratepayers. Another remedy may be in how PacifiCorp's capital structure is treated in future rate cases. In any case, it is clear that PacifiCorp has acquired free capital and cannot retain those benefits without fair treatment for the ratepayers.

B. PacifiCorp Should Not Retain the Benefits of the Refund Because It Violates the Principal that Affiliates Cannot Be Subsidized through Affiliated Interest Transactions or Cost Allocations.

In addressing affiliate issues in its Order approving the merger, the Commission expressed its concern regarding the corporate structure of the newly merged company and stated its intention to protect its ability to regulate:

> Stipulation conditions intended to ensure the independent operation of the utility and to protect our ability to regulate it in the public interest are important because the merger brings a number of changes. There will be a new holding company corporate structure, corporate headquarters will be in another country with regulatory practices unlike those here, there will be accounting system differences, and there may be new affiliates with which the utility may develop relationships. Thus, we must be satisfied that Stipulation conditions address key points in language conveying a clear and unambiguous intent to maintain unimpaired out ability to regulate the utility.

---

[6] If PHI had properly allocated the tax benefits to PacifiCorp, PacifiCorp's tax liability would have been less, and ratepayers would have paid less.

Merger Order, II.F.2 Affiliation Issues and the Ability to Properly Regulate the Utility. The Commission also noted that the stipulation was conditioned to "prevent subsidization of nonutility operations through affiliated interest transactions or cost allocations." *Id.*

ScottishPower and PacifiCorp violated the conditions of the Merger Order. PHI charged PacifiCorp for taxes (which PacifiCorp collected from ratepayers) that were not due under the provisions of the applicable SEC rules and the approved tax sharing agreement. Then PHI kept that money for its own corporate purposes. This behavior is in violation of the Merger Order. Thus, the Commission should not dismiss the Committee's Request, but should review this benefit received in violation of the tax sharing agreement and SEC rules and should address treatment of the refund.

C. PacifiCorp Is Obligated to Establish that Its Transaction with PHI is Prudent Before a Determination of Just and Reasonable Can Be Determined.

PacifiCorp argues that the Committee is estopped from raising the issue of the treatment of the refund because the last rate case determined the rates were just and reasonable. That argument must fail because PacifiCorp never brought forward the information so the Commission did not approve the transaction involving the refund and the prudence of its treatment by PHI and PacifiCorp. "A utility is generally obligated to establish that its transaction with an affiliate is prudent before receiving commission approval for the transaction, and . . . this prudence determination is a prerequisite to the determination of whether a consequent rate increase is just and reasonable." *Committee of Consumer Servs. v. Public Serv. Comm'n of Utah*, 75 P.3d 481, 485 (Utah 2003)). In examining a utility's affiliate relationships, the Utah Supreme

Court recently ruled:

> "In the regulation of public utilities by governmental authority, a fundamental principle is: the *burden* rests heavily upon a utility to prove it is entitled to rate relief and *not upon the Commission, the Commission staff, or any interested party or protestant, to prove the contrary*." The Commission "is entitled to know and before it can act advisedly *must be informed of all relevant facts*," otherwise, "it could not effectively determine whether a proposed rate was justified."

Id. at 486 (quoting *Utah Dep't of Bus. Regulation v. Public Serv. Comm'n*, 614 Pl2d 1242, 1245–46 (Utah 1980)) (emphasis added).

PacifiCorp cannot cry estoppel because it happened to include evidence of the audit and refund in discovery responses or that it happened to send state regulators notification of the SEC audit. The burden is on PacifiCorp and PacifiCorp did not meet this burden of coming forward and informing all interested parties, including non-regulatory parties, of all the relevant facts. PacifiCorp had an obligation to disclose all relevant information regarding the audit and subsequent refund in its filing. It should not have been up to the intervening parties to attempt to ferret-out relevant facts that may or may not affect the rate making proceedings.

The Commission never examined whether the treatment of the refund was prudent and thus, the Commission never determined whether the treatment of the refund was just and reasonable. Therefore, the Committee is not estopped from raising the issue, and the Commission is not precluded from considering it now.

D. <u>The Committee and Other Parties Did Not Waive Their Right to Raise the Issue of the Tax Refund in a Subsequent Proceeding.</u>

The refund was ordered by the SEC in May 2004, and evidence of the refund was discovered during the discovery process of PacifiCorp's rate case, which was filed in August 2004. That rate case was settled by a "black box" settlement by stipulation, and there was no examination by the Commission of the refund ordered by the SEC or the fact that PHI had been overcharging PacifiCorp for several years in violation of its tax sharing agreement and SEC rules. The parties to that stipulation, including PacifiCorp, agreed:

> The Parties' agreement to use, for the purposes of this Stipulation, this cost of equity and capital structure does not in any way affect or limit the rights of any party to argue in a future proceeding for a different cost of equity or capital structure.
>
> . . .
>
> No Party is bound by any position asserted in the negotiation of this Stipulation, except to the extent expressly stated herein, nor shall this Stipulation be construed as a waiver of the rights of any Party unless such rights are expressly waived herein. Execution of this Stipulation shall not be deemed to constitute an acknowledgement by any Party of the validity or invalidity of any particular method, theory or principle of regulation or cost recovery, and no Party shall be deemed to have agreed that any method, theory or principle of regulation or cost recovery employed in arriving at this Stipulation is appropriate for resolving any issues in any other proceeding in the future and shall not be deemed to constitute precedent nor prejudice the rights of any party in future proceedings. No findings of fact or conclusions of law other than those stated herein shall be deemed to be implicit in this Stipulation.

In re Application of PacifiCorp for Approval of Its Proposed Electric Rate Schedules & Electric Serv. Regulations, Docket No. 04-035-42 ¶¶ 10, 23.

PacifiCorp did not raise nor did it address in the rate case filing the fact that PHI had been overcharging PacifiCorp in violation of the tax sharing agreement and SEC rules and how the SEC-ordered refund was treated. Instead, the intervening parties stumbled on evidence of the audit and refund in the course of discovery. It was only after the rate case was settled that PacifiCorp met with interested parties to explain how the refund came about and how ScottishPower, PHI, and PacifiCorp had treated the refund. Subsequently, after further investigation, the Committee filed the present Request for Agency Action.

Accordingly, PacifiCorp cannot argue that the issue of how to treat the refund is precluded. The issue of how to deal with the refund ordered by the SEC has never been put before the Commission, the Commission has never been informed of all the relevant facts regarding the refund nor has it been given the opportunity to examine the issue. The parties reserved their right to raise any issues not specifically addressed in the last rate case, and the Commission is not be precluded now from deciding the issue of how to deal with the refund.

III. EVEN IF THE ISSUE REGARDING THE REFUND WAS NOT ADEQUATELY RESERVED IN THE MERGER ORDER OR THE RATE CASE STIPULATION, IT IS EXEMPT FROM THE RULE AGAINST RETROACTIVE RATE MAKING.

The rule against retroactive rate making is only applicable if an issue could have been considered in a rate making proceeding. In this case, PacifiCorp failed to file the relevant information and therefore, the issue could not have been considered in the general rate case and the rule against retroactive rate making is not applicable.

In general, "a utility's recoupment of costs that were greater than projected or revenues that were less than projected from future rates constitutes retroactive rate making." *MCI*

Telecomms. v. Public Serv. Comm'n, 840 P.2d 765, 770 (Utah 1992). However, there are two exceptions to this rule: (1) Extraordinary and Unforeseeable Expenses or Revenues; and (2) Utility Misconduct. *Id.* at 771–75. This situation could possibly fall within both exceptions.

A. Extraordinary and Unforeseeable

The treatment of the SEC-ordered refund is extraordinary and unforeseeable. PacifiCorp's holding company, PHI, and PacifiCorp were acting contrary to their filed tax sharing agreement and the SEC's rules. Such a violation is certainly extraordinary and unforeseeable to all except PacifiCorp and PHI. The state regulators and especially the intervening parties had no way of knowing that PacifiCorp and PHI were acting contrary to the SEC rules and their tax sharing agreement or that the SEC would order a refund. Unless the utility discloses otherwise, everyone is entitled to assume that the utility and its holding company will act in accordance with the law and their executed agreements. Parties cannot be expected to foresee that others will violate SEC rules and breach their contracts.

ScottishPower and PacifiCorp did not disclose the audit and its results as a part of the filing of the 2004 rate case. As previously explained, this information was accidentally uncovered during the course of discovery, and the treatment of the refund was not disclosed until after the rate case was settled. Therefore, the refund and how it was treated by PHI and PacifiCorp was also unforeseen.

In addition, the infusion of approximately $229,000,000 must certainly have had an extraordinary effect on the utility's earnings. Therefore, this issue is unforeseen and extraordinary and thus, an exception to the rule against retroactive ratemaking.

B. <u>Utility Misconduct</u>

If a "utility misleads or *fails to disclose information pertinent* to whether a rate-making proceeding should be initiated or *to the proper resolution of such a proceeding* [it] cannot invoke the rule against retroactive rate making to avoid refunding rates improperly collected." *Id.* at 775 (emphasis added).

ScottishPower and PacifiCorp did not disclose as a part of the filing in the 2004 rate case that the SEC conducted an audit, found violations of the SEC rules and tax sharing agreement, and ordered a refund to PacifiCorp of approximately $229,000,000. They did not disclose until after the rate case was settled how the refund was treated.

Even though the audit itself may have been reported at some point to state regulators, the intervenors had no way of receiving this information, and the utility had the burden of bringing that information forward in its filing. "[T]he burden rests heavily upon a utility to prove it is entitled to rate relief and not upon the Commission, the Commission staff, or any interested party or protestant, to prove the contrary." *Committee of Consumer Servs. v. Public Serv. Comm'n of Utah*, 75 P.3d at 486 (internal quotations omitted). PacifiCorp did not file in its rate case the possible effect of the audit and subsequent refund. This is a failure to disclose information pertinent to the proper resolution of the rate case.

PacifiCorp has received free capital and failed to disclose in any meaningful way so as to meet its burden, regarding the effect of the SEC-ordered refund. Thus, PacifiCorp cannot invoke the rule against retroactive rate making to avoid the prospective treatment of this issue.

IV. CONCLUSION

For a motion to dismiss to be granted, PacifiCorp must establish that there is no set of facts under which the requested relief should be granted. Based on the foregoing, PacifiCorp has clearly failed to meet this standard. Therefore, UIEC asks that the Commission deny PacifiCorp's Motion to Dismiss and establish a schedule for proceeding to address this matter.

DATED this _____ day of November, 2005.

____

F. ROBERT REEDER
VICKI M. BALDWIN
Attorneys for UIEC, an Intervention Group

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of November, 2005, I caused to be e-mailed and/or mailed, first class, postage prepaid, a true and correct copy of the foregoing **PETITION OF THE UTAH INDUSTRIAL ENERGY CONSUMERS TO FILE A BRIEF IN OPPOSITION TO PACIFICORP'S MOTION TO DISMISS**, to:

Edward Hunter /Jennifer Horan
STOEL RIVES LLP
Attorneys for PacifiCorp
201 South Main Street Suite 1100
Salt Lake City, Utah 84111
jhmartin@stoel.com
eahunter@stoel.com

Michael Ginsberg
ASSISTANT ATTORNEY GENERAL
500 Heber M. Wells Building
160 East 300 South
Salt Lake City, UT 84111
mginsberg@utah.gov

Reed Warnick
ASSISTANT ATTORNEY GENERAL
500 Heber M. Wells Building
160 East 300 South
Salt Lake City, UT 84111
rwarnick@utah.gov

Gary Dodge
Hatch James & Dodge
10 West Broadway, Suite 400
Salt Lake City, Utah 84101
gdodge@hjdlaw.com

Leslie Reberg
Committee of Consumer Services
500 Heber M. Wells Building
160 East 300 South
Salt Lake City, UT 84111
LREBERG@utah.gov

Constance White
Division of Public Utilities
500 Heber M. Wells Building
160 East 300 South
Salt Lake City, UT 84111
CBWHITE@utah.gov

Dan Gimble
Committee of Consumer Services
500 Heber M. Wells Building
160 East 300 South
Salt Lake City, UT 84111
DGIMBLE@utah.gov

William Powell
Division of Public Utilities
500 Heber M. Wells Building
160 East 300 South
Salt Lake City, UT 84111
WPowell@utah.gov

____
Gail E. Moschini
Assistant to Vicki M. Baldwin