CITY OF

PORTLAND, OREGON

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TO: Public Utility Commission

FROM: Portland City Commissioner Randy Leonard

RE: Portland General Electric

The City of Portland is initiating a process to resolve fundamental questions about PGE's rate setting, tax collection, tax payment, and accounting practices. The answers to those questions may lead to the City of Portland exercising its authority to set rates for PGE customers residing within the City limits of Portland.

The following list outlines key areas of interest to the City of Portland that we believe should be resolved completely in any rate setting process for a public utility:

1. ***PGE is a profitable entity whose tax liability has been engulfed by the massive losses of its parent company Enron. However, there are multiple provisions of state law which enable the State to retain those dollars paid by ratepayers for State taxes in Oregon, instead of having them paid to Enron:***

   The Department of Revenue is authorized by ORS 314.280 (OAR 150-314-280(M)) to require the segregated method of reporting for a public utility. This is the alternative to the consolidated method of reporting, which is the current practice of PGE and Enron and allows PGE and Enron to combine their income for tax reporting purposes. The consolidated method in this case has reduced or eliminated any tax debt to Oregon for PGE because of substantial losses reported by Enron. Under the status quo, any PGE tax debts are paid to Enron as cash and not to State government.

   Additionally, ORS 314.670 states that where the reporting requirement utilized does not fairly represent the extent of the taxpayer's business in the State, the Department of Revenue may require separate accounting, which would dramatically increase PGE's tax liability in the State of Oregon, since nearly all its income is derived within the State.

   Finally, even though PGE and Enron have been allowed to use the consolidated method of reporting, their application of this provision under State Law is incorrect. ORS 317.710 states in section 5(a) that if two or more affiliated Corporations (in this case PGE, Enron, and all of Enron's 346 subsidiaries) are filing a joint return for Federal tax purposes, that they shall only file a joint State

return with those entities who are unitary in nature (in other words affiliated entities who engage in similar business). In the case of PGE and Enron, this provision would not have allowed the summary consolidation of Enron's filing with PGE, but rather consolidated filing with only like companies under Enron. Available information suggests that complying with this statute would result in PGE consolidating their filing with only a small number of Enron affiliates, and it would almost certainly result in income tax due to the State.

The need for Senate Bill 408 would not be necessary were the State enforcing these provisions.

In light of these features of State Law, why wasn't the Oregon Public Utility Commission proactive in making sure the taxes provided for in rates for the State of Oregon were paid to the State of Oregon?

2. ***Why would PGE be permitted to include the cost of income tax liability in rates if there is no actual or potential income tax liability to be paid by PGE?***

Federal Energy Regulatory Commission Policy permits an income tax allowance in rates for all entities owning utility assets **ONLY** if the entity has an actual or potential income tax liability to be paid. When Enron declared bankruptcy in 2002, the possibility of a potential tax liability for PGE was effectively eliminated and the PUC had basis for reducing rates by the amount of tax expense collected in rates.

3. ***What is the explanation for PGE retroactively more than doubling its assignment of wholesale revenue to Multnomah County in 2001?***

Emails between PGE employees in 2001 demonstrate an initiative by PGE to ascribe additional wholesale revenues to Multnomah County for the purpose of elevating their Multnomah County Business Income Tax (MCBIT) liability, even though trading energy through Multnomah County is virtually unheard of. Since it is clear from the emails that PGE did not consider the MCBIT a liability, but rather an opportunity to increase their cash disbursements to Enron, the question of whether or not it is appropriate to ascribe the revenue to Multnomah County is secondary to the apparent motivation behind this change in approach.

4. ***Did PGE violate its fiduciary duty to the ratepayers and Multnomah County by disbursing monies collected for Multnomah County Business Income Tax (MCBIT) to Enron?***

It is clear that PGE collects money for the purpose of paying the Multnomah County Business Income Tax because it is explicit as an adder on ratepayer bills. What is also clear is that PGE has paid almost no Multnomah County Business Income Tax over the past several years. This is important because by placing the

adder outlining to the ratepayer exactly what amount of their payment is going to Multnomah County for taxes, PGE accepts the role as fiduciary of those monies, and should correspondingly act in scrupulous good faith and candor. If PGE has inappropriately disbursed these monies for any purpose other than tax payments to Multnomah County, they are in violation of their fiduciary duty to the ratepayers and the County.

5. ***In addition to not paying the Multnomah County Business Income Tax, has PGE been double charging the ratepayers for this tax, once in rates and again in the bill adder?***

Public financial statement information about its actual effective tax rate at 46% versus an expected combined federal and state rate of 39 % suggests that PGE may have charged ratepayers in Multnomah County twice for its Multnomah County Business Income Tax liability—once in rates and again on the PUC authorized bill adder. Further, despite the potential double charging of this tax to ratepayers, the tax was never paid to Multnomah County.

6. ***Did PGE engage in unlawful or fraudulent trading activities that contributed to the inflated energy costs during the west coast energy crisis? Did PGE use the high cost of energy and the unstable market they helped create as a basis for a 41% residential rate increase in 2001?***

In 2000, a west coast "energy crisis" occurred when Enron and subsidiary traders engaged in market manipulation, which created artificial energy shortages and drove up energy prices. PGE traders were directly involved in "Death Star" trading schemes which contributed to this crisis. PGE went to the OPUC seeking a 41% residential rate increase in the wake of the crisis, despite a trend of substantial increases in profits between 1999 and 2001, which suggested that they were not in need of a rate increase at all.

Given the questionable need for a rate increase, and the fact that PGE was involved in fraudulent "Death Star" trades, which in part served to artificially inflate energy markets, it follows that PGE may have been motivated to pursue a rate case in 2001 to capitalize on an environment of instability in energy markets that they had a hand in creating, rather than to address new revenue requirements.

7. ***Is PGE now preparing to disburse $106 million in deferred taxes and $54 million in current taxes to Enron?***

PGE's September Form 10-Q shows a sudden increase in current deferred tax liability, meaning the deferred tax was owed within a year. Combined with other current tax liabilities of $54 million, this may signal an additional disbursement to Enron totaling $158 million right before the stock redistribution occurs.

We are appealing the PUC's decision to approve the redistribution of stock from Enron to its creditors. While we are not suggesting the following as the only alternative to the plan that the PUC approved, we do believe it represents but one example of many that the PUC could have added to the approval as a condition that would have resulted in a huge benefit to ratepayers:

Proposed Alternative to PUC Approved PGE Stock Redistribution Plan:

PGE seeks their stock redistribution plan to get a "fresh start" in the wake of Enron's unfortunate stewardship of the utility. What the OPUC should consider is how also to help the ratepayers enjoy the same kind of "fresh start." The City of Portland has identified a reorganization approach that has all the same benefits to PGE and its shareholders that the current proposal does, *plus* the benefit of reduced electricity rates due to reduced tax liability, thus providing an undeniable benefit. Part of this benefit could also be dedicated to restoring the lost pensions of PGE employees.

The City of Portland's suggested alternative reorganization is based on the following:

Revenue Ruling 63-228, provides in part:

> "Where property having a fair market value is received in satisfaction of a debt, such fair market value is the unadjusted basis of the property for the purpose of computing gain or loss upon the subsequent sale or other disposition of the property. See Lawrence S. Vadner et ux. V. Commissioner, Tax Court Memorandum Opinion filed July 29, 1955, and Mary Kavanaugh Feathers v. Commissioner, 8 T.C. 376 (1947)"

In addition, Treas. reg. 301.7701-3(b)(1) and (2), provides in part:

> "an eligible entity with a single owner may be disregarded as an entity separate from its owner."

The City's proposed course of action is to have PGE convert to an LLC (a disregarded entity) prior to its distribution to Enron's creditors such that PGE LLC would receive a "step up" in the basis of its assets to the fair market value of the assets (as opposed to their fully depreciated value). The net benefit to ratepayers would be 40% of the amount of the step up in reduced future income taxes to PGE flowing through to them via the elimination of the deferred taxes currently listed on PGE's balance sheet. The net benefit amounts to a rate savings estimated to be between 7 and 10%.