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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 **PACIFICORP'S MOTION TO DISMISS AND ANSWER**

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I. INTRODUCTION

PacifiCorp dba Utah Power & Light Company ("PacifiCorp" or "Company"), pursuant to Utah Code Ann. § 63-46b-6(1) and Utah Admin. Code R746-100-3.H and R746-100-4.D, hereby submits its Motion to Dismiss and Answer ("Response") to the Request for Agency Action ("Request") filed by the Committee of Consumer Services ("Committee") on October 6, 2005.

This Response is organized into the following sections:

1. A summary of the legal arguments in support of PacifiCorp's Motion to Dismiss (Section II).

2. A background section recounting general factual information regarding the prior general rate case filings and Commission orders and the Securities and Exchange Commission ("SEC") Public Utility Holding Company Act of 1935 as amended ("PUHCA") compliance audit ("SEC PUHCA Audit") (Section III).

3. A motion to dismiss discussing the Committee's specific claims, including the legal and policy reasons why these claims are unlawful or inappropriate and should be dismissed (Section IV).

4. The Company's Answer to the specific factual allegations of the Request (Section V).

5. The Company's defenses to the claims asserted by the Committee (Section VI).

6. The relief requested by the Company (Section VII).

II. SUMMARY

The Committee's Request seeks a refund or other remedy associated with the SEC PUHCA Audit conducted by the SEC in 2003 and 2004. This Response demonstrates that the Request must be dismissed. Assuming the facts in this matter are as alleged (and without

crediting the conclusory allegations made by the Committee), they provide the Committee with no entitlement to the relief sought. Therefore, PacifiCorp moves that the Request be dismissed.

The facts that were or could be alleged in this proceeding conclusively demonstrate that: (1) PacifiCorp's rates during the SEC PUHCA Audit period were determined by the Commission to be just and reasonable; (2) the Company's tax expense included in rates has been calculated in compliance with the Commission's long-approved stand-alone methodology; (3) this Commission has never adopted any exception to the stand-alone ratemaking methodology to take into account actual taxes paid; (4) the Company has properly accounted for and recorded its regulatory tax expense in each of the five rate case proceedings conducted since the merger; (5) there is no allegation nor could there be that the Company misled regulators regarding the SEC PUHCA Audit; (6) there is no allegation nor could there be that the Company failed to disclose the SEC PUHCA Audit to regulators; (7) the Company provided notice of the SEC PUHCA Audit to the Utah Commission at its inception; (8) the SEC made no finding whatsoever that PacifiCorp had engaged in any illegal or unlawful conduct; (9) PacifiCorp provided notice to the Division and the Committee of the SEC PUHCA Audit findings just after conclusion of the SEC PUHCA Audit; (10) the Committee was aware of the SEC PUHCA Audit findings during the last general rate case, obtained discovery regarding the SEC PUHCA Audit, investigated the SEC PUHCA Audit during its on-site review, filed testimony regarding the SEC findings and nonetheless stipulated that rates established in that case were lawful, just and reasonable and in the public interest; (11) the SEC PUHCA Audit findings did not affect utility expense or earnings in any manner; and (12) ratepayers have already received the full benefit of the $229 million.

PacifiCorp has charged the lawful rate determined to be just and reasonable by this Commission during the entire SEC PUHCA Audit period. Therefore, the only basis for seeking refunds is if an exception to the rule against retroactive ratemaking applies. Nothing in the Request or the history of this matter demonstrates misconduct or any extraordinary impact on expenses or earnings such that an exception to the rule against retroactive ratemaking would be applicable and a refund justified. The Company fully complied with Commission orders during the rate period and fully disclosed the SEC PUHCA Audit and its findings to regulators. The SEC PUHCA Audit itself required absolutely no change to tax expense, stated earnings or financial statements. Accordingly, it could have had no effect on the financial statements on which Utah rates were based.

Nor is there any support for the Committee's assertion that PacifiCorp has "double-charged" ratepayers for the extraordinary costs associated with the Western energy crisis. In fact, the Company's shareholders, not ratepayers paid for the majority of the run-up in costs. Rather than double-charging ratepayers, ratepayers actually got the financial benefits associated with capital contributions from ScottishPower, which improved PacifiCorp's credit ratings and lowered its overall cost of capital.

Finally, the Committee has previously stipulated to the justness and reasonableness of the utility rates in question, including stipulating to current rates after full disclosure of the SEC PUHCA Audit and its findings. The Committee's suggestion that the SEC PUHCA Audit and its findings are new issues rings entirely hollow in light of its participation in meetings on the Audit and its review of the very same SEC PUHCA Audit documents in the last general rate case.

For all of these reasons, discussed in greater detail below, the Commission should dismiss the Committee's Request.[1] A motion to dismiss is entirely proper, where, as here, the Committee cannot allege any set of facts to support its requested relief.

III. GENERAL BACKGROUND

The Request misleadingly twists the results of a routine audit by the SEC pursuant to PUHCA[2] of ScottishPower plc ("ScottishPower"), PacifiCorp Holdings, Incorporated ("PHI") and PacifiCorp in an attempt to secure a refund or regulatory liability account that cannot be justified under Utah law. The Request, stocked with conclusory allegations of "unlawful" conduct, alleges that PacifiCorp: (i) collected money in rates to pay purported income tax costs that PacifiCorp "knew were in excess of any lawful income tax liability" and (ii) collected money in rates to "subsidize or pay costs of the 1999 merger in contravention of the Commission's order that approved the merger of ScottishPower" and PacifiCorp ("Merger") on the condition that neither merger costs nor the acquisition premium would be recoverable in rates. *See* Request at ¶ 1.

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[1] The Committee filed its request for agency action pursuant to the provisions of Utah Code Ann. §§ 54-7-9 and 54-10-4. Pursuant to the provisions of Section 54-7-9, no request for agency action can be considered by the Commission unless it is signed by "not less than 25 consumers." The Committee has failed to include the necessary signatures in its Request and, therefore, the Commission could refuse to initiate this proceeding until such time as this statutory deficiency is corrected by the Committee. Nonetheless, the Company recognizes that compliance with this requirement would likely only temporarily bar action on the Request and believes the Request should be dismissed for the reasons set forth in this Response. Therefore, the Company does not seek to delay this final resolution pending Committee correction of this temporary procedural flaw.

[2] PUHCA has been and will continue to be administered by the SEC, until February 8, 2006. Thereafter, the Public Utility Holding Company Act of 2005 will be administered by the Federal Energy Regulatory Commission ("FERC").

A. THE PACIFICORP - SCOTTISHPOWER MERGER

On December 31, 1998, PacifiCorp and ScottishPower filed a joint application requesting an order from the Commission approving the ScottishPower/PacifiCorp merger. The Commission issued an order approving the application on November 23, 1999.[3] As a result of the Merger, ScottishPower became a registered holding company, and ScottishPower and all of its subsidiary companies, including PacifiCorp, became subject to the provisions of the PUHCA.

The primary purpose of PUHCA is to prevent holding companies from using their control of public utilities to engage in abusive financial practices or to evade state regulatory jurisdiction. Among other things, PUHCA regulates the allocation of cash tax payments among associate companies in a holding company system that are parties to a consolidated tax allocation agreement. Notably, PUHCA does not in any way regulate the amount or propriety of recovery of utility tax payments from ratepayers.

B. PACIFICORP'S RATES SINCE THE MERGER

The Committee's Request states that since the merger, PacifiCorp has "unlawfully collected monies in Utah rates in excess of any lawful income tax liability." Request at ¶ 16. PacifiCorp's rates in Utah are established in general rate case proceedings. Since the time of the merger, there have been five such rate case proceedings, Docket Nos. 97-035-01, 99-035-01, 01-035-01, 03-2035-02 and 04-035-42. In setting rates in each of the foregoing dockets, the PacifiCorp utilized the stand-alone federal income tax calculation for the test period used in the docket. The use of a PacifiCorp stand-alone tax calculation for ratemaking is consistent with long-standing Commission policy.

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[3] *See In re Application of PacifiCorp and ScottishPower plc for an Order Approving the Issuance of PacifiCorp Common Stock*, Report and Order, Docket No. 98-2035-04 (Utah PSC Nov. 23, 1999) ("Merger Order").

In Docket Nos. 97-035-01 and 99-035-01, PacifiCorp's rates were determined based on historic revenue and cost data that predated the ScottishPower merger. As a result, the ScottishPower corporate structure, tax allocation agreement and federal tax payments were not considered and, based on the Commission's policy on test period and post-test period adjustments, could not have been considered in setting rates in those proceedings. Notably, PacifiCorp participated in filing a consolidated tax return prior to the ScottishPower merger. Although PacifiCorp participated in a consolidated tax return, stand-alone tax expense was the basis for income tax expense in the historic test years for both of these dockets. No party raised any issue regarding the use of the Commission's long-standing stand-alone tax calculation for ratemaking purposes in these two cases.

In the remaining three rate cases, rates were determined based on data for test periods subsequent to the ScottishPower merger. In each of those cases, PacifiCorp provided filed federal income tax data on both a stand-alone and consolidated basis, even though the Commission's policy on income tax expense was based on the stand-alone method. Each of these rate cases was settled.[4] The Committee was a signatory to each stipulation. Each stipulation included the agreement of all parties to the stipulation that the rates established by the stipulation were "just and reasonable."

C. SEC PUHCA AUDIT

Pursuant to PUHCA, the SEC staff conducts routine administrative compliance audits of registered holding companies every four to five years in order to determine compliance with PUHCA. In September 2003, the SEC staff notified ScottishPower, PHI and PacifiCorp that it

[4] There was a stipulation in Docket No. 01-035-01 of all revenue requirement issues except net power costs issues which were tried to the Commission. Docket Nos. 03-2035-02 and 04-035-42 were both settled with stipulations that resolved all outstanding issues.

would commence its routine audit of affiliate transactions among associate companies in the ScottishPower registered holding company system. On May 11, 2004, the SEC issued a final audit report ("Audit Report ") incorporating a total of sixteen recommendations ("Recommendations") and findings ("Findings").

The Audit Report and the Recommendations and Findings made therein were routine in nature and limited in scope. Despite the Committee's rhetoric, the Findings did not reveal any evidence of illegality or unlawful conduct, and the SEC Staff did not recommend any sanctions that may have been consistent with such findings. ScottishPower immediately reviewed and took action on all of the Recommendations and Findings, and all such issues were ultimately resolved to the complete satisfaction of the SEC.

The Request focuses on Findings 13 and 14, both of which relate to tax allocation issues. Finding 13 includes a recommendation that PHI amend the PHI group's tax allocation agreement to clarify the method of allocation the group would utilize going forward. Finding 14 includes recommendations concerning the proper allocation of tax payments to PacifiCorp's parent company, PHI for the tax years 1999 to 2004.[5]

1. The Structure and Purpose of Rule 45

During the SEC PUHCA Audit, the staff examined, among other things, whether PHI allocated tax losses in accordance with Rule 45 of PUHCA. Rule 45 was promulgated under Section 12 of PUHCA and sets forth the reporting requirements of associate companies subject to the provisions of PUHCA. Rule 45(c) regulates tax allocation agreements, which were the

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[5] The Committee's request references the entire time period since the Merger. The Merger closed on November 29, 1999. The referenced time period includes only December 1999. Therefore, while the Request references 1999, this should be read to include only December 1999 and not the entire year.

subject of rulemaking because such agreements could involve implicit loans, extensions of credit or indemnities.[6] Rule 45(c) is intended to regulate only the allocation of cash associated with tax payments; it does not in any way affect or modify the underlying tax expense of the individual holding company or its subsidiary companies.[7] "As a safe harbor rule, Rule 45(c) does not address all possible situations or allocation methods. It merely provides an accepted method that the [SEC] has found to be consistent with the [PUHCA]."[8] So long as a tax allocation agreement is drafted in accordance with Rule 45, it does not have to be filed with or approved by the SEC.

Generally, Section 12 of the PUHCA and Rule 45 promulgated thereunder do not permit a holding company that is party to a consolidated tax allocation agreement to retain any cash related to tax payments associated with holding company tax liabilities. But the SEC has routinely recognized an exception to this general rule so that a holding company may retain the tax benefits arising from interest paid on the holding company's acquisition-related debt. This narrow exception makes good sense as a policy matter: where the holding company is responsible for the burden of paying interest on the acquisition-related debt, the holding company should receive the tax benefit of such interest payments.

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[6] *Adoption of Amendment to Rule Governing Allocation of Consolidated Income Taxes Among Member Companies of Registered Holding Company Systems, Rule U-45(b)(6)*, Holding Co. Act Release No. 12776 (Jan. 12, 1955).

[7] There is, of course, nothing improper about PacifiCorp's method of paying taxes or collecting its tax expenses from ratepayers. In accordance with Federal tax laws, PacifiCorp has, both prior to and after its merger with ScottishPower, participated in a consolidated federal tax return. However, for ratemaking purposes in Utah, PacifiCorp, has always calculated and paid its tax liability on a stand-alone company basis. PacifiCorp did so prior to the Merger, during the period which was the subject of the Audit Report and still does so today. Such treatment is consistent with the long-standing Commission policy regarding public utility tax expenses.

[8] *See* Memorandum submitted to the SEC in support of National Grid Tax Allocation Agreement, dated January 4, 2002.

2. Finding 14

In Finding 14, the SEC staff questioned whether PHI had properly sought prior exemptive approval from the SEC to allocate to PHI the benefits associated with tax payments stemming from PHI's payment of acquisition-related debt. That PHI was, in theory, entitled to such exemptive relief from 1999 through 2003 was never a disputed issue. The acquisition-related debt has always been maintained on PHI's balance sheet. The burden of servicing such debt was never included in the rates of Utah customers. The shareholders made all of the interest payments on the acquisition-related debt, and it is reasonable and equitable that the shareholders receive the benefit of such payments. The SEC did not disagree with PHI's position that, as a matter of fairness, PHI was entitled to the benefits associated with its acquisition-related debt service. Rather, the central issue presented by the audit was whether PHI had properly sought prior approval from the SEC to retain such benefits at PHI.

In the original financing application, ScottishPower requested and believed it had received from the SEC the customary authorization to retain tax payments related to the tax deductions associated with the acquisition-related indebtedness at the holding company level. The language in the financing application clearly described the tax structure and adequately demonstrated the need for customary exemption relating to acquisition-related debt. The SEC staff, however, determined that the initial financing application and the subsequent order did not contain a sufficiently specific request to retain such benefits at the holding company level.

The purported violation was purely procedural, and the SEC staff endeavored to fashion a remedy consistent with its insignificance. PHI and the SEC PUHCA Audit staff agreed that PHI could offset all cash payments that it made to PacifiCorp during the audit period against the $229 million that the SEC PUHCA Audit Staff believed should have been distributed to PacifiCorp for

the tax years 1999-2003. This agreement was consistent with past SEC practice. When the SEC determines that a holding company did not allocate sufficient cash to a regulated or non-regulated subsidiary in a particular transaction, the SEC will allow the holding company to remedy the situation by making a capital contribution to such subsidiary or demonstrate that it has committed excess capital to the subsidiary during the audit period.[9] The SEC recognizes that, as a matter of equity, a holding company should not be penalized for individual payments that may be technically inconsistent with Rule 45, where the holding company has made other capital contributions that redound to the benefit of the regulated subsidiary.

Here, as the Request concedes (*see* ¶ 11), the SEC credited a $150 million capital contribution made to PacifiCorp during the audit period. The $150 million contribution, made on December 19, 2002, was voluntary and intended to increase the equity capitalization of PacifiCorp and enhance its ability to meet its obligations as a public utility. The $150 million contribution was used solely for utility purposes, and directly benefited ratepayers.[10]

In order to foreclose any further dispute with the SEC, PHI agreed to forego $79 million ($229 million - $150 million) in dividend payments associated with the sale of certain Australian assets, Powercor and Hazelwood ("Australian Assets"), and leave those monies in PacifiCorp. Accordingly, PHI amended its dividend authority so as to retain $79 million at PacifiCorp. The proceeds from the sale of the Australian Assets were never PacifiCorp public utility property; ratepayers had not funded the initial investments in the Australian Assets. Indeed, this

[9] Section 12 of PUHCA and Rule 45 promulgated thereunder provide that a public utility subsidiary company may receive cash payments from its parent company, by way of capital contributions and extensions of credit, which may include withholding dividend payments.

[10] Notice of the capital infusion was provided to the Commission on February 28, 2003, in the Company's quarterly financial report filing letter, and the capital infusion dollars were included in the capital structure utilized in the forecast test year included in Docket No. 04-035-42.

Commission recognized that these sale proceeds were not ratepayer property in its Merger Order. *See* Merger Order at 19. This cash benefit, which prior to the SEC PUHCA Audit would not have belonged to ratepayers, was made available to PacifiCorp for its utility operations.[11]

Together, these two actions, the capital contribution of $150 million and the election to forego $79 million in dividend payments, satisfied the SEC that PHI had contributed an equivalent amount of capital to PacifiCorp to offset any tax payments retained at PHI. The SEC staff approved these actions as a ***complete*** remedy to the purported defect in PHI's initial application for exemptive relief. Significantly, the SEC staff did not require: (i) movement of any cash from PHI to PacifiCorp; (ii) an amendment or adjustment to financial statements; or (iii) an amendment or adjustment to any of the tax expense entries for years 1999-2003.

Contrary to the assertions in the Request, there simply was no SEC finding – explicit or implicit – that PacifiCorp "unlawfully provided" or that PHI "unlawfully appropriated" tax payments properly belonging to PacifiCorp. *See* Request at ¶ 6. Rather, the SEC staff highlighted a technical violation of Rule 45, and the SEC accepted a resolution of the matter that left PacifiCorp completely whole.

That the purported violation was technical and that there was no "unlawful" conduct is amply borne out by the fact that, in 2004, ScottishPower sought and received from the SEC permission to retain at PHI the benefits stemming from acquisition-related debt payments on a

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[11] In fact, while PacifiCorp has had authority from the SEC to dividend the remaining $221 million from the sale to PHI and ScottishPower, it has never done so. Instead, those dollars have remained at PacifiCorp for the benefit of ratepayers and have been included in the most recent general rate case proceedings.

going forward basis.[12] The SEC, therefore, explicitly authorized (albeit on a going forward basis) the exact same method of tax allocation utilized by PHI from 1999-2003.

3. Finding 13

The Committee also invokes Finding 13 of the Audit Report, which focused on whether PHI had elected to allocate tax payments among its associate companies according to Rule 45(c)(4) or Rule 45(c)(5).[13] The Committee misleadingly conflates Finding 13 and Finding 14, implicitly suggesting that the tax allocation agreement, as written between 1999 and 2003, should have required PHI to allocate to PacifiCorp all tax payments stemming from PHI's payment of acquisition-related debt. *See* Request at ¶¶ 13-14. In fact, the tax allocation agreement had no bearing on the SEC staff's determination that ScottishPower had not specifically requested the exemption detailed above. Rather, the issue of whether the Company made a Rule 45(c)(4) or a Rule 45(c)(5) election impacted how the acquisition-related debt tax payments retained by PHI would be distributed to the associate companies. If the Company made a Rule 45(c)(4) election in its 1999 tax allocation agreement, PHI should have allocated to PacifiCorp $229 million in tax payments. If the Company made a Rule 45(c)(5) election, PHI should have allocated to PacifiCorp a substantially lesser amount in tax payments. The SEC ultimately determined that the Company made a Rule 45(c)(4) election.

A company making a Rule 45(c)(4) election excludes all associate companies without positive corporate taxable income (*e.g.* PHI) from participating in an allocation of tax payments. Loss companies, other than holding companies, would accrue benefits that would offset their tax

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[12] The request was made in an amended application and supplemental order for omnibus financing activities for the ScottishPower system. *See Scottish Power plc,* Holding Co. Act Release No. 27851 (May 28, 2004).

[13] While the holding company must utilize a tax allocation agreement that complies with Rule 45(c), there is no requirement that the SEC approve such agreement in advance.

liability once they become profitable. Holding companies, with the exception of holding companies authorized to retain tax payments associated with acquisition-related debt (as noted above), would have to surrender their benefits to subsidiary companies, not to lower the subsidiaries' tax expense, as apparently assumed by the Committee, but to redistribute cash in the form of a capital contribution. The 45(c)(4) election further provides that the tax allocation agreement must have an equitable provision for each subsidiary company that preserves the equivalent of any rights such company would have had if it had filed a separate return.

Rule 45(c)(5), on the other hand, includes all members of the tax group recognizing both negative and positive corporate tax income. A Rule 45(c)(5) tax allocation agreement must provide that associate companies with a positive allocation will pay amounts allocated to such subsidiary companies with a negative allocation and such companies will receive current payment of their corporate tax credits. Under the Rule 45(c)(5) election, all tax payments are made up to and through the holding company.

PHI believed that its original tax allocation agreement made an appropriate election for the purpose of its tax allocations and accordingly, did not allocate excess tax payments to profitable companies like PacifiCorp. Based on the SEC Staff's interpretation of the initial tax allocation agreement, it determined that PHI invoked the Rule 45(c)(4) election. The SEC did not find that PHI unlawfully failed to comply with the tax allocation agreement. Instead, the SEC PUHCA Audit staff found that the tax payments should have been allocated pursuant to Rule 45(c)(4). As a result, the SEC concluded that $229 million of the tax payment discussed above should have been allocated to PacifiCorp.

PHI did not agree with the SEC staff belief that PHI lacked authority for its tax allocation payments, but, in light of the remedy sought by the SEC staff, PHI accepted the recommendation

made by the SEC staff with respect to the new application then pending before the SEC. Accordingly, PHI amended the financing application and tax allocation agreement to clarify that PHI intended a Rule 45(c)(5) election and authorization to retain tax payments associated with losses incurred as a result of interest payments on the acquisition-related debt, on a going forward basis. There was no finding of "unlawful conduct."

D. Regulator Involvement Related to SEC PUHCA Audit

The Committee's mischaracterizations of the SEC's conclusions are particularly unwarranted here, where the Commission participated in the SEC PUHCA Audit process. Neither PUHCA nor state law required the Company to notify the Commission about the SEC PUHCA Audit, but the Company, in good faith, so notified the Commission. The Commission elected to participate in the audit, delegating responsibility for that participation to the Division of Public Utilities ("DPU"). Accordingly, in January of 2004, the Company provided the DPU with relevant SEC data requests and Company responses.

Upon completion of the SEC PUHCA Audit, the Company provided a copy of the Audit Report to the Commission. Again, the Company had no obligation under PUHCA to provide the Commission with a copy of the Audit Report, but in the interests of openness, provided the Commission with the Audit Report. On July 9, 2004, the Company conducted a follow-up meeting with the Committee and the DPU, during which the Company discussed in detail all of the relevant Findings in the Audit Report, with a particular emphasis on the tax allocation issues. During that meeting, no one raised any concerns about the SEC's treatment of tax allocation issues in the Audit Report, including its determination that PHI had contributed sufficient capital to offset the tax allocation issues, and no one suggested that PHI's tax allocation treatment going forward was flawed or in any way improper.

IV. MOTION TO DISMISS

A. LEGAL STANDARD

The Commission has the authority to summarily dismiss a matter under Utah Rule of Civil Procedure 12(b)(6) prior to hearing in appropriate circumstances. *See* Utah Code Ann. § 63-46b-4(b); *In the Matter of Beaver County et al.*, Order Granting Motion for Summary Judgment, Docket No. 01-049-75 (Utah PSC June 17, 2005) ("*Beaver County*"). Under Rule 12(b)(6), a complaint should be dismissed if the "plaintiffs would not be entitled to relief under the facts alleged or under any state of facts they could prove to support their claim." *Franco v. The Church of Jesus Christ of Latter-Day Saints*, 21 P.3d 198, 202 (Utah 2001) (citations omitted). In making this assessment, the court must accept all material allegations in the complaint but is not required to credit mere conclusory allegations. *See Chapman v. Primary Children's Hospital*, 784 P.2d 1181, 1186 (Utah 1989) (citing *Ellefsen v. Roberts*, 526 P.2d 912, 915 (Utah 1974)).

B. PACIFICORP HAS COLLECTED LAWFUL RATES DURING THE ENTIRE PERIOD FOR WHICH THE COMMITTEE SEEKS REFUNDS.

During the time period at issue in the Committee's Request (1999 to 2005), PacifiCorp requested rate increases that included recovery for stand-alone income tax expenses. *See* Utah Code § 54-7-12(2)(a). In each of these proceedings, the Commission issued final orders finding that the proposed rates, which included recovery for income tax expenses calculated using the Commission's long-standing stand-alone methodology, were just and reasonable. *See Utah Code Ann.* § 54-7-12(2)(b). Rates which included the tax expenses then went into effect. *See id.* § 54-7-12(2)(c). These were the lawful rates to be "thereafter observed" and PacifiCorp was required by law to charge those rates until such time as the rates were changed in the succeeding rate case. *See id.* § 54-4-4(1).

The Committee argues that PacifiCorp charged unlawful rates by virtue of the inclusion of an allowance for federal income taxes in those rates. *See* Request at ¶ 1, 16-17, 19-20. In fact, pursuant to Utah Code Ann. § 54-3-7, PacifiCorp was obligated to charge the rates set forth in its filed tariffs. Had PacifiCorp charged something other than the filed rates, it would have been in violation of both the law and Commission order and subject to penalties and enforcement action therefor.[14] *See* Utah Code Ann. § 54-7-25; *see also American Salt Co. v. W.S. Hatch Co.*, 748 P.2d 1060 (Utah 1987) (requiring common carrier to charge filed rate despite agreement with customer to charge lower rate).[15] Thus, the mere fact that PacifiCorp's rates included income tax expense calculated using the Commission-approved methodology cannot support any theory of recovery under the Request.

Moreover, pursuant to these statutory provisions, the final orders issued in the general rate case dockets established rates that were "deemed permanent," on which the parties were entitled to rely. *See, e.g., Utah-Idaho Cent. R.R. v. Public Utilities Comm'n*, 227 P. 1025, 1027 (Utah 1924) ("The fact is that in the very nature of things the rates promulgated by the commission must be deemed permanent, unless the commission expressly provides to the contrary, and in the order itself provides what the rights of the parties shall be, with respect to the rates.") Once a rate becomes final, it is tantamount to a statute, which can only be changed

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[14] In addition, PacifiCorp's officers and employees would also have been subject to penalties. *Id.* § 54-7-26.

[15] In *American Salt*, a common carrier contracted to haul salt for American Salt at a rate lower than the carrier's tariff rate. 748 P.2d at 1061. The Commission held that American Salt was presumed to know that hauls by the carrier were subject to applicable tariff provisions and that the carrier could not agree to charge a rate lower than that provided in the tariff. *Id.* at 1062. On rehearing, the Commission recognized the harsh result of its conclusions but, nevertheless, upheld the tariff rate. The Utah Supreme Court upheld the Commission's application of the filed rate doctrine: "in this case, the general commodity tariff was the only tariff on file which could properly be applied to the shipments in question." *Id.* at 1066.

prospectively. *See, e.g., New England Tel. & Tel. Co. v. Public Utilities Comm'n*, 358 A.2d 1, 21 (R.I. 1976); *Montana Horse Products v. Great Northern Ry. Co.*, 7 P.2d 919, 924-25 (Mont. 1932).

C. A CLAIM THAT RATES DURING THE REQUEST PERIOD WERE UNJUST AND UNREASONABLE IS BARRED BY THE LIMITATION IN SECTION 54-7-20.

The only statutory provision allowing for refund of lawful rates paid pursuant to final, unappealed orders of the Commission is Utah Code Ann. § 54-7-20, the reparations statute. Only if the Committee could state a claim under the reparations statute could it be entitled to the refund sought in the Request. Subsection 1 of the statute provides:

> When complaint has been made to the commission concerning any rate, fare, toll, rental or charge for any product or commodity furnished or service performed by any public utility, and the commission has found, after investigation, that the public utility **has charged an amount** for such product, commodity or service **in excess of the schedules, rates and tariffs on file** with the commission, **or has charged an unjust, unreasonable or discriminatory amount** against the complainant, the commission may order that the public utility make due reparation to the complainant therefor, with interest from the date of collection.[16]

Thus, the statute provides for rate reparations when charges have been in excess of the tariff or schedules in effect or have been unjust, unreasonable, or discriminatory. There is no claim here that the rates paid were in excess of the tariffs or schedules of PacifiCorp or were discriminatory. Therefore, the only valid basis for a claim of refund would be that the rates were unjust or unreasonable.

However, there exists a statute of limitations on the availability of the remedy afforded under the reparations statute which would act as a complete bar to the Committee's requested

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[16] *Utah Code Ann.* § 54-7-20(l) (emphasis added).

relief even if there were a valid basis for that request. Subsection (2) of the reparation statutes provides, in relevant part:

> All complaints concerning unjust, unreasonable or discriminatory charges shall be filed with the commission within one year . . . from the time such charge was made . . . .

Thus, for each charge made to customers, the period of time in which a complaint for reparations on the ground that the rate was unjust or unreasonable may have been filed was within one year of the relevant charge. For example, if a customer wished to file a reparations claim for a charge made on December 31, 2003, the claim had to be filed by December 31, 2004. Here, if the Committee had intended to seek reparations for rates paid during the period covered by the SEC PUHCA Audit, which began on December 1, 1999 and ended on March 31, 2004, it would have been required to file a claim by March 31, 2005. The Committee did not file its Request until October 7, 2005. Accordingly, while the claims are without merit for the reasons discussed herein, all of the Committee claims related to the time period of the SEC PUHCA Audit are also time-barred.

D. ABSENT AN EXCEPTION TO THE RULE AGAINST RETROACTIVE RATEMAKING, THE SEC PUHCA AUDIT COULD NOT SERVE AS A BASIS TO AWARD REPARATIONS FOR RATES PREVIOUSLY FOUND JUST AND REASONABLE.

While the Request also seeks relief for time periods after the end of the SEC PUHCA Audit, the Committee has failed to include any proper factual allegations supporting its claim that PacifiCorp's rates were unjust and unreasonable after the SEC PUHCA Audit. The Request only provides a conclusory and unsupported allegation that because the SEC made findings regarding reallocation with respect to the SEC PUHCA Audit period, there must be an issue with

the period after the SEC PUHCA Audit as well.[17] In fact, as stated above, the SEC fully approved on a going-forward basis the Company's new tax allocation agreement and the allocation to PHI of tax payments associated with the acquisition debt service for which PHI is responsible. Other than the mere conclusory (and demonstrably incorrect) allegations included in the Request, which the Commission must give no credit in ruling on this motion to dismiss,[18] there is no set of facts the Committee has alleged or could allege to support a claim of unjust and unreasonable rates after the SEC PUHCA Audit.

In *American Salt Co.*, the Utah Supreme Court concluded that reparations under section 54-7-20 for "unjust" or "unreasonable" charges cannot be awarded when the Commission had previously determined the charges complained of are just and reasonable in a final rate order. 748 P.2d at 1064-65. This holding was consistent with other courts that have considered the issue and held that, where facts emerge that render the previously charged rates unjust or unreasonable, such rates should only be addressed prospectively through rate-setting, not through reparations.[19]

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[17] *See* Paragraph 19 of the Request in which the Committee asserts that because tax payments were reallocated "prior to 2004", then fiscal 2004 [April 1, 2003 to March 31, 2004] rates "were necessarily unjust, unreasonable and unlawful." It is insufficient as a matter of law to assert that reallocations ordered for the time period of the audit (1999 to March 31, 2003) "necessarily" impact customer rates for the later time period. *Chapman*, 784 P.2d at 1186.

[18] *Chapman*, 784 P.2d at 1186.

[19] *See, e.g., Arizona Grocery Co. v. Atchison, T. & S. F. Ry. Co.*, 284 U.S. 370, 390 (1932 ("Where the Commission has upon complaint, and after hearing, declared what is the maximum reasonable rate to be charged by a carrier, it may not at a later time, and upon the same or additional evidence as to the fact situation existing when its previous order was promulgated, by declaring its own finding as to reasonableness erroneous, subject a carrier which conformed thereto to the payment of reparation measured by what the Commission now holds it should have decided in the earlier proceeding to be a reasonable rate."); *Entergy Gulf States, Inc. v. Louisiana Public Service Comm'n*, 730 So.2d 890, 920-21 (La. 1999) ("A commission-made rate furnishes the applicable law for the utility and its customers until a change is made by the Commission. Therefore, the utility is entitled to rely on a final rate order until a new rate in lieu thereof is fixed by the Commission. Consequently, the revenues collected under the lawfully imposed rates become the property of the utility and cannot rightfully be made the subject of

Under these principles, a reallocation of tax payments, especially one that does not change tax expense in any manner, does not bring into effect the backward-looking operation of the reparations statute. Here, the Commission found that the rates were just and reasonable in all five general rate cases during the time period of the Request. Indeed, the Committee was a party to stipulations covering the majority of that time period, and covering all of the time period in which ScottishPower data was used in setting rates, in which the Committee agreed that the rates then being established were just and reasonable. Therefore, no refund is justified unless an exception to the rule against retroactive ratemaking applies.

E. THE REQUEST IS BARRED BY THE RULE AGAINST RETROACTIVE RATEMAKING.

Utah law recognizes the rule against retroactive ratemaking, which precludes adjustments to approved rates to correct for errors or missteps in the rate-making process. *Utah Dep't of Bus. Regulation v. Pub. Serv. Comm'n*, 720 P.2d 420, 423 (Utah 1986). "As a general proposition, adjustments made in future rates to compensate for errors in prior rate-making proceedings are deemed retroactive in nature, and such adjustments are generally not consistent with a statutory regulatory scheme based on prospective ratemaking." *Stewart v. Utah Pub. Serv. Comm'n*, 885 P.2d 759, 778 (Utah 1994). This rule gives a degree of reliability and predictability to the inherently imprecise process of fixing rates. 885 P.2d at 779.

Because setting rates on a prospective basis is clearly the presumptive standard under Utah law, the Committee must bear the burden of demonstrating that the Commission should depart from the rule. The Committee has failed to meet its burden. The facts alleged by the

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a refund."); *State ex re. Boynton v. Public Service Comm'n*, 11 P.2d 999, 1006 (Kan. 1932) ("any rate . . . prescribed by the commission and put into effect by the carriers may be confidently collected and retained by them as their very own, without misgiving that at some future time a further hearing of the commission may be had and more evidence taken and a different conclusion reached and those rates condemned as unreasonable and reparation certificates allowed . . . .").

Committee cannot support the application of an exception to the rule against retroactive ratemaking.

Utah recognizes two exceptions to the rule against retroactive ratemaking: (1) unforeseen and extraordinary increases and decreases in utility expenses and (2) utility misconduct. *MCI Telecomm. Corp. v. Pub. Serv. Comm'n*, 840 P2d 765 (Utah 1992).

Under the first exception, the *MCI* court stated that, for the extraordinary component of extraordinary-and-unforeseeable exception to apply, the event "must have an extraordinary effect on the utility's **earnings**." 840 P.2d at 771 (emphasis added). The "increase or decrease [in earnings] will necessarily be outside the normal range of variance that occurs in projecting future expenses." *Id*. at 771-72. The exception "cannot be invoked simply because a utility experiences expenses that are greater or revenues that are less than those projected in the general rate proceeding." *Id.* at 772. The *MCI* court cited cases where utilities were permitted to change rates on a retroactive basis in response to severe storms or other acts of God. *Id*. at 771. Thus, the unforeseen and extraordinary exception had its genesis in situations in which a utility experienced unanticipated and extraordinary increases in expenses that would not otherwise be recoverable in normal ratemaking processes to deal with something like a severe storm or some other event outside of its control.

The second exception to the rule against retroactive ratemaking is situations involving utility misconduct in rate-setting proceedings. "A utility that 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 cannot invoke the rule against retroactive rate making to avoid refunding rates improperly collected." *Id.* at 775. Therefore, if the PSC finds that a utility has engaged in misconduct in the ratemaking process, it may reopen a rate order. *Id.* ("The rule

against retroactive rate making was not intended to permit a utility to subvert the integrity of rate-making proceedings.")

1. Neither Exception Is Applicable For Rates Set in Docket No. 04-035-42 because PacifiCorp Fully Disclosed the SEC PUHCA Audit and Audit Findings to Regulators.

While the Utah courts have recognized two narrow exceptions to the rule against retroactive ratemaking, neither exception is applicable to retroactively change rates established in a rate case where the events claimed as the basis for invoking one or both of the exceptions were fully disclosed and clearly known. The extraordinary and unforeseen event exception requires the Commission to find that an event occurred that was unforeseen at the time of setting rates and that the event had an extraordinary impact on earnings. The utility misconduct exception requires the Commission to find that the utility has misled or failed to disclose information relevant to the ratemaking proceeding. Neither exception can apply under any facts alleged for rates established in Docket No. 04-035-42 because PacifiCorp fully disclosed the SEC PUHCA Audit and Findings and the impact on earnings (or more accurately the absence of any impact) was transparent to all parties during the ratemaking process.

At the close of the SEC PUHCA Audit, the Company provided a copy of the SEC PUHCA Audit Findings to the Commission. In addition, it conducted a meeting with the Committee and Division on July 9, 2004, during which the Company discussed the SEC PUHCA Audit Findings, specifically including the tax allocation issue. The Company also disclosed the SEC PUHCA Audit and Findings during its 2004 rate case in written responses to discovery requests submitted by the Committee and in document review by the Committee.

Indeed, Committee witness Michael L. Arndt filed direct testimony in that case that raised many of the same issues identified in the Request. For example, Mr. Arndt suggested that

PacifiCorp rates should be based on consolidated tax liability and alleged that the failure to set rates on that basis resulted in customers paying for acquisition indebtedness costs. *See* Arndt Direct Testimony at page 6-17. As noted above, the Committee ultimately stipulated to a resolution of the 2004 rate case.

Accordingly, in stark contrast to the facts of the *MCI* case, all parties were aware the SEC PUHCA Audit and the findings in the SEC PUHCA Audit. The Committee's claim for any period during and after the 2004 rate case must be summarily dismissed because it has not and cannot allege any facts to support a Commission finding that an exception to the rule against retroactive ratemaking is applicable in this case.

2. The Extraordinary and Unforeseen Increases or Decreases in Expenses Exception to the Rule Against Retroactive Ratemaking Is Inapplicable to the Alleged Claims.

Under *MCI*, the Commission must find an extraordinary impact **on earnings** before an event becomes extraordinary. *See* 840 P.2d at 771. There is no possible set of facts that the Committee could allege or prove to establish facts sufficient to support this exception. The SEC PUHCA Audit Findings have absolutely no impact on utility expenses or revenues and therefore, no impact on utility earnings. The SEC does not regulate tax expense and, therefore, no change in tax expense affecting revenues or earnings could result under any outcome in the SEC PUHCA Audit.[20] With respect to the SEC PUHCA Audit at issue, no expense was changed, no cash moved between PHI and PacifiCorp and no amendment or adjustment to financial statements was required. The SEC found that prior capital contributions and an agreement to leave money associated with the sale of the Australian Assets at PacifiCorp fully demonstrated

[20] The Committee also claims that PacifiCorp collected income tax expenses that it "knew were in excess of any lawful income tax liability." Request at ¶ 1. Given that the SEC PUHCA Audit did not change the Company's income tax expense in any manner, this allegation is utterly without merit.

that there had been no improper retention of cash at PHI. Because there was no impact on expenses or earnings, the exception is wholly inapplicable.[21]

Moreover, the *MCI* case established a refund would only be appropriate of funds collected above the utility's authorized rate of return. *Id.* at 776 ("[I]f on remand the Tax Reform Act of 1986 is found to have resulted in an unforeseeable and extraordinary decrease in expenses or if U.S. West is found to have engaged in misconduct, we hold that **U.S. West's earnings, to the extent they exceeded its authorized rate of return established in the 1985 general rate case, should be refunded** to U.S. West ratepayers.") (emphasis added). In the recent *Beaver County* case, the facts before the Commission established that the property tax refund at issue there had minimal impact on expenses, revenues and on utility earnings. While the facts established that Qwest was overearning by just over 3% during the period in question in that case, the Commission nevertheless granted summary judgment, stating that "reasonable minds can find that the refund was not extraordinary." *Beaver County* at 47.

Here, the facts establish that there was no impact, much less an extraordinary impact, on expenses or earnings. First, the SEC PUHCA Audit did not require any change in expense. Second, the SEC did not require any reallocation of cash between PHI and PacifiCorp, finding instead that sufficient and equivalent cash capital contributions had already been made. Therefore, there was no impact on expenses, earnings or paid-in capital as a result of the SEC PUHCA Audit.[22]

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[21] The Commission has recently made clear that it will not entertain arguments that the exceptions previously adopted by the Utah Supreme Court should be expanded where factually analogous arguments are being proffered. *See Beaver County* at 45.

[22] As stated in the fact section above, the capital infusions had already been accounted for in PacifiCorp's books and, therefore, no additional impact on the capital structure results from the SEC PUHCA Audit.

Finally, even if the Commission were to take as accurate the Committee's allegation that utility tax expense would have changed commensurate with the reallocation discussed in the SEC PUHCA Audit Findings, a fact that is simply not true nor consistent with federal law, PacifiCorp would not have earned more than its authorized rate of return, and therefore, under *MCI*, no refunds are available.[23]

Assuming that SEC PUHCA Audit actually impacted utility tax expense (which as noted above is neither factually true or legally correct), information filed with the Commission conclusively demonstrates that PacifiCorp would not have earned over its authorized rate of return. The SEC PUHCA Audit Findings state that the PacifiCorp-allocated portion of the $229 million for FY03 was $74.5 million. If the Commission applied that reallocated portion against utility tax expense for that year, PacifiCorp's adjusted return on equity would increase from 5.73% to only 7.41%, well below the Company's then-authorized return on equity of 11.0%.[24]

The SEC PUHCA Audit does not explicitly state the breakdown of the remainder of the $229 million ($229 million - $74.5 million = $154.5 million) for the remaining years covered by the SEC PUHCA Audit. However, if this Commission assumed the very worst case scenario—that all of the remaining amount was applied against expense in the highest earning year covered by the SEC PUHCA Audit, PacifiCorp would still not be overearning. Specifically, fiscal year

[23] The Committee's Request is ambiguous on its theory of how these dollars might have become available to PacifiCorp. Whether the tax expense would have changed, which is, as noted above, inconsistent with federal law governing the jurisdiction of the IRS and SEC, or whether the expense would have stayed the same but no payment would have been made to PHI or to affiliate companies, the result is nevertheless the same—PacifiCorp would never have earned above its authorized rate of return.

[24] *See Semi-Annual Results of Operations for the Period Ending March 2003*, ("2003 Semi-Annual") at page 2.2. The calculation is based on the following assumption: a federal income tax rate of 35%; income before taxes factor of 30.2054% from page 2 of Tab 10 of the 2003 Semi-Annual.

2001 was the year during the SEC PUHCA Audit in which PacifiCorp recorded its highest earnings; nevertheless, PacifiCorp's adjusted return on equity was only 7.89% for FY01.[25] If the entire, Utah-allocated portion of the $154.5 million was applied as a reduction to tax expense in that year, PacifiCorp's adjusted return on equity would still be only 10.69%, which is below its then-authorized return of 11.0%.[26]

In other words, while the law and facts clearly establish that tax expense and earnings did not change as a result of the SEC PUHCA Audit, even if the Commission were to credit these incorrect allegations merely for the purposes of deciding this Motion to Dismiss, there is no set of facts that the Committee could plead that would entitle it to the relief of a refund.

3. The Misconduct Exception to the Rule Against Retroactive Ratemaking Is Inapplicable to the Alleged Claims.

The *MCI* court made clear that the utility misconduct exception to the rule against retroactive ratemaking involves conduct that "subvert[s] the integrity of rate-making proceedings." 840 P.2d at 775. Thus, the misconduct cannot be based on general allegations of "financial fraud" or improper motive. It must relate to financial fraud or misrepresentation in the context of the ratemaking process.

Moreover, utility misconduct in the context raised by the Committee is a serious charge. It amounts to a claim that PacifiCorp committed fraud on the Commission by making improper declarations about its federal income taxes. As such, the Committee is required to allege (and obviously prove) the fraud with particularity. *See, e.g., Williams v. State Farm Ins. Co.*, 656 P.2d 966, 972 (Utah 1982) ("The Rule 9(b) requirement should not be understood as limited to

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[25] *See Semi-Annual Results of Operation for the Period Ending March 2001* ("2001 Semi-Annual") at page 2.2.

[26] The calculation is based on the following assumption: a federal income tax rate of 35%; income before taxes factor of 23.4451% from page 2 of Tab 10 of the 2001 Semi-Annual.

allegations of common-law fraud. The purpose of that requirement dictates that it reach all circumstances where the pleader alleges the kind of misrepresentations, omissions, or other deceptions covered by the term 'fraud' in its broadest dimension. Consequently, if the pleading had merely alleged that the insured had given 'fraudulent' or 'deceptive' or 'misrepresenting' answers, it would have been insufficient.").

Unsupported, conclusory allegations of "unlawful" conduct are legally deficient even at the motion to dismiss stage.[27] Simply using the word "unlawful" as the Committee does in its Request to describe PacifiCorp's conduct does not make it so. Rather, the Committee's Request includes absolutely no allegations of "utility misconduct" as that exception has been interpreted and applied by Utah courts.

With respect to the period prior to September 10, 2001,[28] the facts related to the ratemaking proceedings during the SEC PUHCA Audit period are not in dispute and the Request must fail. In all prior rate cases, the Company provided information on its tax expense consistent with long-standing Commission practice and policy. Until rates were established on September 10, 2001 in Docket No. 01-035-10, Utah rates were based on historical data that predated the ScottishPower merger. Thus, the Committee's claims, which are based on differences between purported conclusions in the SEC PUHCA Audit of ScottishPower and the stand-alone PacifiCorp tax expense included in rates, on their face do not apply to the pre-September 10, 2001 period.

With respect to the period after September 10, 2001, the only allegation of misconduct included in the Request is that PacifiCorp "wrongfully and illegally" transferred money to PHI as

[27] *Chapman*, 784 P.2d at 1186.

[28] As discussed in section IV.E.1 above, the Committee's claims related to the time period after the SEC PUHCA Audit also fail as a matter of law.

"conclusively determined" in the SEC PUHCA Audit and that PacifiCorp "knowingly and unlawfully" collected monies in Utah rates to "pay purported income tax costs in excess of any lawful income tax liability." *See* Request at ¶¶ 16, 17. The Committee then alleges that a "proper accounting of those monies during the [Audit] period by PacifiCorp and PHI would have reduced the Utility's income tax costs in Utah rates." *See id.* at ¶ 17. These allegations and any others the Committee could offer in support, even if they were accurate, which they are not, fall far short of satisfying the utility misconduct exception.

Nowhere in its SEC PUHCA Audit Findings does the SEC claim that PacifiCorp engaged in unlawful or illegal conduct as the Committee alleges. Nowhere in the SEC PUHCA Audit findings does the SEC ever make a finding that PacifiCorp (or PHI) acted illegally. In fact, at all times, PHI's actions in its SEC filings and PacifiCorp tax allocation payments were based on an understanding that an appropriate and lawful election had been made that required the action and payments, even though the SEC staff later disagreed with this understanding based on what it deemed a technical error. Regardless, the SEC found the technical error was fully remedied by capital contributions also made during the SEC PUHCA Audit period. With respect to PacifiCorp, the SEC was fully satisfied that there was no improper retention of utility funds by PHI because fully equivalent cash capital contributions had flowed to PacifiCorp during the SEC PUHCA Audit period.

The fact that the SEC regarded its findings as ministerial is fully supported by the fact that the SEC permitted PHI to correct the ministerial error and now permits PHI to retain the tax benefits stemming from acquisition-related debt service. In other words, the SEC now permits the very conduct that the Committee claims was "unlawful." There is no factual support for the

allegation that PacifiCorp acted illegally and therefore, this mere allegation cannot serve to support an exception to the rule against retroactive ratemaking.

In any event to successfully support a claim of utility misconduct, the Committee needs to allege facts that show that PacifiCorp misled the Commission or failed to disclose facts relevant to a ratemaking proceeding.[29] The Committee Request is completely deficient in this regard. Instead, in considering any allegations made or that could be made by the Committee, the Commission must consider the following: (1) PacifiCorp's rates during the SEC PUHCA Audit period were determined by the Commission to be just and reasonable; (2) this Commission has never previously adopted a ratemaking principle that SEC allocations of tax payments for purposes of PUHCA affect income tax expense included in setting Utah rates; (3) there is no allegation that the Company failed to disclose the SEC PUHCA Audit to regulators, in fact, PacifiCorp provided notice of the SEC PUHCA Audit to the Commission at its inception; (4) PacifiCorp provided notice to the DPU and the Committee of the SEC PUHCA Audit Findings just after its conclusion; (5) the Committee was aware of the SEC PUHCA Audit Findings during the last general rate case, asked discovery regarding the SEC PUHCA Audit, investigated the SEC PUHCA Audit during its on-site review, filed testimony regarding the allocation of tax payments and nonetheless stipulated that rates established in that case were lawful, just and reasonable and in the public interest without any adjustment based on the SEC PUHCA Audit Findings; and (6) the SEC PUHCA Audit Findings did not affect utility expense or earnings in any manner. Based on this background, there is no set of facts the Committee could allege that

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[29] *MCI*, 840 P2d at 775 ("A utility that 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 cannot invoke the rule against retroactive rate making to avoid refunding rates improperly collected.") (emphasis added).

PacifiCorp "subvert[ed]" the ratemaking process, intentionally mislead the Commission or failed to disclose relevant information to the Commission.

Here, the Committee failed to even **make** any particular allegations of utility misconduct related to rate setting. Its failure to do so leaves no basis for a Commission finding that utility misconduct has occurred.

F. THE COMMITTEE'S REQUEST INCORRECTLY CHARACTERIZES THE SEC'S PUHCA AUDIT FINDINGS; HOWEVER, THERE IS NO SUPPORT FOR ITS ARGUMENT THAT THERE HAS BEEN DOUBLE-RECOVERY OF EXCESS POWER COSTS SUCH THAT UTAH RATES WOULD BE UNJUST AND UNREASONABLE.

ScottishPower made a substantial $150 million contribution to PacifiCorp, which the SEC recognized as a benefit redounding to PacifiCorp ratepayers. The Committee alleges that recognition of this contribution will permit the Company to double-recover expenses associated with the excess power costs it incurred during the Western power crisis without the Commission granting its requested relief. *See* Request at ¶ 18. This assertion is simply incorrect and therefore fails to state a basis for granting the requested relief.

The run-up in energy prices associated with the Western power crisis began in the summer of 2000. However, PacifiCorp's request for relief from these extraordinary prices covered only the time period November 24, 2000 to May 8, 2001. During the entire time period of the Western energy crisis, PacifiCorp experienced total excess net power costs (*i.e.* power costs above those collected in the rates established in its six state jurisdictions) in excess of $1 billion.[30] PacifiCorp recovered approximately $330 million of that from its customers. In Utah, under the terms of a May 1, 2002 Stipulation in Docket Nos. 01-035-23, 01-035-29 and

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[30] *See* Testimony of D. Douglas Larson, Vice President of Regulation for PacifiCorp, p. 37; as reported in *Reporter's April 17, 2002, Transcript of Proceedings*, Docket Nos. 01-035-23, 01-035-29, and 01-035-36.

01-035-36, PacifiCorp was allowed to recover a portion of excess net power costs through the continuation of an existing surcharge mechanism. That recovery reflected approximately 46 to 49% of the excess power costs incurred by PacifiCorp to serve Utah customers.[31] While it is true that the Company stipulated to a recovery mechanism in Utah which resulted in less than full recovery of its prudently incurred excess power costs, it is also true that due to total unrecovered dollars associated with the energy crisis, PacifiCorp's credit rating was still impaired. ScottishPower determined that it must infuse capital into PacifiCorp in order to increase its equity capitalization and enhance its ability to meet its obligations as a public utility. This contribution was made on December 19, 2002. These funds strengthened PacifiCorp's balance sheet and were used exclusively for utility purposes. Notice of the capital infusion was provided to the Commission on February 28, 2003, in the Company's quarterly financial report filing letter.

The Committee's claim that the SEC linked the $150 million capital infusion to the Western energy crisis is fallacious. While the SEC PUHCA Audit findings mention that the capital infusion was made after the energy crisis, the timing and the motivation behind the contribution were irrelevant to the SEC. Rather, the SEC looked to the contribution as evidence that sufficient capital had been returned to the utility during the SEC PUHCA Audit period.

There are no facts that support the Committee argument that PacifiCorp is "double charging Utah ratepayers for the same costs or losses." *See* Request at ¶ 18. Rather, ratepayers have received the benefit of this capital infusion. The increased credit quality of the utility permits the Company to borrow funds at a lower interest rate which redounds directly to the benefit of ratepayers. In addition, the impact of these dollars has already been accounted for in

[31] *Id.* at 26.

setting Utah rates. The capital infusion was included in the capital structure utilized in the forecast test year included in Docket No. 04-035-42.

Ratepayers have already received the benefit of the entire $229 million. Therefore, it is improper to claim that ratepayers should receive the refund sought by the Committee. To grant the requested relief would be to permit ratepayers to recover twice for the same allocation issue.

G. In any Event, Rates in all Cases During the Request Period Were Calculated Based on the "Stand-Alone" Tax Calculation Methodology; Thus, the SEC PUHCA Audit Is Irrelevant to a Determination of Just and Reasonable Rates.

Even if the Commission were to assume all of the allegations in the Committee Request were accurate, these allegations would not form the basis for any Commission relief in this proceeding. In all of the general rate cases during the Request Period, PacifiCorp calculated its income tax expense using a stand-alone methodology, consistent with Commission order and precedent. Thus, even if the SEC PUHCA Audit Findings had impacted the consolidated tax liability or PacifiCorp's separate-company tax liability, which they did not, the SEC PUHCA Audit Findings would still be irrelevant for ratemaking purposes for calculating income tax expense.

1. The Commission Calculates Income Tax Expense Using a Stand-Alone Methodology for all Utah Utilities.

The Commission has consistently used a stand-alone methodology for determining income tax expenses to be included in utility rates. Accordingly, rates in Utah do not take into account the actual taxes paid to the United States Treasury by a holding company or parent (nor would they take into account later adjustments to the tax expense as a result of an IRS audit). This long-standing policy serves as a mechanism to protect ratepayers from fluctuations in tax

expense associated with profits or losses of affiliated companies not under the jurisdiction of the Commission.

For example, in Docket No. 84-035-02, the Commission authorized the formation of a subsidiary corporation to Utah Power & Light Company ("UP&L"), Energy National, Inc. ("ENI"), but set for hearing the question of the proper relationship between the utility and its subsidiary.[32] The utility had taken steps to ensure that ratepayers were protected from any detrimental aspects of the subsidiary's energy development efforts, by, among other things, calculating income taxes on a stand-alone basis, in spite of the use a consolidated return. The utility also noted that any losses of ENI would be borne solely by shareholders, not ratepayers. Recognizing that the subsidiary was specifically established to "take advantage of tax incentives not available to the parent as a public utility," *see* ENI Order at 2, the Commission nevertheless accepted the protections offered by the utility to protect ratepayers, including specifically the use of the stand-alone methodology for income tax expense. The Commission required that (i) investors bear the costs associated with funding the subsidiary and (ii) the utility compute taxes on a stand-alone basis. *See* ENI Order at 22. In other words, the subsidiary would pay the costs associated with generating any tax benefits, and ratepayers would not be entitled to include these tax benefits in the calculation of stand-alone taxes.

In a 1988 docket involving Qwest's predecessor, US West Communications ("USWC"), the Commission specifically rejected an adjustment to the stand-alone methodology proposed by the same Committee witness who filed testimony in PacifiCorp's most recent general rate case, Mr. Arndt. *See In re Mountain States Telephone and Telegraph Company*, Report and Order,

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[32] *See In re Application of Utah Power & Light for (1) an Order Disclaiming Jurisdiction, or (2) in the Alternative for an Order Authorizing it to Form and Finance a Wholly Owned Subsidiary*, Docket No. 84-035-02, Order (Oct. 1, 1985) ("ENI Order").

Docket No. 88-049-07 (Utah PSC Oct. 18, 1989) ("Mountain States Order"). In *Mountain States*, the hypothetical income tax obligation used for ratemaking purposes calculated on a stand-alone basis was greater than the consolidated actual income tax liability. The Committee proposed an adjustment to "reflect USWC's role in generating the benefits." Mountain States Order at 39. The Division opposed the adjustment, noting that the tax savings generated by the losses experienced by the unregulated subsidiaries would be unfairly shifted to the utility. *Id.* USWC also opposed the adjustment, reasoning that if affiliate losses created the tax savings, the savings should not be appropriated for ratepayers through the regulatory process. *Id.* The Commission rejected the Committee's proposal. *Id.* at 40.

This stand-alone principle was reviewed extensively in a report commissioned by the Commission in 1995.[33] The report affirmed the position of the Division that the stand-alone tax methodology was appropriate, noting that utility income tax expense should be based on income, tax rates, and tax credits directly related to the utility. *See* Foote Passey Report at 32-33.

Since the Foote Passey Report, the Commission has strictly adhered to a stand-alone methodology. *See, e.g., In re Questar Gas Co.*, 203 PUR4th 356 (Utah PSC 2000), overturned on other grounds in *Committee of Consumer Services v. Public Serv. Comm'n*, 75 P.3d 481 (Utah 2003). In *Questar Gas*, the Commission accepted an adjustment to remove a tax benefit allocated to the utility as a result of filing a consolidated state income tax return. The Commission stated:

> This adjustment removes an incremental tax benefit allocated to Questar Gas as a result of Questar Corporation's consolidated Utah tax return, and increases Questar Gas expense by $49,232. For

[33] *See Report on Study of Federal and State Income Tax Policies and Calculations relating to Mountain Fuel Supply Company, PacifiCorp, and US WEST Communications, Inc.*, Foote Passey, Griffin and Company, August 23, 1995 ("Foote Passey Report").

> state income tax purposes, the Utah portion of consolidated business income is computed based upon the ratio of assets, payroll and total sales in Utah to the total of the consolidated Company, including affiliates. **This adjustment prevents ratepayers from paying additional taxes arising as a result of affiliate earnings or, as is the case here, paying less in taxes as a result of affiliates' losses**.

Id. (emphasis added.) Thus, while the Committee has raised the consolidated tax issue on more than one occasion, this Commission has not adopted an income tax expense calculation methodology other than the stand-alone methodology.

These cases demonstrate that the Commission has recognized that a stand-alone methodology protects ratepayers from exposure to the vagaries of tax expenses such as "paying additional taxes arising as a result of affiliate earnings or, . . . paying less in taxes as a result of affiliates' losses." *Id.* This recognition has its foundation in the long-standing principle adhered to by this and other state commissions, cost-causation.

In addition to adhering to cost-causation principles, the stand-alone methodology protects customers from tax expense fluctuations and intergenerational subsidies. For example, in previous rate cases, PacifiCorp has sought recovery of audit payments made to the IRS dealing with audits of prior tax years.[34] In response, other parties have argued that because taxes are calculated on a stand-alone basis, actual payments to the IRS and later audit payments are irrelevant. The Commission likewise has previously rejected any such recovery for audit payments. *See In re PacifiCorp*, Docket No. 97-035-01, Report and Order (March 4, 1999).

PacifiCorp has always adhered to the stand-alone methodology for Utah ratemaking. All of the general rate case proceedings filed during the SEC PUHCA Audit period used stand-alone

[34] PacifiCorp proposed recovery of these IRS audit payments in Docket Nos. 97-035-01 and 03-2035-02.

tax calculations to compute the income tax expense to be included in utility rates. No adjustment to that calculation was adopted by the Commission during the SEC PUHCA Audit period. Accordingly, all rates at issue during the SEC PUHCA Audit period reflected the Commission-approved, long-standing stand-alone methodology.

2. The SEC PUHCA Audit Findings Are Irrelevant to Either the Stand-Alone Methodology or Even to an Actual Taxes Paid Approach.

The SEC ordered that PHI contribute tax payments achieved from its acquisition-related debt service to its subsidiaries, including PacifiCorp. However, the availability to PacifiCorp of tax allocations of PHI has absolutely no effect on PacifiCorp's stand-alone income tax calculation. Whatever contributions PacifiCorp might receive from PHI, its stand-alone income tax liability remains the same. This approach has been utilized by this Commission and recognized under federal law.

If, as the Commission has determined, payments resulting from IRS audits are not relevant to the ratemaking process neither are SEC PUHCA Audit Findings. In fact, the case for recognizing the SEC PUHCA Audit Findings in the ratemaking process is much weaker than that of the IRS audit payments. Whereas, IRS audits may result in actual changes to the utility's separately-calculated tax expense, SEC tax allocation determinations do not affect the utility's separate tax expense in any manner.

In addition, SEC PUHCA Audit Findings or other internal tax allocation issues have never been used or even considered by the Commission as part of its stand-alone methodology. Therefore, just as in the case of the IRS audit payments, the SEC PUHCA Audit Findings are irrelevant to stand-alone tax calculations. Also, as noted in the factual background above, the SEC PUHCA Audit findings had absolutely no impact on actual utility tax expense. Accordingly, even if the Commission had not used a stand-alone tax calculation methodology in

all of the rate proceedings during the Audit period, and thus arguably an actual change in the consolidated tax liability could be relevant, in fact, actual PacifiCorp tax liability did not change as a result of the SEC Findings.

The issue of whether internal tax allocations should have any bearing on stand-alone tax calculations has already been expressly rejected by both the Federal Energy Regulatory Commission ("FERC") and the U.S. Court of Appeals for the D.C. Circuit. In the seminal FERC order adopting the stand-alone methodology, Columbia Gas, Inc. ("Columbia Gas"), a registered holding company, filed a consolidated federal income tax return on behalf of itself and its subsidiaries. The subsidiaries included two interstate natural gas pipelines subject to the jurisdiction of the FERC. Columbia Gas allocated among affiliates pursuant to a tax allocation agreement subject to the SEC's jurisdiction.

An intervenor and customer, the City of Charlottesville, argued that the Columbia Gas tax allocation agreement "funnel[ed] money" away from the utility to affiliate companies.[35] In response, FERC held that under a stand-alone methodology, the internal allocations were entirely irrelevant. *Id.* at ¶¶ 61,861-62, n. 75 ("Equally immaterial to us is what the pipelines forward to their parent pursuant to the SEC's allocation rules and orders. That would occur no matter how we treated the consolidated tax liability for ratemaking purposes.") Charlottesville petitioned the D.C. Court of Appeals for review of FERC's decision to use a "stand-alone" methodology to determine tax expense.[36]

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[35] *See Columbia Gulf Transmission Company*, Opinion No. 173; Opinion and Order Establishing Proper Cost of Service Treatment of Tax Liability Arising from the Filing of a Consolidated Tax Return, Docket No. RP75-105-002, 23 FERC ¶ 61,396, ¶ 61,861 (June 22, 1983) ("FERC Opinion No. 173").

[36] Charlottesville contended that: (1) the FERC must require the pipelines to share with their ratepayers the tax savings resulting from the use of tax losses of the system's gas supply subsidiaries as set forth in the parent company's consolidated return; and (2) that the FERC's benefits/burdens methodology for allocating tax deductions failed to accord to ratepayers a proportionate share of the tax

The Court denied the petition, finding that the stand-alone methodology employed by FERC, as well as its benefits/burdens approach, were reasonable and lawful.[37] The Court also confirmed the irrelevance of the SEC allocations to stand-alone tax calculation. Specifically, then-Judge Scalia writing for the court stated as follows:

> The Commission made essentially the same response to Charlottesville's contention that the Columbia System's practice of "funneling" money from the pipelines to the gas supply affiliates burdens the ratepayers. This funneling results from the procedures the System uses to allocate internally its consolidated tax payments. The parent collects money from its subsidiaries to discharge the System's consolidated tax liability. During the relevant time period, however, rather than collecting a portion based on the ratio of each subsidiary" taxable income to the consolidated tax liability, the System, pursuant to an exemption from S.E.C. Rule 45(b)(6), 17 C.F.R. § 250.45(b)(6), excluded from the consolidated tax liability the savings (deductions) attributable to the gas supply development activities. **The other subsidiaries thus paid to the parent more than was needed to discharge the current year's tax liability, and the excess was "funneled" to the exploration and development companies, allowing them to convert their tax-deferring credits into immediate cash for use in the exploration and development efforts.** In future years, when the gas supply subsidiaries finally become profitable, they will be allocated additional portions of the consolidated tax liability to offset this early-period funneling effect. **As far as the pipelines' ratepayers are concerned, however, this "funneling" is somebody else's business. As the existence of this litigation testifies, what the ratepayers contribute to the consolidated tax liability is determined not by the amount of the parent's allocation, but by the amount that the Commission allows as an operating expense.** To the extent that the former exceeds the latter, it comes out of the pockets of the shareholders of the pipelines (*i.e.,* the parent itself). **We agree with the Commission that, since the internal allocation in no**

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savings resulting from the parent company's interest expense deduction from consolidated income. *See City of Charlottesville v. Federal Energy Reg. Comm'n*, 774 F.2d 1205-06 (D.C. Cir. 1984).

[37] *Id.*

> **way affects rates, there is, under the Commission's test, no burden entitling ratepayers to corresponding tax benefits.**[38]

Just as in the *City of Charlottesville* case, rates set during the SEC PUHCA Audit period in no way related to internal allocations. Accordingly, SEC allocation issues are irrelevant to whether the stand-alone tax calculations were otherwise lawful.

H. THE COMMITTEE'S REQUEST IS AN UNLAWFUL REPUDIATION OF ITS PAST AGREEMENTS, AND IS BARRED BY MULTIPLE PRINCIPLES OF LAW.

The Request seeks refunds for rates paid since the merger of PacifiCorp with ScottishPower, which was approved by the Commission on November 23, 1999. All rates in effect for PacifiCorp since the merger that are based on test years that actually include ScottishPower costs have been set through Commission approval of stipulations.[39] The Committee has been a party to each of those stipulations.

In Docket No. 01-035-01, the Committee stipulated that the stipulation was "just, reasonable and in the public interest", and only reserved the right to withdraw from the stipulation in the event the stipulation was not approved in its entirety.[40] In Docket No. 03-2035-02, the Committee again stipulated that the stipulation was "in the public interest and that all of its terms and conditions are fair, just and reasonable," recommended "that the Commission adopt [the] Stipulation in its entirety," and only reserved the right to withdraw from the stipulation in the event the stipulation was rejected or conditioned in whole or in part by the Commission or an

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[38] *City of Charlottesville*, 774 F.2d at 1218 (citing 23 FERC at ¶¶ 61,861-62) (emphasis added).

[39] Docket 01-035-01 was resolved by Stipulation of all revenue requirement issues with the exception of certain net power cost issues not relevant to utility income tax expense in any manner.

[40] *See* Revenue Requirement Stipulation, Docket No. 01-035-01 (July 12, 2001) ("2001 Stipulation") at page 1, ¶3.

appellate court.[41] Finally, in the Company's most recent rate case, Docket No. 04-035-42, the Committee again agreed that the stipulation was "in the public interest and that all of its terms and conditions, considered together as a whole, will produce fair, just and reasonable results," that it "agreed to the revenue requirement . . . ," and that it only reserved the right to withdraw from the stipulation in the event the stipulation was rejected or conditioned in whole or in part by the Commission or an appellate court.[42]

In Docket No. 01-035-01, the stipulated revenue requirement was $40.6 million, $100.5 million less than the amount originally requested in PacifiCorp's application.[43] In Docket No. 03-2035-02, the stipulated revenue requirement was $65 million, $60 million less than PacifiCorp originally requested.[44] In Docket No. 04-035-42, the stipulated revenue requirement was $51 million, again $60 million less than PacifiCorp originally requested.[45]

Cumulatively, by agreeing with the Committee and other parties to a stipulated revenue requirement over the course of these three dockets, PacifiCorp gave-up the right to argue for an additional $220 million, approximately 57 percent of the cumulative amount it sought in these three proceedings. In return, the Committee bound itself to the stipulated revenue requirements and reserved the right to withdraw from the agreements only under a narrowly circumscribed set

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[41] *See* Revenue Requirement Stipulation, Docket No. 03-2035-02 (Jan. 30, 2004) ("2004 Stipulation") at ¶¶ 20-22.

[42] *See* Stipulation Regarding Revenue Requirement, Rate Spread and Rate Design, Docket No. 04-035-42 (Feb. 14, 2005) ("2005 Stipulation") at ¶¶ 7, 21-22.

[43] *See In re PacifiCorp Application for an Increase in its Rates and Charges*, Report and Order, Docket No. 01-035-01 (Utah PSC Sept. 10, 2001).

[44] *See In re Application of PacifiCorp for Approval of its Proposed Electric Service Schedules and Electric Service Regulations*, Report and Order, Docket No. 03-2035-02 (Utah PSC Jan. 30, 2004).

[45] *See In re Application of PacifiCorp for Approval of its Proposed Electric Service Schedules and Electric Service Regulations*, Report and Order, Docket No. 04-035-42 (Utah PSC Feb. 25, 2005).

of circumstances not present here. The Commission accepted each of the stipulations in total, and their terms were neither altered nor rejected by an appellate court.

Yet the Committee, despite binding itself to the stipulated revenue requirement amounts, now seeks to renege on its agreement and collaterally attack PacifiCorp's rates that were approved in final, un-appealed Commission orders that the Committee itself urged the Commission to approve.[46] PacifiCorp gave up the right to argue for substantial amounts of money (and other valuable consideration) in return for the certainty of settlement. The Committee, already having received the benefit of its bargain through $220 million in foregone rates, should not be allowed to withdraw (on grounds not set forth in the stipulations) from the negotiated agreements and cause PacifiCorp to lose its benefit from the same bargain.

Multiple principles of law forbid the Committee's failure to adhere to its agreements—among them, Commission rule, estoppel, release, res judicata, and laches. "A stipulation of fact filed with and accepted by a court 'acts as an estoppel upon the parties thereto and is conclusive of all matters necessarily included in the stipulation.'"[47] This rule applies to Commission proceedings, with the exception that the Commission must not accept a stipulation that is contrary to its statutory mandate.[48] In the rate cases relevant to this matter, as it was required to do, the Commission fulfilled its statutory mandate to consider the public interest before it accepted the stipulations. The Committee stipulated to a **final** settlement of PacifiCorp's rates, and agreed that such rates were just and reasonable. Such stipulations "are binding on the

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[46] *See, e.g.*, 2005 Stipulation at ¶ 7; 2004 Stipulation at ¶ 20.

[47] *Yeargin, Inc. v. Auditing Div. of Utah State Tax Comm'n*, 2001 UT 11, ¶ 20, 20 P.3d 287, 293 (quoting *Deseret Sav. Bank v. Walker*, 2 P.2d 609 (1931)); *see also, e.g., Johnson v. Peoples Finance & Thrift Co.*, 272 P.2d 171, 172 (Utah 1954) ("It would indeed be a serious reflection upon our system of jurisprudence if parties could stipulate an agreement of settlement but refuse with impunity from performing.").

[48] *See Bradshaw v. Wilkinson Water Co.*, 2004 UT 38, ¶ 33, 94 P.3d 242, 248-49.

participants with respect to any matter stipulated."[49] Thus, the Committee is barred from collateral attack on the very rates it has previously stipulated as being appropriate.[50]

The Committee asserts that this case is exceptional, in that the SEC's action regarding the income tax allocation among the Company's affiliates did not occur until after the various rate case settlements were concluded. The Commission should reject this specious distinction.

The SEC PUHCA Audit had no impact on expenses and would have no impact on utility rates. The Committee cannot, therefore, credibly argue that the existence of the SEC PUHCA Audit would impact utility ratemaking or settlement. Moreover, this argument ignores the fact that settlements are, by their very nature, compromises whereby parties give-up the possibility of results they would consider ideal in exchange for the certainty of acceptable results. In *Beaver County*, the Commission was presented with the analogous claim that after-the-fact reductions in

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[49] *See* Utah Admin. Code R746-100-10.F.4 ("Stipulations may be received in evidence, and if received, are binding on the participants with respect to any matter stipulated.").

[50] *See, e.g., Myers v. Olson*, 100 N.M. 745, 748, 676 P.2d 822, 825 (1984) ("Properly authorized and acknowledged consent judgments and judgments rendered on stipulations are conclusive of all claims determined therein and may not be collaterally attacked by the parties thereto."); *Nottingham Partners v. Trans-Lux Corp.*, 925 F.2d 29, 32 (1st Cir. 1991) ("It is beyond cavil that a suit can be barred by the earlier settlement of another suit in either of two ways: res judicata or release."); *Kellner v. Kellner*, 844 A.2d 743, 746 (Vt. 2004) ("[Res judicata's] purpose is to deliver finality and repose—the very things that plaintiff thought she was securing when she stipulated to the late fee provision in exchange for her agreement to drop the contempt and judgment motion. Res judicata required defendant to bring forth all of his objections to the order before it became final, and if necessary, to renew them immediately on direct appeal."); *Cerbone v. Cerbone*, 428 N.Y.S.2d 777, 780 (N.Y. Civ. 1979) ("Having received substantial benefit from the stipulation of settlement, respondent . . . should be estopped from questioning its result, or his own acts; from claiming the benefits of a part of the agreement and repudiating the rest; from misleading the other parties; and, from retracting the stipulation of settlement and taking advantage of the forbearance of his adversaries thereby induced.") (citing *Matter of Collins*, 34 N.Y.S.2d 993; *Matter of New York, L. & W.RR. Co.*, 98 N.Y. 447, 454; *People v. Stephens*, 52 N.Y. 306, 310; *N.Y.C. Housing v. Gantt*, 292 N.Y.S.2d 759; *Werner v. Cawley*, 61 A.D.2d 758; *Mutual Life Ins. Co. v. O'Donnell*, 146 N.Y. 275, 280); *Plateau Min. Co. v. Utah Div. of State Lands and Forestry*, 802 P.2d 720, 731 (Utah 1990) ("Laches bars a recovery when there has been a delay by one party causing a disadvantage to the other party. *Papanikolas Bros. Enters. v. Sugarhouse Shopping Center Assocs.,* 535 P.2d 1256, 1260 (Utah 1975). Laches has two elements: (1) lack of diligence on the part of the claimant and (2) an injury to the defendant because of the lack of diligence. *Id.* at 1260.").

property tax expense rendered a prior settlement inefficacious. The Commission found that when the utility's customers have received the benefit of a settlement, "[t]he Commission cannot in fairness . . . deprive [the utility] of the benefit of the bargain it struck in entering into that settlement."[51] Moreover, as the Commission also noted in the same *Beaver County* case, in citing its previous order from PacifiCorp's 1997 rate case, attempts to address later changes in tax expense are problematic because:

> a post-test-year adjustment presents a special and serious case of matching and information insufficiency. It is a single-item adjustment, proposed because it is "known and measurable." Since, by definition, it is outside the test year, it cannot be analyzed in a test-year context of matched revenues, expenses, and investments. Hence, it is akin to a single-item rate case. All the arguments against conducting single-item rate cases argue against consideration of post-test-year adjustments. The fact is, events do not occur in isolation. The utility is a complex web of economic relationships, each of which changes as the result of external and internal forces and events. This is the proper context for considering any proposed adjustment.[52]

The simple fact is that the SEC PUHCA Audit does not change utility tax expense. Moreover, it would be unfair to allow the Committee to receive the benefits of settlement while depriving PacifiCorp of those benefits, it would be unfair to retroactively single-out the SEC's ruling on income tax allocation without addressing any possible offsetting increases in expenses that occurred after the test year. Such after-the-fact truing up of rates is, as argued above, precisely the type of activity forbidden by the rule against retroactive ratemaking.

Further, the Committee's argument that its prior settlements are not determinative due to the later SEC order is faulty for another reason—it is factually untrue. The SEC issued its Audit

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[51] *See Beaver County* at 54 (citing MCI settlement).

[52] *See id.* at 57-58 (quoting *Re PacifiCorp*, Docket No. 97-035-01, 1999 WL 218118 (Utah P.S.C. Mar. 4, 1999)).

Findings prior to the last general rate case. PacifiCorp made the parties to the 2004 rate case thoroughly aware of the issue in the course of the proceedings in that docket, months in advance of the entry of the 2005 Stipulation on February 14, 2005. Notwithstanding this, the Committee entered the 2005 Stipulation and agreed that it provided "fair, just and reasonable results."[53] By so doing, the Committee waived any argument it might have had that the Company's revenue requirement should be decreased in light of the SEC's Findings.[54]

There are thus multiple legal grounds for rejecting the Committee's request for a refund. The unfairness of the Committee's attempt to renege on its prior agreements, however, is apparent on its face even without the abundant legal citations provided above. The Commission should enforce the stipulations that the Committee has previously entered, and reject the Committee's Request.

I. THERE IS NO VIOLATION OF ANY CONDITIONS OF THE MERGER ORDER.

Lacking any factual connection between the SEC PUHCA Audit and the rates collected from customers for fiscal year 2005 (April 1, 2004 to March 31, 2005), the Committee instead simply recycles an argument it made in the now-settled 2004 general rate case that a refund for this time period is also warranted. Specifically, the Committee asserts that for Fiscal Year 2005, PacifiCorp's ratepayers provided funds to PHI to subsidize the ScottishPower acquisition costs

[53] *See* 2005 Stipulation at ¶ 22.

[54] *See, e.g., 438 Main Street v. Easy Heat*, 2004 UT 72,¶ 51, 99 P.3d 801 ("Issues that are not raised at trial are usually deemed waived.") (citation omitted); *State v. Brown*, 2002 UT 37, ¶ 10, 46 P.3d 230, 233 ("[D]efendants are thus not entitled to both the benefit of not objecting at trial and the benefit of objecting on appeal ."); *Office of Consumer Advocate v. City of Lancaster Sewer Fund*, R00049862 and R00049862C0001, 2005 WL 2203829 (Pa. P.U.C. Aug. 26, 2005) ("It is well settled that when the parties . . . fail to include all the issues they wish to have reviewed, the unbriefed issues may properly be viewed as having been waived.") (citation omitted).

and, therefore, PacifiCorp has violated the merger order requirement that the acquisition premium not be recovered in rates.[55] This argument is specious and must be rejected.

First, the Committee misleadingly points to the order in the Company's recently-concluded Oregon rate case as support for its assertion that ratepayers are paying the acquisition costs in violation of the merger order. *See* Request at ¶¶ 9, 21. In fact, the Oregon Commission order had nothing to do with the SEC PUHCA Audit or past rate collections. It was a forward-looking order only, a fact that the Committee concedes (albeit only in the middle of a long footnote to its argument). *See* Request at n. 7. Nor did the Oregon Commission conclude or find that its adjustment was connected to ratepayers paying for the acquisition premium. Instead, the Oregon Commission found that newly-passed Oregon legislation (SB 408) required that the commission "reflect the taxes paid to units of government" in determining "fair, just and reasonable" rates for PacifiCorp. *See* Oregon Commission Order No. 05-1050 at 17-18.

Second, the Committee's argument is based on a flawed premise of ratemaking. The Committee argues that because rates collected from ratepayers are used by the parent company to pay for parent company expenses, then the parent company expenses are necessarily paid for by ratepayers. This argument confuses the amounts recovered from customers in rates with the expense paid by shareholders and must be rejected.

While the Commission clearly has jurisdiction to determine whether a utility expense will be recoverable from customers in rates, the utility of course retains the managerial discretion to incur, at shareholder expense, below-the-line expenses. For example, this Commission has previously determined that PacifiCorp will not be allowed to recover charitable contributions

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[55] The Committee also asserts that this same allegation "probably" applies "with respect to earlier fiscal tax years as well." *See* Request at ¶ 21. As stated above, the Commission need not give any credit to such a conclusory allegation.

from its customers. However, PacifiCorp, as a good corporate citizen, regularly makes, at shareholder expense, charitable contributions and takes, for shareholders, the tax benefits associated with those contributions. Under the Committee argument, the fact that the Company makes charitable contributions and reduces its tax liability as a result would constitute a violation of the Commission's prohibition against recovery of charitable contributions, an obviously inaccurate conclusion.

Moreover, under similar factual circumstances, the FERC rejected this argument in the *Charlottesville* case in which it first adopted the stand-alone methodology. Intervenors there argued that they were bearing the burden of the costs associated with the efforts to generate tax savings by virtue of the fact that ratepayers supplied the funds that the parent company could use in the subsidiaries that created the tax benefit. FERC rejected this argument stating:

> [I]t is argued that the ratepayers are burdened because the pipelines' internally generated funds are used to finance the systems gas supply efforts. Internally generated funds consist of net income (or profits), depreciation, and deferred income taxes. **Since a pipeline would not have these funds but for the revenue provided by the ratepayers**, the ratepayers can be said to be bearing a burden here. But this is not a burden imposed by the systems gas development activities. Pipelines are not eleemosynary institutions. **Their shareholders are entitled to a return on, and a return of, their capital.** Pipelines are also entitled to the use of the money ratepayers have paid for taxes that have not yet been paid to the government. The ratepayers have paid no more in rates because of the gas supply efforts. Moreover, **what the pipelines' shareholders do with this cash is largely their own business. They may reinvest it in the pipelines or they may invest it in other business ventures**.[56]

This holding was upheld by the U.S. Court of Appeals for the D.C. Circuit.[57]

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[56] FERC Order No. 173, 23 FERC at ¶ 61,861 (emphasis added).

[57] *Charlottesville*, 774 F.2d at 1218.

Finally, just as it did in the testimony of Mr. Arndt in Docket No. 04-035-42, the Committee ignores the reality of how tax deductions are created. As Mr. Martin testified, tax expense is a result of a math equation. Tax expense or benefit is always a percentage of some other operational income or expense item. For a dollar of revenue, 35 cents of tax is incurred. For a dollar of eligible benefit, 35 cents of tax benefit is earned. The tax cannot be separated from its underlying source or cause. With respect to the acquisition indebtedness, shareholders have the obligation to make the debt and interest payments, which in turn creates a tax benefit. The Committee ignores these facts and the fact that the acquisition premium is not on PacifiCorp's books. Ratepayers have never been responsible for paying a return on the acquisition premium or the debt or interest payments associated with the premium. Instead, ratepayers pay rates which include recovery for tax expense commensurate with the cost of providing utility service. The Committee's allegations cannot support a Commission finding that the merger order has been violated in any way.

V. ANSWER

With respect to the specific allegations of the Request, PacifiCorp admits, denies and alleges as follows:

1. Paragraph 1 sets forth requests for relief for which no response is required. To the extent paragraph 1 requires a response, PacifiCorp incorporates by reference its responses to Paragraphs 3-28 as if fully set forth herein.

2. Paragraph 2 sets forth requests for relief for which no response is required. To the extent paragraph 2 requires a response, PacifiCorp incorporates by reference its responses to Paragraphs 3-28 as if fully set forth herein.

3. Paragraph 3 sets forth legal conclusions to which no response is required. To the extent that Paragraph 3 can be construed as stating factual allegations, PacifiCorp admits these allegations.

4. PacifiCorp admits that it is an Oregon corporation, that it does business in the state of Utah and that it is subject to the regulatory authority of the Commission as set forth in the Commission's statutory charge. PacifiCorp admits that it is a wholly-owned subsidiary of PHI, a Delaware corporation, which is an indirect, wholly-owned subsidiary of ScottishPower, an energy-supply company incorporated and headquartered in Scotland. With regard to the allegation that PHI is a second-tier holding company, PacifiCorp admits that immediately subsequent to the merger with ScottishPower, NA General Partnership ("NAGP") was the indirect, holding company parent of PacifiCorp. PacifiCorp alleges that NAGP and PHI merged, effective December 1, 2003, and PHI was the surviving entity. To the extent any factual allegation of Paragraph 4 is not specifically admitted in this Paragraph, PacifiCorp denies the same.

5. PacifiCorp admits that PHI and its subsidiaries in the United States are a holding company system as that term is defined in PUHCA, and as such that PHI and its subsidiaries were regulated by the SEC under PUHCA and the rules promulgated by the SEC thereunder.

6. PacifiCorp admits that ScottishPower's USA holdings were subject to an SEC PUHCA Audit in 2003-2004. Otherwise, PacifiCorp denies the allegations, express or implied, of Paragraph 6.

7. PacifiCorp admits that a consolidated federal income tax return nets affiliate group members' losses against affiliate group members' gains, and can lower the current year tax liability of the consolidated group and that PHI Group subsidiaries pay PHI their tax liability as

if they were separate taxpayers under the terms of the PHI tax allocation agreement. Otherwise, PacifiCorp denies the allegations, express or implied, of Paragraph 7.

8. PacifiCorp denies the allegations of Paragraph 8. PacifiCorp refers to the SEC PUHCA Audit Findings for their terms and conditions.

9. PacifiCorp admits that Paragraph 9 correctly quotes a portion of the September 28, 2005 order ("Order No. 05-1050") of the Public Utility Commission of Oregon ("Oregon Commission"). PacifiCorp denies that the reference to the annual interest expense is included in the Oregon Commission's findings. PacifiCorp otherwise refers to Order No. 05-1050 for its terms and conditions.

10. PacifiCorp denies that the SEC found any conduct of PHI "illegal" in its Audit Findings. PacifiCorp admits that Paragraph 10 correctly quotes a portion of the SEC PUHCA Audit Findings. To the extent the Committee's characterization of the SEC PUHCA Audit Findings related to the quoted language differs from the actual terms and conditions set forth in the SEC PUHCA Audit Findings, PacifiCorp denies these allegations. PacifiCorp otherwise refers to the SEC PUHCA Audit Findings for their terms and conditions.

11. PacifiCorp admits that the first footnote to Paragraph 11 correctly quotes a portion of the SEC PUHCA Audit Findings. PacifiCorp otherwise refers to the SEC PUHCA Audit Findings for their terms and conditions. To the extent the Committee's characterization of the SEC PUHCA Audit Findings related to the quoted language differs from the actual terms and conditions set forth in the SEC PUHCA Audit Findings, PacifiCorp denies these allegations contained in Paragraph 11. To the extent that Paragraph 11 implies that PHI "wrongful[ly]" "misappropriated" money, PacifiCorp denies these allegations. With respect to the allegations regarding what the SEC PUHCA Audit Findings did not say, PacifiCorp states that the SEC

PUHCA Audit Findings speak for themselves and no response is required. To the extent that these statements not included in the SEC PUHCA Audit Findings can be construed as stating factual allegations, PacifiCorp denies these allegations. PacifiCorp admits that its rates were adjusted based on the factors mentioned in the third footnote of Paragraph 11. Otherwise, PacifiCorp denies the allegations, express or implied of Paragraph 11.

12. To the extent that Paragraph 12 implies that PHI "wrongful[ly] appropriate[ed]" money, PacifiCorp denies these allegations. PacifiCorp admits that the SEC PUHCA Audit Findings required PHI to demonstrate that tax allocations were properly paid during fiscal tax year 2004. Otherwise, PacifiCorp denies the allegations, express or implied of Paragraph 12.

13. PacifiCorp admits that during the SEC PUHCA Audit, PHI sought and was granted an exemption, which would permit the holding company to retain the cash tax payments associated with acquisition-related indebtedness. PacifiCorp admits that the second footnote to Paragraph 13 correctly quotes a portion of the SEC PUHCA Audit Findings. PacifiCorp otherwise refers to the SEC PUHCA Audit Findings for their terms and conditions. To the extent the Committee's characterization of the SEC PUHCA Audit Findings related to the quoted language differs from the actual terms and conditions set forth in the SEC PUHCA Audit Findings, PacifiCorp denies these allegations contained in Paragraph 13. Otherwise, PacifiCorp denies the allegations, express or implied of Paragraph 13.

14. PacifiCorp admits that Paragraph 14 correctly quotes a portion of the SEC PUHCA Audit Findings. PacifiCorp otherwise refers to the SEC PUHCA Audit Findings for their terms and conditions. To the extent the Committee's characterization of the SEC PUHCA Audit Findings related to the quoted language differs from the actual terms and conditions set forth in the SEC PUHCA Audit Findings, PacifiCorp denies these allegations contained in

Paragraph 14. To the extent that the remainder of Paragraph 14 implies that the ScottishPower request was outside the normal course of exemptions granted by the SEC, PacifiCorp denies those allegations.

15. PacifiCorp admits that a new PHI tax allocation agreement, dated April 1, 2004, was approved by the SEC. PacifiCorp otherwise refers to the SEC PUHCA Audit Findings for terms and conditions of their findings related to the new tax allocation agreement. To the extent that the remainder of Paragraph 15 implies that tax allocations related to the SEC PUHCA Audit period required any refund related to acquisition indebtedness with respect to PacifiCorp, PacifiCorp denies those allegations. Otherwise, PacifiCorp denies the allegations, express or implied of Paragraph 15.

16. PacifiCorp denies the allegations of Paragraph 16.

17. PacifiCorp denies the allegations of Paragraph 17.

18. PacifiCorp denies the allegations of Paragraph 18.

19. The first sentence of Paragraph 19 summarizes and restates the allegations of Paragraph 12. PacifiCorp, therefore incorporates by reference its response to Paragraph 12 as if fully set forth herein. PacifiCorp otherwise denies the allegations, express or implied, of Paragraph 19.

20. PacifiCorp denies the allegations of Paragraph 20.

21. PacifiCorp denies the allegations of Paragraph 21.

22. PacifiCorp admits that Paragraph 22 correctly quotes a portion of the Commission's Report and Order in Docket No. 98-2035-04 issued on November 23, 1999 ("Report and Order"). PacifiCorp otherwise refers to the Report and Order for its terms and conditions. To the extent the Committee's characterization of the Report and Order related to the

quoted language differs from the actual terms and conditions set forth in the Report and Order, PacifiCorp denies these allegations contained in Paragraph 22. Otherwise, PacifiCorp denies the allegations, express or implied of Paragraph 22.

23. Paragraph 23 refers to the language from the Commission's Report and Order quoted in Paragraph 22. To the extent the Committee's characterization of the Report and Order related to the quoted language differs from the actual terms and conditions set forth in the Report and Order, PacifiCorp denies these allegations contained in Paragraph 23. To the extent that the remainder of Paragraph 23 implies that the PacifiCorp's rates violate the terms and conditions of the Report and Order, PacifiCorp denies those allegations. PacifiCorp denies the remaining allegations of Paragraph 23.

24. PacifiCorp denies the allegations of Paragraph 24.

25. PacifiCorp denies the allegations of Paragraph 25.

26. PacifiCorp denies the allegations of Paragraph 26.

27. Paragraph 27 sets forth a request for relief for which no response is required. To the extent paragraph 27 requires a response, PacifiCorp incorporates by reference its responses to Paragraphs 1-28 as if fully set forth herein.

28. To the extent any allegation in the Request has not been specifically admitted above, it is denied.

VI. DEFENSES

A. FIRST DEFENSE

Petitioners have failed to state a claim upon which relief can be granted.

B. SECOND DEFENSE

The Committee's requests for refund or request to establish a regulatory liability account or other mechanism are barred by the statute of limitations, the reparations statute, the bar on retroactive ratemaking, Commission rule, estoppel, waiver, release, accord and satisfaction, res judicata, and laches.

C. THIRD DEFENSE

PacifiCorp reserves the right to assert any additional affirmative or special defense that may become known through discovery or further proceedings in this matter or as may be otherwise appropriate.

VII. RELIEF REQUESTED

Based upon the foregoing answer and defenses, PacifiCorp requests that the Commission issue an order dismissing the Request with prejudice.

RESPECTFULLY SUBMITTED: November 4, 2005.

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Edward A. Hunter
Jennifer H. Martin

Attorneys for PacifiCorp dba Utah Power

CERTIFICATE OF SERVICE

This is to certify that a true and correct copy of the foregoing **PACIFICORP'S MOTION TO DISMISS AND ANSWER** was sent by electronic mail and mailed by U.S. Mail, postage prepaid, to the foregoing on November 4, 2005:

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