PUC Staff Review of the Portland City Attorney's "Report on Documents received from Portland General Electric pursuant to Resolution No. 36337 (Substitute)" and Other Matters

March 2, 2006

What is the purpose of this Staff report?

At the direction of the Commissioners, Staff has reviewed the issues raised in a December 6, 2005 memorandum by Portland's City Attorney entitled, "Report on Documents received from Portland General Electric pursuant to Resolution No. 36337 (Substitute)," as well as follow-up issues identified by the Portland City Council. The purpose of Staff's review was to thoroughly evaluate the issues raised and to determine what action, if any, to recommend the Commission take in response. Staff's recommendations are presented in an accompanying public meeting memo.

What does the City's report address?

The City's report is its preliminary assessment of information provided by PGE on: a) how much PGE was authorized by the PUC to collect in taxes, b) how much it actually collected, c) how much it paid to Enron in taxes, and d) how much Enron paid to the respective taxing authorities. The City's report also discusses PGE's handling of claims it had against Enron. In addition, the City Council has raised questions about how PGE collected the Multnomah County Business Income Tax from customers, its sale of the Coyote Springs 2 site to an Enron affiliate, and its trading activities during the energy crisis of 2000-01.

What issues did PUC Staff address?

Staff addressed the following six questions:

1) Did PGE keep $88 million collected from customers to pay income taxes?

2) Did the company change the allocation of income from certain wholesale transactions for the 2000 tax year in order to boost its Multnomah County Business Income Tax liability, knowing that any taxes collected would be sent to and kept by Enron?

3) Can the Commission require refunds of income taxes collected but not paid to taxing authorities?

4) Did PGE fail to collect $246 million owed to customers by Enron?

5) Did customers benefit from the sale of the Coyote Springs 2 site?

6) Did PGE engage in improper trading activity during the energy crisis of 2000-01? Are PGE's rates high today because of trading activity and market conditions during the energy crisis?

1. Income Taxes Collected versus Paid

What issue does Staff address in this section?

The specific issue discussed here is whether PGE kept $88 million collected from customers to pay for income taxes.

Much of the debate in recent years about utility income taxes has focused on the difference between how those taxes are included in rates and how they are actually paid to taxing authorities when the utility is part of a corporate family. Rates traditionally have been set on the basis that the utility is a stand alone business and pays its taxes directly. However, if the utility's parent files its taxes on a consolidated (total company) basis, then the utility pays its taxes to the parent and the amount paid by the parent to the taxing authorities will depend on its overall operating results. By any measure, PGE collected substantially more from its customers for income taxes than its parent (Enron) paid in taxes in 1997-2005. Whether the Commission can require a refund of that difference is discussed in Section 3. The specific issue addressed here is that the City's analysis shows that PGE collected $88 million more from customers than it turned over to Enron or paid directly to taxing authorities.

The City's analysis shows a figure of $88.4 million as "Net Federal/State/Local Income Taxes Retained by PGE" for 1997-2005. How was this figure calculated?

As shown below, the City's analysis calculated this amount as the difference between the amount of income taxes PGE collected from mid-1997 through 3rd Quarter 2005 and the amount of income taxes PGE paid directly to taxing authorities or to Enron for federal, state and local income taxes during the period. The analysis concluded that PGE retained the difference of $88.4 million.[1] The annual amounts are shown in Appendix A.

City of Portland Analysis 12/6/05 ($ millions)	
683.4	Income Taxes "Collected" by PGE 1997-2005
	MINUS
0.7	Federal and State Income Taxes Paid by PGE to Taxing Authorities 1997-2005
594.3	Federal, State and Local Income Taxes Paid by PGE to Enron 1997-2005
	EQUALS
88.4	Income Taxes PGE "Retained"

[1] An earlier City analysis calculated a difference of $95.1 million.

How did the City's analysis calculate taxes collected in rates?

For 1997 through 2004, the City used income tax figures from PGE's annual Results of Operations reports filed with the Commission. The City used the amount from the column titled "Regulated Utility Actuals," which includes accounting adjustments to remove certain revenues and costs that typically would be excluded in setting regulated utility rates. For 2005, the City used figures based on PGE's 3rd Quarter 2005 Form 10-Q report.

Did the City use the correct approach for calculating the amount of income taxes PGE collected in rates?

There is no one right way to determine the amount of federal and state income taxes a utility collects in its rates, because those taxes are not charged to customers through a separate rate or line item on the bill.[2] Utility rates are set based on the total amount estimated for taxes and other costs. Once rates are set, the utility collects revenue and then pays its actual expenses, which may be more or less than expected.

The City's analysis, by relying on the income taxes shown in PGE's Results of Operations reports, in effect uses the actual tax expense or tax liability for PGE's regulated operations as its measure of taxes collected.[3] This amount may be more or less than expected when setting rates, depending on the utility's actual costs and net income.

Senate Bill 408, the legislation enacted last year to better match taxes collected from customers and taxes paid to taxing authorities, focuses more on the tax estimate in the utility's last rate case to determine taxes collected (by adjusting the rate case tax amount for changes in overall revenue). As a result, the City's approach can produce a higher or lower result for taxes collected than the "SB 408 method."

Although there are various methods for estimating the amount of taxes collected in customer rates, staff used the City's approach (PGE's Results of Operations report data) in our analysis.

Did PGE keep $88 million collected to pay income taxes?

No. As discussed below, three adjustments in the analysis should be made. The first makes the treatment of deferred taxes consistent across the study period. The second includes all of 1997 in the analysis as a way to recognize that tax payments are made infrequently. The third removes the tax liability associated with PGE's non-regulated operations, in order to make a fair comparison between taxes collected in utility rates and taxes paid to Enron. The result is that

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[2] As PGE stated in its response to the City's question 001, there are "no generally accepted accounting or regulatory conventions that answer this question [the amount of income taxes collected from customers]."

[3] The tax expense amounts in the Results of Operations reports are calculated on the same basis as taxes are estimated for setting rates. These amounts are known as "book taxes." As discussed below, there is an important difference between a utility's regulated tax liability (book taxes) and its actual tax liability ("current taxes") in any time period, related to the difference in allowed depreciation methods.

PGE made payments to its corporate parents or directly to taxing authorities that were about $56 million more than it collected from customers, not $88 million less.

What is the first adjustment?

The first adjustment makes the treatment of deferred taxes consistent throughout the study period.

What are deferred taxes?

Deferred taxes arise primarily because of the difference between book depreciation (i.e., the depreciation methods used for regulatory and financial reporting) and tax depreciation. Book depreciation for a utility's physical assets (like generating plants) is usually figured on a straight-line basis. Tax depreciation is the utility's use of accelerated depreciation schedules, as allowed by federal and state tax law, to determine its current taxes.

The difference in income taxes calculated under the two methods is deferred taxes. In other words:

Deferred taxes = Book taxes – Current taxes

Compared to straight-line depreciation, accelerated depreciation produces a depreciation expense and tax deduction that is higher in the early years of a plant's life and lower in the later years. As a result, deferred taxes are positive in the early years (book taxes greater than current taxes) and negative in the later years (book taxes less than current taxes).

How are deferred taxes treated for ratemaking purposes?

For setting rates, the PUC must include both current and deferred tax expense. IRS regulations prohibit utilities and their regulators from passing the benefits of accelerated depreciation (current tax expense only) through to customers. If the PUC attempted to capture the early-year benefits of accelerated depreciation for customers, the IRS would not allow the utility to use that method for determining its tax liability. SB 408 contains provisions to ensure that its true-up of taxes collected and taxes paid preserves these tax benefits.

How are customers affected by the use of different methods for setting utility rates and determining the utility's actual (current) taxes?

For a particular asset, customers pay more taxes in their utility rates than the utility actually incurs in the early years of the asset's life. This relationship reverses in the later years, so that the utility pays more taxes related to use of the asset than it collects from customers.

The amount by which the payments by customers exceed the utility's tax liability, i.e., the deferred taxes, can be construed as a loan by customers to the utility. This "loan" earns interest at the utility's authorized rate of return (just over 9 percent for PGE) because the total amount of deferred taxes is subtracted from the investment amount (known as rate base) on which the company is allowed to earn that rate of return. And the "loan" is repaid in the later years when the company pays out more in actual taxes than it collects from customers through rates.

How is the utility affected by the use of different depreciation methods for book taxes and current taxes?

For a particular asset, the deferred taxes associated with using straight-line depreciation for book taxes and accelerated depreciation for current taxes improves the utility's cash flow in the early years and worsens it in the later years. The deferred taxes, however, do not affect the earnings (profits) reported by the utility.

Deferred taxes are discussed in more detail in Appendix B.

Why is an adjustment needed in the treatment of deferred taxes?

Deferred taxes for all years in the study period should be recognized in the taxes collected amounts, because the Commission sets rates that reflect both current and deferred taxes (i.e., book taxes). This is consistent with long-standing regulatory policy as well as IRS requirements.

For the years 1997 and 2002, the City's taxes collected figures are the sum of PGE's current tax expense, deferred tax expense and investment tax credits (ITC). (ITC are amounts that businesses deduct from their tax liability; tax regulations may allow ITC for certain qualifying investments and expenditures, in order to encourage economic growth.)

However, for the years 1998-2001 and 2003-2005, the City's figures exclude deferred taxes and ITC. For those years, the cumulative amount of these tax components was a <u>credit</u> of $85.5 million that reduced book taxes for those years. Including the deferred taxes and ITC for those years would reduce the City's overall estimate of taxes collected.

Why was PGE's deferred tax expense a net credit over the 1997-2005 study period?

As described above, the primary cause of deferred taxes is the difference between book depreciation and tax depreciation related to PGE's plant-in-service assets. For any particular asset, tax depreciation is typically higher than book depreciation in the early years of plant life and lower in later years.

The fact that PGE's deferred tax expense was a net credit during these years is a reflection of the relatively high overall age of PGE's assets, resulting in book depreciation exceeding tax depreciation. For example, PGE has not built a large electric generating facility since Coyote Springs in 1995.

What is the effect of including deferred taxes and ITC on a consistent basis?

Using the definition in the City's analysis, the amount of total income taxes collected would have been $85.5 million lower, dropping from $683 million down to $598 million.

What is the second adjustment?

The second adjustment addresses the likelihood that Taxes Collected will not equal Taxes Paid in any particular period because taxes are collected steadily (through rates) but paid out only sporadically. Tax payments properly attributed to the period that occur before or after the period are missed. This appears to be a particular problem for 1997.

For taxes collected, the City apparently prorated total 1997 taxes in the Results of Operations report. The City labeled the $48.3 million amount as "Net Collected for Partial Year of Enron Ownership," to reflect the mid-year acquisition of PGE by Enron. For taxes paid, the City's analysis recognizes the amount of payments PGE made to Enron during 1997; that amount was zero. Based on this comparison, PGE appears to have collected $48.3 million more from customers than it paid in income taxes.

But during the first half of 1997, PGE paid $90.3 million for federal, state and local income taxes to Portland General Corporation (PGC), its parent at the time.[4] In turn, PGC paid $90.5 million to federal, state and local taxing authorities. If the City had included figures for the entire year of 1997 in its analysis, it would have shown that PGE collected $86.0 million for income taxes and paid $90.3 million. In other words, the figures for 1997 would have shown that PGE "under-collected" by $4.3 million, not "over-collected" by $48.3 million.

This timing mismatch between taxes collected and taxes paid in a particular time period could be eliminated by including full years in the study period and comparing taxes collected in the period to taxes paid <u>for</u> the period. Some of those payments may occur outside the period. Staff has not attempted to do this analysis and believes it cannot be done now for the entire study period because final IRS tax reviews have probably not been completed for the more recent years.

What is the third adjustment?

The third adjustment removes the tax liability associated with PGE's non-regulated operations, in order to make a fair comparison between taxes collected in utility rates and taxes paid to Enron. The amount used in the analysis for taxes collected reflects PGE's regulated operations,

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[4] PGE provided the PGC figures to the City in an analysis dated December 5, 2005: $78.0 million for federal income taxes, $11.3 million for state income taxes, and $1.0 million for local income taxes.

because it is based on PGE's "Regulated Utility Actuals." The amount of taxes paid, however, covers both PGE's regulated and non-regulated operations.

To make a consistent comparison between the two amounts, the tax liability for non-regulated operations should be excluded from the amount of taxes paid. During the study period, PGE's non-regulated operations had a total tax liability of negative $6.3 million. This amount should be removed from the analysis.

What is the cumulative effect of these three adjustments?

As shown on the next page, using the City's definition of taxes collected, PGE paid $56.0 million more to taxing authorities and its parent companies for income taxes than it collected from customers from January 1997 through September 2005.

Taxes Collected (Book Taxes)	Taxes Paid Directly or to Parent	Income Taxes PGE "Retained" ("Overpaid")	
$683.4	$595.0	$88.4	City of Portland Analysis 12/6/05
			ADJUSTMENTS
(85.5)			Adjust Taxes Collected to include deferred taxes and ITC for all years
37.7	90.3		Reflect full year for 1997
	6.3		Remove PGE non-regulated tax liability
$635.6	$691.6	$(56.0)	Revised Results

Did PGE actually "overpay" income taxes by $56 million during the study period?

No. We would not expect the Taxes Collected figure to closely match the Taxes Paid figure. The main reason is that the Taxes Collected figure properly includes the effect of deferred taxes, because the Commission includes deferred taxes in the total amount of income taxes when it sets rates.

During this period, PGE recorded $71.7 million of deferred tax <u>credits</u>, meaning that its current taxes were that much higher than its book taxes. This amount explains most of the difference between Taxes Collected and Taxes Paid, which reflects current tax liability only.

The remaining difference, $16 million over the entire study period, shows that PGE collected virtually the same amount for payment of current taxes as it paid either to its parent or taxing authorities. This minor disparity is probably due to the timing differences between tax collections and tax payments noted above. There may also be audit settlements (refunds or surcharges) related to prior periods in the Taxes Paid figures that are not reflected in Taxes Collected.

2. Multnomah County Business Income Tax

What issue has been raised about PGE's calculation of the Multnomah County Business Income Tax?

The issue is whether PGE changed the allocation of income from certain wholesale transactions for the 2000 tax year in order to boost its local income tax liability, knowing that any taxes collected would be sent to and kept by Enron.

How did PGE calculate the rate charged to customers for the Multnomah County Business Income Tax during the years 1997 through 2005?

PGE's basic approach was to set the rate to collect the current year's estimated tax liability and to recover or refund the difference between collections and actual tax liability in prior years. For example, in May 1999, PGE calculated the rate per kilowatt-hour that would collect an amount equal to the sum of projected 1999 tax, the difference between the actual and estimated tax liability for 1998, and a refund of $274,238 over-collected in prior periods. The company reset the collection rate twice each year.

How did PGE determine the amount of its actual or estimated tax liability?

PGE calculated its Multnomah County tax liability using stand-alone PGE results of operations, in the same manner as federal and state taxes have been included in the company's base rates. The county tax is based on the portion of total taxable income attributable to the county, with the allocation based on gross income. As described below, PGE's gross income from wholesale sales was assigned outside the county, except for the year 2000.

How much did PGE collect for Multnomah County Business Income Taxes for the period 1997 through June 2005?

PGE collected approximately $7.5 million during this period and sent the amount of its tax liability to Enron. (See Appendix C for detail.)

What are the PUC's requirements for charging local income taxes to customers?

The Commission's rule regarding local income taxes, OAR 860-022-0045, requires the tax be charged to ratepayers in the county as a separate line item on the bill instead of included in base rates. However, there is no requirement on how the rate is calculated or that the rates must be filed with the Commission. In Order No. 05-1064 (Docket DR 32), the Commission recently concluded that OAR 860-022-0045 does not require local income taxes to be collected from ratepayers on a stand-alone basis, but also that PGE did not violate the rule when it did so and passed the tax collections on to Enron.

Did the share of income allocated to Multnomah County increase in 2000?

Yes. The county's share of PGE's income jumped from 26 to 55 percent, because of a change in the treatment of bookouts.

What are bookouts?

Bookouts are amounts of power that are not physically delivered when there are purchase and sale transactions with the same counterparty at the same delivery point. This is a common practice for major electric utilities in the Northwest. A utility might enter into transactions that wind up offsetting because its assessment of the balance between its loads and resources changes over time up to the time of delivery.

For example, if PGE contracted for a purchase from BPA for 75 MW and, separately, a sale to BPA for 25 MW at the same hub for the same time period, BPA would schedule 50 MW of physical power to be delivered at the hub. The other 25 MW would be settled financially as a bookout.

How has PGE treated bookouts in determining the amount of Multnomah County tax to charge customers from 1997 through 2005?

PGE used three different methods for handling bookouts.

For 1997-1999, PGE assigned gross income from all wholesale sales, including the sale side of a bookout, to the location of the counterparty. Since very few counterparties are located in Multnomah County, almost all the sales (including bookouts) were assigned elsewhere.

For 2000, the company treated delivered sales and bookouts differently. Gross income from delivered sales was assigned to the delivery location (the nearest hub, all outside of Multnomah County). However, bookouts were assigned to the county, where PGE's trading floor is located.

For 2001-2005, PGE assigned the gross income from all wholesale sales to the delivery location (hub) for the contract, regardless of whether the power was physically delivered.[5]

In other words, for the year 2000, unlike the years before and after, PGE assigned bookouts to Multnomah County, which increased gross income allocated to the county and, as a result, the share of PGE net income used to compute the tax liability.

[5] This is the method PacifiCorp has used for many years.

What is PGE's explanation for the change in assigning bookouts in 2000?

In response to a staff data request (attached as Appendix D), PGE explained that before the 2000 tax year its tax department used information from the company's "FERC Form 1" to identify the location of counterparties.[6] PGE then assigned the revenue from the wholesale sales to different jurisdictions based on those locations.

For the 2000 county tax filing, the new manager of the tax department asked the Risk Management department to provide wholesale sales information in electronic form. Risk Management provided a spreadsheet that separated physical deliveries (listed by hub) and bookouts (that had no hub listed), which prompted discussion about how to assign the bookouts. PGE concluded that the bookouts should be assigned to Multnomah County, reasoning that since power did not flow the transaction occurred in the county.

During 2001, PGE began to track all transactions, including those that were booked out, by hub. It did so because it expected to be subject to Public Utility Holding Company Act (PUHCA) reporting requirements that require all transactions to be assigned to hubs for purposes of distinguishing between interstate and intrastate activities. For the county tax filings beginning with the 2001 tax year, Risk Management provided the tax department with sales information by hub, without a separate bookout category, so the bookouts have been assigned to jurisdictions based on the hub location.

PGE reports that it has hired Ernst and Young to pursue a private ruling from Multnomah County regarding the treatment of bookouts.

What was the effect on the calculation of income tax collected from Multnomah County customers for 2000?

As noted above, assigning bookouts to Multnomah County for the 2000 tax year about doubled the share of income allocated to the county, from 26 percent to 55 percent. PGE showed charges of $1.45 million for local income taxes for 2000. Thus, the effect of this treatment for 2000 was roughly three-quarters of a million dollars.

How did the amount of PGE's bookouts change over time?

PGE's bookout sales increased from $245.7 million in 1999 to $766.5 million in 2000 (due to both price and volume increases), so the accounting change for 2000 significantly increased the amount of taxable income apportioned to Multnomah County. Gross income related to bookouts remained high after that: $1.49 billion in 2001, $729.4 million in 2002, and $922.8 million in 2003. Had PGE continued to assign bookouts to the county after 2000, the amount of local income taxes charged to customers would have been significantly higher than actually occurred.

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[6] The FERC Form 1 is a report of financial and operating statistics that electric utilities provide to the Federal Energy Regulatory Commission (FERC) each year. It lists wholesale sales information by counterparty.

Is PGE's explanation of the changes it made in the assignment of bookouts plausible?

Yes, for two reasons. First, the methods used were consistent with the information available at the time. For years prior to the 2000 tax return, the tax department used FERC Form 1 data to assign wholesale sales income. Bookouts were never considered, because they were not separately identified in the Form 1. For the 2000 return, the tax department got access to bookout data because PGE's new Tax Manager made a process change--getting sales information electronically from Risk Management instead of manually from the FERC Form 1. For tax years after 2000, information about the delivery hub for bookouts became available because the company tracked it for other reasons (PUHCA reporting). Second, the company's explanation for the 2000 treatment--that the bookouts should be assigned to Multnomah County because no power flowed and the transaction occurred there--seems reasonable on its face.

However, PGE did have other options. For example, it could have continued to use the FERC Form 1 data for the 2000 return and assign bookout sales to the location of the counterparty. While PGE's explanation of why its treatment of wholesale sales changed over time is plausible, Staff has not seen contemporaneous documents describing the company's decision making process at the time, i.e., why it chose one option over another.

Is Staff aware of any evidence that PGE purposefully increased its county tax liability, knowing that any taxes collected would be sent to and kept by Enron?

No. A series of internal PGE e-mails has been publicized because they allegedly show that the company manipulated its calculations to collect more money from Multnomah County residents, but Staff disagrees with that interpretation.

The e-mails are attached in Appendix E, and PGE's response to Staff's data request on their meaning is in Appendix F.

What do the e-mails say?

One e-mail that has been highlighted is representative of the discussion. An October 26, 2001 message states that a proposed increase in the rate charged to customers would increase PGE's revenues without affecting its tax expense. Some have viewed this as an acknowledgement that "a tax collected through a line item on customer bills is being used to increase revenues, which increase profits."[7]

How does Staff interpret the October 26, 2001 e-mail?

The e-mail is entirely aboveboard. It discusses the effect of increasing the rate charged to customers. Any change in that rate affects the amount collected to pay the county taxes, not the

[7] Willamette Week, November 30, 2005.

underlying tax expense or liability itself. An increase in the rate would increase revenue, but the purpose of changing the rate was to match the amount collected with the company's tax expense.

What is Staff's overall interpretation of the e-mails?

The e-mails are entirely consistent with the process described above to calculate the county tax and collect the necessary amounts from customers, i.e.,

- PGE's tax liability, calculated on a stand-alone basis and with an allocation of income to the County, is the basis for the amount that must be collected.
- The rate charged to customers is set to collect the estimated tax liability for the year and to true up for past differences, so that PGE ultimately collects its actual tax liability, no more and no less.

The only question raised by the emails is the same one discussed above: was it reasonable that PGE assigned bookouts in calendar year 2000 to Multnomah County? There is no evidence in the e-mails that PGE changed the allocation of income to the County simply to increase the amount it could collect from customers.

Is Staff aware of any evidence that PGE did <u>not</u> purposefully increase its county tax liability, knowing that any taxes collected would be sent to and kept by Enron?

No, and it is not apparent that such evidence (to "prove a negative") could exist. However, the simple fact that PGE assigned the bookouts to Multnomah County in only one year (2000) and then changed its approach in a way that reduced the allocation to the County suggest that the changes were not made for the purpose of funneling money to Enron.

Does Senate Bill 408 apply to the Multnomah County Business Income Tax?

Yes. SB 408, passed by the legislature in 2005 to more closely match taxes collected with taxes paid, applies to local income taxes as well as federal and state taxes. The new law requires PGE and three other Oregon utilities to establish an automatic adjustment clause beginning with 2006 taxes.

3. Refunds and Rate Adjustments

What issue does Staff address in this section?

In 1997-2005, PGE collected substantially more from customers than was paid to taxing authorities. The City estimates that only $11 million of the $683 million collected was paid to the taxing authorities. The specific issue addressed here is whether the PUC has the authority to require PGE to refund the over collection from customers.

What does Staff mean by "refund"?

"Refund" means to return to customers an amount that was incurred in the past (here, the difference between taxes collected and taxes paid as late as the end of 2005). The refund could take the form of a one-time payment, a reduction in rates, or a credit against some other costs that customers would have to pay in the future. The refund could be allocated to customers based on their estimated "overpayment" in the past or on their usage going forward.

Does the PUC have the authority to require refund of the past over collection of taxes?

The Department of Justice (DOJ) advises that the answer is no, because the PUC must follow what is known as the filed rate doctrine. The filed rate doctrine states that a regulator cannot order refunds of, or surcharges on, amounts collected under legally approved tariffs. It protects both the utility and its customers by insuring that the regulator cannot adjust what a customer paid for service after the fact.

Is the filed rate doctrine spelled out in statute?

Not in so many words, but other statutes effectively create an obligation to follow the filed rate doctrine.

When the Legislature created the PUC, it did not pass any statutes that allow the agency to act retroactively. That is not surprising because rate setting is a legislative function,[8] and legislatures typically act only prospectively. In 1987, the Legislature made an exception when it passed ORS 757.259, which allows the PUC to act retroactively in certain cases. There is nothing in that statute, however, that would allow the PUC to take retroactive action now with respect to taxes that PGE sent to Enron and Enron did not pay.

Two other statutes read together also suggest that the PUC lacks authority to order refunds for the taxes in question. ORS 757.225 requires PGE to charge the rates authorized by the PUC. The rates authorized by the PUC in the 1997-2005 period included an estimate of the taxes PGE would pay if it were a stand alone company. ORS 756.565 states that all rates the PUC sets

[8] In fact, the Oregon Legislature did set utility rates at one time.

"...shall be prima facie lawful and reasonable, until found otherwise..." by a court. No court has found that the rates the PUC set from 1997 through 2005 were illegal because of the way taxes were handled. Absent any such finding, the rates the PUC set for that period remain "prima facie lawful and reasonable."[1]

How does Senate Bill 408 address differences between taxes collected and taxes paid in the past?

SB 408 does not require retroactive adjustments. The Legislature considered whether to order the PUC to require refund of past over collections, but the adjustment mechanism it established in the bill deals only with 2006 forward.

Is the filed rate doctrine being considered by Oregon courts?

Yes. The PUC currently is appealing a Marion Circuit Court ruling on a Trojan case with respect to the PUC's ability to order refunds related to return on investment that the court found was illegally included in rates. Thus, the PUC has taken the legal position in both orders and briefs that it does not have authority to require refunds and is awaiting a ruling from the Oregon Court of Appeals on this issue.

Will the Court of Appeals decision on the Trojan case apply to other situations?

Since the Trojan case deals with a situation where rates were found to be illegal, that decision may not be dispositive for other cases without that finding. For example, DOJ has advised that even if the PUC found that a utility had perpetrated fraud in its rate filing, it is questionable whether the agency has the authority to order refunds for the harm.

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[1] The principle that underpins these statutes and the prohibition against retroactive ratemaking has its roots in the filed rate doctrine as it was developed in the 19th century to help regulate the monopoly power of the nation's railroads. Complaints by shippers about unjust and unreasonable rates charged by the railroads led to the passage of the Interstate Commerce Act (ICA). Under the ICA, a railroad could charge a shipper only those rates incorporated in a tariff filed with the Interstate Commerce Commission. To ensure rate stability and certainty, the doctrine held that the approved rates could not be made unlawful during the period of their approved operation by any subsequent retroactive finding.

The United State Supreme Court first articulated the filed rate doctrine as applied to energy utilities in 1951. *See Montana-Dakota Utility Co. v. Northwestern Public Service Co*., 341 U.S. 246 (1951). The Court held that rates filed with and approved by the Federal Power Commission were not only binding on the parties, but also the courts. In other cases, the Court has clarified that rates in an approved tariff are the law, effective and enforceable from their inception, and may be adjusted only prospectively. *See e.g., Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981); *AT&T v. Central Office Telephone Inc*., 524 U.S. 214 (1986). Oregon courts have also recognized the filed rate doctrine. *See e.g., Adamson v. WorldCom Communications, Inc*., 1190 Or. App. 215 (2003); *Perla Development Co., Inc. v. PacifiCorp*, 82 Or. App. 50 (1986).

What action could the PUC take if it concluded a utility had committed fraud?

The PUC could consider past fraud in setting new rates for a utility. One of the expenses the PUC considers in setting rates is the cost of managing the utility. If a utility has a history of fraudulent behavior, the PUC could consider the quality of management when it determines how much to allow for it in rates. Customers should not continue to pay for good management when they are not receiving it, so fraud by a company can give the PUC cause to set rates below what they would be with good management. The Commission may also consider poor management in determining the rate of return on equity to allow a utility. Poor management may be a basis for the Commission's setting an equity return at the bottom of a reasonable range of returns.

In sum, aside from the Commission's narrow authority in ORS 757.259 to retroactively set rates, the PUC cannot establish rates to offset what went on in the past; it can, however, set new--and lower--rates that reflect what the cost of service should be going forward, and it can estimate that cost of service by considering the past as a reasonable predictor of the future.

Has the Commission been requested to make a determination that PGE committed fraud with respect to its calculation of income taxes included in rates?

Yes. In March 2003, the Utility Reform Project and Linda K. Williams (collectively, URP) filed a complaint with the PUC that was docketed as UCB 13. The complaint alleged that PGE's rates for several years were not just and reasonable because they contained amounts for income taxes that were in fact not paid to taxing authorities. The Commission dismissed the complaint in Order 03-401, and in August 2004, the Marion County Circuit Court reversed and remanded the order to the Commission for further proceedings. In its Judgment, the Court stated:

> It is interesting that a claim in the Complaint before the Commission was that Enron (the parent company) did not pay taxes … As stated in the record, OPUC determines the estimated costs of PGE as a "stand alone" entity. The Court agrees that what the consolidated company (Enron) paid in taxes is not relevant.
>
> The focus of this determination is whether the argument of PGE and OPUC is correct as it relates to the claim of fraud and deceit of PGE in its estimate of taxes.
>
> [Case No. 03C21227, Page 4]

What was the outcome of the UCB 13 remand proceeding?

The Court's ruling provided URP with the opportunity to demonstrate that PGE committed fraud by knowingly providing incorrect estimates of taxes for the company as a stand alone entity. URP filed an amended complaint in November 2004, and a procedural schedule was set.

However, in April 2005, URP filed a notice of voluntary dismissal of the complaint and the docket was closed.

Did PGE commit fraud with respect to calculating the amount of income taxes to include in its rates?

No. PGE calculated its estimated federal and state income taxes in the manner required by the PUC, i.e., based on the company's stand-alone results of operations, which excludes costs of non-regulated operations anywhere in the corporate family.

Even if PGE knew that Enron would be paying little or nothing for income taxes, PGE did not commit fraud when it calculated its income taxes on a stand-alone basis. As the Marion County Circuit Court recognized in its opinion, the PUC estimates PGE's costs as a stand-alone entity, and the amount of taxes Enron paid is not relevant to the claim of fraud.

Why did the PUC require PGE to calculate its taxes on a stand-alone basis?

This method is consistent with long-standing PUC policy and practice as well as standard ratemaking principles, and it has been used consistently by most state regulatory commissions. In addition, federal case law has concluded that use of the stand-alone method is reasonable.[10] The stand-alone approach protects customers from bearing the costs and risks of unregulated activities.

How does SB 408 address the mismatch between taxes collected and taxes paid going forward?

SB 408 has required PGE to establish an automatic adjustment clause that will true up its tax collections to the tax payments properly attributed to it from January 1, 2006 on.

How will the distribution of PGE stock to Enron creditors affect how the company calculates and pays its taxes?

With the stock distribution, which was authorized by the PUC in late 2005, PGE will no longer be in a holding company structure. It will continue to estimate taxes for rates on a stand alone basis, but it will make its tax payments directly to the various taxing authorities, not to Enron.

[10] *See City of Charlottesville, Virginia v. FERC*, 249 U.S. App. D.C. 236; 774 F.2d 1205 (1985).

4. PGE Claims against Enron

What is the concern about PGE's treatment of its claims against Enron?

The concern is that PGE failed to collect about $246 million owed to its customers by Enron.

What does Staff conclude?

Staff finds that:

- The money belonged to investors, not customers. Any amounts recovered from Enron would not have been refunded or credited to customers.
- PGE's net claim against Enron was about $68 million. The $246 million owed by Enron to PGE was offset in part by amounts PGE owed to Enron.
- PGE remained financially healthy even though it "gave up" its $68 million claim against Enron. Customers were not harmed by higher financing costs for new plant investment.

What are the claims in question?

At the time it filed bankruptcy, Enron (and some of its subsidiaries) owed PGE $246 million. Three items account for more than 95 percent of the total:

- $80 million owed by Enron Power Marketing for power and transmission service bought from PGE
- $86 million to cover possible third party claims against PGE related to certain employee benefit plans (PGC/PGH Non-Qualified Benefit Plans).
- $73 million for the merger credit Enron promised to pay when it acquired PGE in 1997

The claims are identified in more detail in Appendix G.

Did PGE have any offsetting debts to Enron?

Yes. PGE owed Enron $93 million. Most of that ($78 million) was for power PGE purchased from Enron Power Marketing.

Did anything else reduce PGE's net claim against Enron?

Yes. The $86 million claim related to employee benefit plans existed to protect PGE in the event that third parties sued the company. Those parties settled the matter with Enron, so the indemnification was not needed and the amount was removed from PGE's claims against Enron.

Did customers get the full benefit of the merger credit Enron agreed to pay when it acquired PGE?

Yes. Enron agreed to a merger credit of $105 million, to be paid out to customers over eight years, beginning in 1997. PGE customers got the credit as a line item on their bills until late 2000. At that time, the Commission approved a settlement agreement that used the remaining balance of the merger credit ($73 million) to offset some of the remaining investment in the Trojan plant that customers would have paid back over time. Customers got the benefit of the $73 million through lower overall rates. The $73 million claim by PGE against Enron for the merger credit represents money Enron owed to PGE, not to PGE's customers.

Would any money recovered by PGE for its claims against Enron have been refunded to customers?

No. As discussed above, the claims that were not offset by PGE debts to Enron, or zeroed out when contingencies did not occur, involved monies that belonged to investors, not customers.

How did PGE handle its claims against Enron?

PGE filed certain Proofs of Claim[11] against Enron and various Enron affiliates in the Bankruptcy Court. The Proofs of Claim covered the entire $246 million.

At the end of 2004, PGE "settled" its claims against Enron by making a non-cash distribution to Enron of approximately $66.3 million and a cash payment of $9.3 million.

Why did PGE make the distributions to Enron?

PGE made the distributions for two reasons. First, it wanted to clear its books of accounts receivable and payable with Enron before the anticipated sale to the Texas Pacific Group (TPG). Since PGE didn't expect substantial recovery in the bankruptcy proceeding[12] or that it would receive any proceeds and be able to book them before the sale to TPG, it decided to settle the claims through the non-cash dividend and cash payment.

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[11] A proof of claim is a written statement that sets forth a claim against a bankrupt debtor.

[12] With an estimated net claim at the time of $64.5 million and an expected recovery percentage of 16.5 percent, PGE projected recovery of about $10.6 million. (Actual payout to Enron creditors has been valued at 15-20 cents on the dollar.)

What is the second reason PGE made the distribution?

The second reason is that any recovery by PGE could then have been returned to Enron as a dividend anyway. PGE is authorized to provide dividends to Enron as long as it maintains a minimum level of equity in its capital structure (i.e., the combination of debt and equity with which it finances the company). The minimum equity standard protects customers by helping to prevent investment rating downgrades and a resulting increase in financing costs. Since PGE met the standard, any recovery of claims could have been sent back to Enron as a dividend.

Were customers harmed by PGE's distributions to Enron?

No. The elimination of intercompany liabilities did not harm customers because PGE maintained a reasonable level of equity in the business. If Enron had been required to pay monies to PGE, Enron could have required PGE to pay that amount back as a dividend. The dividend would not have violated the minimum equity standard adopted as a condition of the Enron merger to protect customers, and therefore it would not have required Commission approval.

Has Staff reviewed the accounting for these distributions to ensure that customers will not be harmed?

Yes. The amounts involved were primarily recorded in PGE's accounts receivable and accounts payable. Staff confirmed that they were not recorded in "regulatory" accounts that would be included when setting customer rates.

5. Coyote Springs 2

What is Coyote Springs 2?

Coyote Springs 2 is a 280 MW gas-fired generating plant located near Boardman, Oregon. It is owned by Avista Corporation, which serves retail electricity customers in Washington and Idaho. The plant is located adjacent to, and share common facilities with, the Coyote Springs generating plant owned by PGE. PGE operates both units.

In early 2000, PGE sold the undeveloped Coyote Springs 2 site to an Enron affiliate, which subsequently sold it to Avista, along with a turbine generator and construction contracts.

What issue does Staff address?

The issue is whether PGE's customers benefited from the sale of the Coyote Springs 2 site.

What transactions did PGE enter into for the sale of the site?

On December 23, 1999, PGE submitted an application requesting PUC approval to enter into certain agreements with an affiliate, Enron North America (Enron or ENA). PGE proposed to sell its rights, title, and interest in the site for Coyote Springs 2, and a 50 percent interest in the site's common facilities to Enron. Enron planned to make the site ready for construction (e.g., by obtaining permits) and resell it. The application included a formula for sharing the gains from the resale between PGE and Enron.

The PUC approved the transaction in Order 00-115, dated February 25, 2000. PGE amended the application twice. The first recognized that Enron would also sell a turbine generator to the site buyer (who did not have ready access to one) and extended the deadline for Enron to complete the sale. The second amended application restructured PGE's ownership interest to facilitate financing by site buyer (identified by this time as Avista). The amended applications were approved by the PUC in Order 00-214, dated April 20, 2000, and Order 00-389, dated July 19, 2000.

How were the proceeds from the sale of the site to be split between PGE and Enron?

After payment for the net book value of the transferred assets and for PGE's and Enron's development costs, PGE would receive the next $10.47 million of the proceeds. Enron would receive the next $12 million. Any remaining proceeds would be shared, 60 percent to PGE and 40 percent to Enron.

Did PGE need the site to build a generating plant for its own customers?

No. In PGE's 1998-1999 Integrated Resource Plan, acknowledged by the PUC in July 1999, the company stated:

> . . .it is prudent to continue to rely on the market for our incremental resource needs during our transition to a competitive direct-access market. . . We find it both prudent and economical to fill our supply needs through purchases on the open market. We continue to monitor the cost-effectiveness of our existing energy-producing assets, and to take the necessary steps in obtaining permits and conducting engineering studies that we would need should it become prudent for us to repower certain existing plants or build new ones. Today we propose neither to build nor to repower, however, because of the opportunities available on the open energy market."

When it reviewed PGE's application to sell the Coyote Springs 2 site in early 2000, the PUC concluded that customers would benefit more from the sale than by PGE retaining and possibly developing the site in the future. Order 00-115 stated:

> Staff's analysis identified another benefit of the current application; i.e., that a power plant is built sooner which increases available generation to meet loads. There have been regional discussions and studies identifying the need for additional resources to meet load requirements. Also, this plant will be a merchant plant thereby increasing the competition in the bulk power markets. These qualitative considerations provide benefits to PGE customers and the region.
>
> Potential benefits to PGE and its customers of developing the project at a later time are that perhaps a better price may be available, or that some of the monies currently shared with ENA would all accrue to PGE. We find, however, that there is considerable uncertainty about when, or even if, PGE would develop the project. This is especially so given that the Commission is currently developing policies to implement SB 1149, and utilities will need to assess their impact on company business risk.

(SB 1149 was the industry restructuring bill, passed in 1999, that gave PGE's business customers the right to buy power from other utilities, independent power producers, and marketers.)

In short, at the time PGE proposed the sale of the site for Coyote Springs 2, it did not need the site for a generating plant for its customers because it had access to cheaper sources of supply.

Did customers benefit from any gain on the sale of the site?

Yes. Consistent with the formula for sharing the gain, PGE received the first $10.47 million after reimbursement of costs. The remaining proceeds were less than $12 million, so Enron did not receive its full $12 million share and there was no balance to be shared 60/40 between PGE and Enron.

PGE booked its portion of the gain ($10.47 million) in August 2000. Most of this amount ($9.79 million) returned, with interest at PGE's authorized rate of return, directly to customers from October 2001 through December 2002. The balance was used to offset amount owed by customers to the company.

Did customers receive any other benefits from the sale?

Yes. PGE has saved $579,000 a year in operations and maintenance (O&M) costs as a result of joint operation of the two units at Coyote Springs. It has also saved $821,000 a year related to shared use of certain gas transportation facilities. These savings have been passed through to customers (through lower rates) since October 2001.

Have any questions been raised about the legality of the transactions to develop Coyote Springs 2?

Not with respect to the PGE-Enron transaction.

However, The US Department of Justice has obtained a guilty plea from an Enron vice-president for structuring the sale of the turbine generator to Avista in a way that recognized earnings prematurely and improperly.

The deal in question came about because Enron's auditors would not allow it to recognize a gain on the turbine sale unless it occurred at least two weeks before the sale of the site and the related construction contracts, in order to demonstrate that the turbine sale was independent of the other sales. That left Avista with the concern that it might buy the turbine and have the remaining transactions fall through.

Enron therefore arranged for an affiliate, LJM2, to provide Avista with a "put" option for the turbine. The put option gave Avista the right to require LJM2 to buy the turbine if Enron did not sell the site and construction contracts to Avista two weeks after the turbine sale. However, Enron, not Avista, effectively paid for the put by reducing the price for the turbine by the cost of the put. LJM2 orally agreed to refund most of the payment for the put to ENA if the put expired, and ENA agreed to buy the turbine back from LJM2 if Avista did exercise the put. Enron subsequently concealed the role of LJM2 in the transaction.

Were PGE's customers affected by the way Enron structured the sale of the turbine to Avista?

No. Even if the payment for the put option were added to the gain on the transactions (instead of being offset by a reduction in the price paid for the turbine), the additional proceeds would not have been enough to complete Enron’s $12 million share and qualify for 60/40 sharing between PGE and Enron.

6. PGE's Trading Activity

What concern has been raised by the City about PGE's trading activity?

The concern is that PGE's rates are higher than they should be because of 1) improper trades the company engaged in during the western electricity crisis of 2000-2001 and 2) Enron's manipulation of the market during that time.

Has the Commission investigated the Enron trading strategies and whether PGE engaged in these practices?

Yes. At the Commission's request, Staff conducted an investigation of the trading activities of PGE, PacifiCorp, and Idaho Power during the western electricity crisis of 2000-2001. At a Commission meeting on June 12, 2003, Staff presented its final trading activity report (Report).[13] The Report described the Enron trading strategies and explained why they were considered to be illegal or improper. It examined the evidence of PGE involvement in the suspect trading activities. The Report set forth Staff's recommendations for Commission action.

What was the scope and depth of the Staff investigation?

Staff investigated the trading activities of PGE, PacifiCorp, and Idaho Power during the period January 2000 through June 2001. This encompassed the period of inflated wholesale electricity prices in the western U.S. Staff's investigation focused on whether the activities of Oregon's three investor-owned electric utilities violated any Oregon statutes or Commission rules or orders. Staff reviewed the following evidence related to PGE's trading activities:

- Affidavits and information submitted to FERC that described PGE's trading activities during 2000-2001

- Screens of PGE's databases of transmission and trading transactions used to identify potential involvement in Enron Death Star transactions during January 2000 through December 2001

- Transcripts of PGE trader telephone conversations occurring on more than 50 days in 2000-2001

- Tape recordings of PGE trader telephone conversations covering selected days in May, June, August, and December 2000, and January 2001

[13] The Report is available on the agency's website at http://www.puc.state.or.us/PUC/electric_gas/invest/tradeact.shtml

- E-mails sent or received by PGE trading floor and power supply personnel containing keywords related to the Enron trading strategies during 5 days, chosen by FERC Staff, between December 11, 2000 and February 12, 2001

- Electronic bulletin board postings of nearly 2,000 buy-sell transactions between PGE and Enron during 1999-2001

- Depositions of six PGE real-time traders

- PGE responses to Staff data requests related to its involvement in Enron Death Star transactions and specifically the use of its AC Intertie and Bonneville Power Administration IR transmission contracts

What were the findings of the Staff investigation?

Staff found evidence that PGE was involved in 17 days of potential Enron Death Star transactions. Staff also found evidence that PGE failed to correctly post 65 percent of its transactions with Enron on its electronic bulletin board, in apparent violation of its FERC tariff.

Staff indicated that the Enron-PGE Death Star transactions accounted for less than 2,500 MWh of scheduled energy and that PGE's compensation for the transactions was minimal (e.g., $0.90 per MWh). Staff also indicated that Enron collected less than $500,000 from this type of transaction over the period 1998-2001. Evidence suggested that the last Death Star transaction involving PGE occurred on June 6, 2000.

What conclusions did Staff reach regarding PGE's trading activities?

Staff concluded that any impact of the Enron-PGE Death Star transactions on wholesale power prices was likely very small. Staff based its conclusion on the small amounts of power and dollars involved in these transactions. Staff also concluded that PGE's errors in posting transactions with Enron on its electronic bulletin board had no adverse effect on the market because nearly all of the transactions were priced at index, meaning the transactions did not factor into published wholesale electricity prices.

Staff also concluded, however, that there was a prima facie case that PGE *mismanaged* its trading activities with Enron. Staff argued that PGE management should have been more vigilant and cautious in its transactions with Enron. The convoluted nature of the Enron-PGE Death Star transactions should have raised red flags at PGE. Staff also faulted PGE management for failing to have controls in place to ensure it was posting its trades with Enron in accordance with its FERC tariff. By failing to properly post 65 percent of its transactions with Enron, PGE jeopardized its market-based rate authority. The loss of PGE's ability to sell excess power at market prices had the potential to harm PGE's retail customers.

The Department of Justice advised Staff that the remedy for PGE mismanagement of its trading activities was a proceeding to prospectively reduce PGE's rates to reflect the reduced quality of management.

What actions did the Commission take in response to Staff's trading activity report?

Instead of pursuing a mismanagement case against PGE, in Order 03-599, issued on October 8, 2003, the Commission resolved these management issues as part of the settlement of the FERC investigation of PGE. The Commission specifically waived any claims regarding PGE's posting errors and potential involvement in 17 days of alleged Death Star transactions. The total settlement for Oregon customers was $1.3 million.

Have there been other investigations into PGE's trading activities?

Yes. FERC conducted a second investigation into PGE's trading activities. The Oregon Department of Justice also pursued a civil investigation into PGE's trading activities during 2000-2001.

What where the results of these investigations?

FERC approved a settlement in its second PGE investigation in which PGE--while not acknowledging any wrongdoing--agreed to pay $12,370 to resolve charges that it had engaged in the Enron trading strategy known as Non-firm Export.

The Department of Justice civil investigation ended in a settlement and dismissal of cases at the Ninth Circuit of the Untied States Court of Appeals, the State of Oregon Court of Appeals, and Multnomah County Circuit Court.

Did Staff investigate Enron's trading activities during the western electricity crisis?

No. In its Report, Staff discussed the Enron trading strategies described in memos that jump-started the FERC investigations. Staff described each of the strategies, indicated if they were considered to be illegal or improper, and indicated the likely impact of the strategies on wholesale electricity prices. Staff focused its investigation on the trading activities of Oregon's three investor-owned electric utilities. The FERC conducted extensive investigations of Enron's trading activities during the western electricity crisis.

Have PGE's overall rates changed since October 2001?

No. Prior to October 2001, PGE's overall rates averaged 5.2 cents per kWh. On October 1, 2001, largely due to the massive increase in wholesale electricity prices during the preceding 17 months, PGE's overall rates jumped to 7.4 cents per kWh. PGE's current overall rates remain at about 7.4 cents per kWh.

Are PGE's current rates inflated because of high-cost power purchased during the western electricity crisis?

No. The power purchased during the energy crisis accounts for only a small portion of PGE's power supply and actually costs less than power available in the market today.

Only four transactions from the period of the western electricity crisis continue to be included in PGE's rates. None of the four transactions are with Enron or any of its subsidiaries. The four contracts provide 100 MW of energy on an around-the-clock basis (less than 5 percent of annual system load) at an average price of $43.44 per MWh. Although PGE entered into these transactions in 2001, the contracts called for power deliveries to be made during 2004-2006. The prices of the four contracts are lower than the day-ahead prices that prevailed during the western electricity crisis because the power deliveries were set to begin so far into the future. The average contract price of $43.44 per MWh is also lower than recent day-ahead electricity prices and is lower than the overall average cost of purchased power now in rates of $56.36 per MWh. All four contracts expire at the end of 2006.

Why do PGE's rates remain high?

The cost of nearly all of PGE's power supply resources has increased since October 2001. However, the primary driver of PGE's continued high power costs is the company's exposure to natural gas prices. Natural gas prices affect PGE's power costs in two ways. First, the cost of natural gas affects the cost of running PGE's gas-fired generating plants. Second, the wholesale market price for electricity tends to be based on the cost of operating gas-fired resources. Currently, gas-fired generation and market purchases account for 42 percent of PGE's power supply. Natural gas prices increased from an average of $1.29 per million Btu in PGE's pre-October 2001 rates to $9.35 per million Btu in PGE's current rates. *See* Appendix H.

Given current regional supply and demand conditions, if natural gas prices were at levels included in PGE rates prior to October 2001, Staff estimates that PGE's overall rates would be 1.7 cents per kWh (23 percent) lower than they are today.

What explains the difference between PGE and PacifiCorp rates?

PacifiCorp's current overall average rate of 6.2 cents per kWh is 1.2 cents per kWh lower than PGE's. The difference is largely due to the power supply portfolios of the two utilities. PacifiCorp's power costs are 1.7 cents per kWh lower than PGE's power costs. Low-cost coal-fired generation accounts for 60 percent of PacifiCorp's power supply. Gas-fired generation and market purchases account for 42 percent of PGE's power supply, while these sources account for only 14 percent of PacifiCorp's power supply.

PGE Taxes "Collected" and Tax Payments
1997-2005

		City of Portland Analysis 12/6/05
Income Taxes "Collected" by PGE		
	1997	48,319,044
	1998	92,198,000
	1999	97,868,000
	2000	95,985,000
	2001	53,053,000
	2002	70,625,000
	2003	76,115,000
	2004	85,286,000
	2005	64,000,000
		683,449,044
Federal Income Taxes Paid by PGE to Enron 1997-2005		
	1997	-
	1998	111,331,777
	1999	113,512,357
	2000	92,665,953
	2001	29,341,127
	2002	-
	2003	35,114,773
	2004	73,885,366
	2005	67,814,743
		523,666,096
State Income Taxes Paid by PGE to Enron 1997-2005		
	1997	-
	1998	11,041,874
	1999	14,405,568
	2000	15,279,676
	2001	5,579,393
	2002	-
	2003	2,313,700
	2004	7,812,517
	2005	7,401,163
		63,833,891
Local Income Taxes Paid by PGE to Enron 1997-2005		
	1997	-
	1998	430,553
	1999	1,212,082
	2000	1,453,449
	2001	403,608
	2002	-
	2003	426,466
	2004	990,690
	2005	1,890,072
		6,806,920

PGE Taxes "Collected" and Tax Payments
Page 2

		City of Portland Analysis 12/6/05		
		PGE Payments	Enron Payments	Total
Federal Income Taxes Paid by PGE and Enron	1997		(108,734)	
	1998		5,041,153	
	1999		1,687,054	
	2000		877,061	
	2001	(63,265)	321,384	
	2002	789,510	1,225,563	
	2003		247,675	
	2004		1,021,953	
	2005	-	-	
		726,245	10,313,109	11,039,354
State Income Taxes Paid by PGE and Enron	1997		10	
	1998		10	
	1999		10	
	2000		10	
	2001	(34,130)	10	
	2002	860	10	
	2003	10	10	
	2004		10	
	2005	-	-	
		(33,260)	80	(33,180)
Local Income Taxes Paid by PGE and Enron	1997-2005	-	-	-
Total Payments to Taxing Authorities	1997-2005	692,985	10,313,189	11,006,174

DEFERRED TAXES

This Q&A explains what deferred taxes are and how they affect both utilities and customers.

Throughout the discussion, assume a hypothetical generating plant built by an electric utility that the agency regulates. The plant costs $400 million to build, and the utility expects it to provide service for 40 years. Of course, the Internal Revenue Service (IRS) recognizes that plant wears out, so it allows an annual deduction for depreciation. If the utility were to use so-called straight-line depreciation for the plant, it would have an annual deduction of $10 million per year.

Income tax law, however, allows accelerated depreciation. The law allows a 20 year life to the plant for tax purposes, so the utility can average a deduction for depreciation of $20 million per year, or double what it would be entitled to under a straight line approach.

Moreover, the law allows what tax people call a declining balance, meaning that the utility can take more than $20 million in depreciation deductions in the early years of the plant, so long as it takes less in its later years. In our example, the utility takes $25 million in year 1. The number declines in years 2, 3, 4, etc., so that by years 10 and 11, the utility is taking about $20 million a year as a deduction. Thereafter, the deduction continues to decline, so that in year 20, the utility is taking only $15 million. By the end of year 20, the utility has taken $400 million in depreciation deductions, the total to which it is entitled. It gets no deductions in years 21 through 40.

How does the PUC determine the amount of money a utility should be able to collect from its customers?

Using data for a 12-month "test year," the PUC determines what regulators call a "revenue requirement." A revenue requirement is an estimate of the amount of money a utility needs annually to:

(1) pay reasonable expenses (such as the cost of generating or buying power, maintenance, employee compensation, taxes) it incurs in serving its customers; and

(2) earn a reasonable return on the "rate base," or net book investment it has made to serve customers. The PUC determines the investment on which a utility may earn a return by starting with the dollars the company invested in plant and reduces that original investment by dollars customers have returned to the company as payment for depreciation on the plant. Consider the $400 million investment in the hypothetical plant above. If the PUC is setting rates at a time when customers have returned $150 million to the utility for depreciation payments through rates, then the net book of that plant is $250 million. That's now the amount in rate base on which the utility earns a return.

What are deferred taxes?

Deferred Taxes are caused by temporary differences between book and income tax accounting. The primary cause is the fact that there are two depreciation schedules used for utility plant: one is an accelerated depreciation schedule the utility uses for calculating taxes for its income tax return; the other is a straight-line schedule the Commission uses for estimating the taxes that go into revenue requirement.

Why are utilities allowed to use accelerated depreciation for tax purposes?

Federal and state tax law allow business certain tax incentives such as accelerated depreciation. These tax benefits are designed to encourage businesses to invest in plant and other assets. The benefit to the utility is simply timing. For example, by using accelerated depreciation, the utility takes a higher tax deduction and reduces its tax liability in the early years of a plant asset compared to what is calculated for customer rates. In later years, however, the tax deductions (and tax benefits) related to that asset are lower than what is included in calculating tax expense in customer rates. Over the life of the plant, the total depreciation deductions and related tax benefits are the same.

Using the example above of a $400 million plant with a 40-year life, how are deferred taxes calculated?

In this example, the utility depreciates the plant over only 20 years using a so-called declining balance for tax return purposes. In year 1, the utility takes a $25 million tax deduction, which will decline every year until it is only $15 million in year 20. In year 20, the utility has received the entire $400 million of tax depreciation deductions to which it is entitled, so there are no deductions during years 21-40.

Now contrast the actual tax schedule to the second, straight-line (known as “book”) depreciation schedule. Under the IRS ruling, the PUC must not lower its estimate of taxes that go into revenue requirement by taking into account the utility’s front loaded deductions for depreciation. Instead, the PUC must assume the utility is receiving only a $10 million annual deduction.

Using these assumptions, the utility books a deferred tax expense (in year 1, the difference between $25 million and $10 million, multiplied by the tax rate) in each of the first 20 years. In years 21-40, the utility books a deferred tax credit, reflecting the fact that tax depreciation is less than book depreciation by $10 million each year.

Aren’t customers being harmed by the IRS requirement than the PUC cannot reflect the accelerated depreciation in rates?

No. First, let's look at what the utility is getting. The IRS ruling gives the utility the benefit of the difference between what it would get under straight-line depreciation and what it is actually getting under accelerated depreciation. In year 1, that difference is $6 million (the difference of $15 million in tax deduction multiplied by an assumed tax rate of 40%). Because the IRS ruling does not allow the PUC to reflect the lower tax payment in rates, the utility gets the use of $6 million tax savings **earlier** than it would have received that saving under straight-line depreciation.

Second, let's look at what customers are getting. Although the PUC must assume a lower tax deduction than the one the utility is actually getting, it is able to **reduce rate base** by the tax effect of the difference between tax and book (straight-line) depreciation. Recall that rate base is the net book on which the utility earns a return. And recall that the greater the rate base, everything else being equal, the higher the revenue requirement. If year 1 coincides with a "test year" used to set rates, the PUC is able to **lower** the rate base, in this example, by the $6 million the utility saved on its taxes and **lower rates** accordingly. (Moreover, the rate base effect is cumulative, in that the difference each year accumulates through year 20 in this example, then begins to go down until it reaches zero at year 40. A test year at any time prior to year 40 would reflect a rate base reduction.)

So both the utility and its customers benefit from deferred taxes?

Absolutely. As the example shows, the utility gets its tax deduction for depreciation earlier rather than later, so it has the time value of the dollars. In our example, it has the time value of $6 million in year 1. The time value is what the utility avoids in interest by not having to borrow that $6 million. Again, customers get a rate base reduction of $6 million. If the rate of the return for the utility is, say, 10%, then the utility needs to collect $600,000 less from customers to cover its return on rate base.

One can see the benefits clearly by apply a "but for" test. But for the federal and state tax law that allows for accelerated depreciation, what would the utility and its customers get? The utility would lose the front-loaded deduction for depreciation than it can use interest free. And the customers would lose lower rates through the rate base reduction. It is important to note that the IRS has issued several rulings concluding that if a utility attempted to pass through accelerated deductions to customers, the IRS would disallow the deductions, and both the utility and customers would lose these benefits.

What does Senate Bill 408, which the Legislative Assembly passed last session, say about deferred taxes?

The Legislative Assembly passed Senate Bill 408 to match up the taxes that a utility collects in rates with what it ultimately pays. But with respect to deferred taxes, it made an exception by allowing--expressly--a mismatch between taxes collected in rates and taxes paid. The Legislative Assembly did so because it realized that deferred taxes are a benefit to both the utility and its customers.

Please summarize the effect of deferred taxes.

Deferred taxes are not money that the utility is "keeping" instead of sending to its tax authorities or to its parent corporation, in the event that parent files a consolidated return. Rather, deferred taxes represent a timing difference in the utility's tax liability over the life of an asset. As a result of tax law that allows accelerated depreciation of utility plant, deferred taxes provide an important benefit to both utilities and their customers. Not allowing deferred taxes to be included in customer rates would cause those benefits to be lost.

PGE
Multnomah County Business Income Tax

Effective Date	Collection Rate
05/01/97	0.00353
11/01/97	0.00388
05/01/98	0.00367
11/01/98	0.00342
05/01/99	0.00164
11/01/99	0.00852
05/01/00	0.00001
11/01/00	0.00026
05/01/01	0.00273
11/01/01	0.00728
05/01/02	0.00159
11/01/02	0.00001
05/01/03	0.00001
11/01/03	0.00001
05/01/04	0.00001
11/01/04	0.00356

Calendar Year Collection

	Amount Collected
1997	$ 741,234
1998	1,167,599
1999	1,114,275
2000	1,085,752
2001	1,017,597
2002	1,539,528
2003	1,487
2004	129,028
Jun-05	752,215

February 8, 2006

TO: Vikie Bailey-Goggins
Oregon Public Utility Commission

FROM: Patrick Hager
Manager, Regulatory Affairs

PORTLAND GENERAL ELECTRIC
City of Portland Tax Analysis 2005
PGE Response to OPUC *Informal* Data Request
Dated January 27, 2006
Question 018

Request:
Please provide an explanation of why methodologies changed for where to assign bookouts from 1997 to 2005.

Response:

Since the enactment of the Multnomah County Income Tax ordinance, PGE's tax department has used the data included in the FERC Form 1 (pages 326-7) to determine which wholesale sales were in Multnomah County as well as to determine which sales were in-state for purposes of Oregon State Excise Taxes. Historically, the amount of wholesale sales attributed to Multnomah County was extremely low because the analyst reviewing the data used the location of the counterparty to site the transaction.[14] Few counterparties are located in Multnomah County.

When beginning to prepare for the 2000 tax return, the new Tax Manager asked Risk Management to provide electronic information to eliminate the manual process used by the Tax Analysts. Risk Management provided a spreadsheet that listed sales by hub and a category called bookouts. Discussions between the Tax Department and others concluded that the bookouts should be attributed to Multnomah County because no power flowed from these transactions. Because power did not flow, the transaction occurred in Multnomah County. Parties to the discussions believed that trading transactions that didn't physically deliver or were

[14] For instance, if the counterparty was Avista, the sale was recorded for tax purposes in Washington, were the power was delivered. For PacifiCorp, the sale was recorded in Oregon.

"netted/booked" against each other should be assigned to Multnomah County since that was where the transaction was originated.

In 2001, PGE expected to be subject to PUHCA reporting requirements that required that **all** transactions to be assigned to a trading hub to evaluate interstate and intrastate activities. During the year, sales, purchases, **and** bookouts were tracked by hub. The spreadsheet provided in 2002 for the 2001 tax filing did not contain a separate bookout category and the transactions were assigned by hub and continue to be assigned to a hub. PGE has continued using this methodology. However, to address the issue of attribution of wholesale sales, PGE has hired Ernst and Young to pursue a private ruling from Multnomah County regarding the treatment of these financial transactions.

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From: Karen Laumand
To: Jennifer Busch
Date: 5/8/03 11:52AM
Subject: Re: Multnomah County Tax Billed to Customers

Jennifer,

Thanks for the info. Since the tax is not currently appearing on the average customers bill due to the small percentage/rounding, the tax will now come and go. Your statement that the rate was really chosen as a placeholder is understandable and therefore the only reason a rate should always be maintained. It seems that implementing a minimum rate of 1 cent during times of overcollection would always insure that the tax appeared on ALL customers bills. An idea to think about for the future.

Karen

Karen Laumand
PGE
503-464-8918
503-464-2236 Fax

>>> Jennifer Busch 05/08/03 11:28AM >>>

The TIB 44 rate is .00001
At the time, Marcia said we really didn't need to collect but that it was historically better to collect something rather than having the tax come and go which is more confusing to customers. So, the rate was chosen really as a placeholder for the tax for when we do need to collect.

>>> Karen Laumand 05/08/03 11:16AM >>>

The Multnomah County taxes collected remains overcollected therefore the Multnomah County Tax rate should remain at .00001 (or .0001?). This rate was determined back in October 2002 and was effective 10-29-02 with cycle 1. It is my opinion that we should not be collecting any Mult. Cty taxes from the customers but perhaps there are circumstances that I am not aware of.

A few comments I have.....
- Marcia Romito submitted a rate of .00001 in Oct. 2002, the confirmation back showed .0001
- The current amount collected monthly is approx. $150/mth
- The rate is so small that it is apparently appearing only on very large customer bills (I assume industrial/commercial) and is not shown on the average customer bill. This disputes the argument that some rate, no matter what, should always be included on the customers bill so that the tax collection is always shown.

Let me know your comments.

Thanks,
Karen

Karen Laumand
PGE
503-464-8918
503-464-2236 Fax

CC: Bruce Sirnio; Debra Halverson; Katherine Schaffran; Sarah Anderson; Wil Devenport

From: Marcia Romito
To: Jim Barnes
Date: 10/26/2001 1:07 PM
S ject: Re: Multnomah County Tax Billed to Customers
Brian Kuehne; Carolyn Winowitch; DARRINGTON OUTAMA; Karen Orr; RANDY DAHLGREN; Valerie Giles

See below. Let me know if you have more questions.

>>> Jim Barnes 10/26/01 12:34PM >>>
Marcia - sorry, I still have a couple of questions. Can you or Karen summarize this along the following lines, with the goal of determining if we need to make any changes to the 2001 Earnings Forecast or 2002 Budget

1) What is the impact on tax expense and revenue for 2001 and 2002, relative to what is included in the September 2001 FOR and 2002 budget.

Answer: No effect on tax expense. I calculate additional revenue of 551,000 for taxes collected in 2001. I will have to get a complete forecast for 2002 from Karen.

2) per your email, I presume we are increasing the tax rate to .007282 to collect the increased tax expense.

Answer: We are increasing the tax rate to pick up the under collection of taxes for 1999, 2000 based on actual tax returns filed and revised estimate for the remaining 2001.

3) given items one and two, is there a timing difference between when we recognize the tax expense and the increased revenue flow, such that we need to either create a reserve to capture the timing difference or to simply note that there is a timing diffenece in our variance analysis.

Yes, there is a timing difference between when we recognzie the tax expense and increased revenue. Usually there is not much of a difference, however with the wholesale sales activity in 2000, with some of those sales being apportioned to Multnomah Cty. we did not have that increase included in our apportionment.

ny understanding that only Multnomah county residents pay this tax. Have we allocated all of our wholesale sales to Multnomah county? If yes, then only Multnomah county res..nts are paying the tax for sales that benefitted all our customers. I'm concerned with overcharging a subset of our customer base. Or did we somehow only allocate a portion of these sales to Multnomah county and the rest to Washington, Clackamas, etc?

We have not allocated all wholesale sales to Multnomah County. We allocated only the sales which occur in Multnomah County. Then our income is apportioned accordingly.
Thanks, jb

>>> Marcia Romito 10/26/01 12:00PM >>>
We need to change the Multnomah County Tax rate to .007282 to be effective on or around November 1, 20001.

It was determined that the ratepayers did benefit as we avoided a rate increase due to wholesale sales. We recalculated the Multnomah County tax for 2000 excluding the speculative profits from wholesale sales.

like to thank all of you for your input and patience as we worked through the calculation.

Let me know if you have any questions. Thanks! Marcia

AFFIDAVIT Ex. 5

Kafoury v. PGE
PGE000214

From: Marcia Romito
To: LAURA LIDDELL; RUSS ORR
Date: 10/26/2001 12:00 PM
Subject: Multnomah County Tax Billed to Customers
Jim Barnes; Jim Murray; Karen Orr; MARC CODY; RANDY DAHLGREN; SARA CARDWELL

We need to change the Multnomah County Tax rate to .007282 to be effective on or around November 1, 20001.

It was determined that the ratepayers did benefit as we avoided a rate increase due to wholesale sales. We recalculated the Multnomah County tax for 2000 excluding the speculative profits from wholesale sales.

I would like to thank all of you for your input and patience as we worked through the calculation.

Let me know if you have any questions. Thanks! Marcia

AFFIDAVIT Ex. 6

From: Scott Gardner
To: Jim Murray; Marcia Romito; Renee Harris
Date: 10/26/2001 10:29 AM
Subject: 2000-2002 Speculative Settlements
Scott Gardner

Attached is a breakdown of the speculative (trading) settlements for 2000-2002 (excludes all mark-to-market). Included are actuals for 2000 and YTD 2001, along with remaining forecast of settlements for Q4 2001 and 2002.

Please let me know if you have any questions.

Scott

From: Jim Barnes
To: Brian Kuehne; Kirk Stevens
Date: 10/26/2001 8:54 AM
Subject: Re: Fwd: Multnomah County Tax Billed to Customers
C Marcia Romito; RANDY DAHLGREN

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fyi - I talked to Dahlgren this morning and he is going to figure out whether the 2000 amount can also be recovered through our supplemental Mult. Cty tax tariff. If yes, then we would not have to take the $1.1 MM as a hit to earnings. Also since the 2001 taxes are recoverable via the tariff there should not be an earnings hit, just timing on cash flow.

I also asked Marcia to determine if the sales were split between retail and spec, our retail customers shouldn't pay for spec trading taxes.

I would also argue that customers did benefit from the sales in 2000 because they resulted in not having to file for a NVPC deferral in 2000, i.e, customers avoided a rate increase due to the good wholesale margins.

jb

>>> Jim Piro 10/25/01 06:24PM >>>
we need to get this into the forecast

>>> Marcia Romito 10/25/01 11:41AM >>>

In calculating a new rate for Multnomah County tax billed to customers, there could be a substantial increase. (approximately from .00273 to .0163) The reason for the increase is our income apportioned to Multnomah County increased from 26% to 55% as a result of Wholesale Sales being allocated to Mult. Cty. This resulted in an under collection of Multnomah County Tax for the year 2000 in the amount of 1.1 million.

The question is since the ratepayers in 2000 did not benefit from the wholesale sales, can we pass the under collection of tax to the shareholders?

We have the same situation in 2001, however, there is a PCA in 2001, and the ratepayers are benefitting from the wholesale sales. Therefore all of the Multnomah County Tax will be allocated to the ratepayers in 2001.

Please let us know your thoughts on this. Thanks! Marcia

AFFIDAVIT Ex. 8

860-022-0045

Relating to Local Government Fees, Taxes, and Other Assessments Imposed Upon an Energy or Large Telecommunications Utility

(1) If any county in Oregon, other than a city-county, imposes upon an energy or large telecommunications utility any new taxes or license, franchise, or operating permit fees, or increases any such taxes or fees, the utility required to pay such taxes or fees shall collect from its customers within the county imposing such taxes or fees the amount of the taxes or fees, or the amount of increase in such taxes or fees. However, if the taxes or fees cover the operations of an energy or large telecommunications utility in only a portion of a county, then the affected utility shall recover the amount of the taxes or fees or increase in the amount thereof from customers in the portion of the county which is subject to the taxes or fees. "Taxes," as used in this rule, means sales, use, net income, gross receipts, payroll, business or occupation taxes, levies, fees, or charges other than ad valorem taxes.

(2) The amount collected from each utility customer pursuant to section (1) of this rule shall be separately stated and identified in all customer billings.

(3) This rule applies to new or increased taxes imposed on and after December 16, 1971, including new or increased taxes imposed retroactively after that date.

(4) If any county, energy or large telecommunications utility, or customer affected by this rule deems the rule's application in any instance to be unjust or unreasonable, it may apply for a waiver of this rule by petition to the Commission, setting forth the reasons why the rule should not apply.

Stat. Auth.: ORS 183, ORS 756, ORS 757 & ORS 759
Stats. Implemented: ORS 757.110 & ORS 759.115
Hist.: PUC 164, f. 4-18-74, ef. 5-11-74 (Order No. 74-307); PUC 7-1998, f. & cert. ef. 4-8-98; PUC 16-2001, f. & cert. ef. 6-21-01

Dave Hunt - Billing of wholesale sales. ie - Change on the cty. Tax

Retail -vs- wholesale - due to prices) -vs- volume

55%

26%

AFFIDAVIT Ex. 9

Kafoury v. PGE
PGE000240

From: RUSS ORR
To: Jerilynn Coleman, Marcia Romito
Date: Mon, Nov 1, 1999 1:41 PM
Subject: Re: Multnomah Count Tax Rate Change

The new Multnomah County Tax rate has been changed to .00852 in the billing programs (Online and Batch). The new rate is effective with meter readings on Nov 2, 1999.

Thanks,
Russ Orr
612-3992

>>> Marcia Romito 10/21 3:37 PM >>>
We need to change the Multnomah County Business Tax rate to .00852 to be effective on November 2, 1999.

At the of 1998 we were undercollected due to Multnomah County having a one time 1998 increase of .5% tax, which we did not include in our estimated rate. This is the reason for the jump from .00164 to .00852, in case you get some phone calls on it. Let me know if you have any questions.

Please let me know when the rate chage has been implemented.

Thanks!

>>> RUSS ORR 10/18 12:59 PM >>>
It's that time again. I will need the new rate by 10-25-99 so I can update all the billing programs. The effective date will be 11-2-99.

Thanks,
Russ Orr
612-3992

CC: Kurt Eggebrecht, LAURA LIDDELL, Ron Unruh, Sara...

February 15, 2006

TO: Vikie Bailey-Goggins
Oregon Public Utility Commission

FROM: Patrick Hager
Manager, Regulatory Affairs

PORTLAND GENERAL ELECTRIC
City of Portland Tax Analysis 2005
PGE Response to OPUC *Informal* Data Request
Dated January 27, 2006
Question No. 017

Request:

Please provide an explanation of the PGE e-mails featured in Willamette Week newspaper article.

Response:

The e-mails reported in the *Willamette Week* weekly were taken out of context and misinterpreted by the reporter (as well as others). PGE provided thirteen e-mails that were written between October 18, 1999 and May 8, 2003 related to Multnomah County Business Income Tax calculations, but excerpts from only two e-mails were quoted. It is helpful to consider the e-mails in light of the two separate activities involved with collecting Multnomah County Business Income Tax; the derivation of the rate used to bill customers, and the development of PGE's stand alone tax liability.

Rate Development

PGE's practice at that time was to assess the rate charged for Multnomah County Business Income Tax every six months (changed to annual on January 1, 2006) based on a pro forma tax calculation that takes into account: a) the current balance (positive or negative) between prior period tax liabilities and taxes collected, b) the estimated ongoing tax liability, and c) the estimated taxes collected in the prior six months. The rate was calculated using estimated retail revenue in Multnomah County for the next six months.[15] All estimated Multnomah County Business Income Tax liabilities were computed assuming PGE operated on a stand alone basis.

[15] The portion of retail revenues attributable to the county is also reviewed at this time. The formula is (*Expected Retail Revenues in Multnomah County)/(Expected Retail Revenues)*.

This was true regardless of whether PGE was consolidated or unconsolidated. Although the rates applied as a result of this calculation changed over time, the overall goal remained the same--collect only Multnomah County Business Income Taxes equal to the utility portion of the Multnomah County Business Income Tax liability computed on a PGE stand alone basis. As is true for all companies and individual taxpayers, a timing difference exists between the time the liability is incurred and the date when the final tax payment is made.

When Ms. Romito began to prepare the November 2001 rate update, she discovered that the actual taxes collected in 2000 varied from the tax liability computed on the 2000 Multnomah County Business Income Tax return, which had recently been completed. (Multnomah County Business Income Tax returns are generally filed in September of the following year.) At this point, the e-mails between Ms. Romito and Mr. Barnes began. Ms. Romito sought advice from her manager and also through e-mail from Mr. Barnes.

An exchange on October 26, 2001 between Ms. Romito and Mr. Barnes is the source of the purported controversy in the *Willamette Week*. Ms. Romito notifies Mr. Barnes of the need to change the tax rate charged on customer statements. Mr. Barnes then asks Ms. Romito for the answers to several questions. The e-mail exchanges and explanations follow:

<u>E-mail Statement:</u>

1) *What is the impact on tax expense for 2001 and 2002, relative to what is included in the September 2001 FOR and 2002 budget?*

Answer: No effect on tax expense. I calculate additional revenue of $551,000 for taxes collected in 2001. I will have to get a complete forecast for 2002 from Karen.

<u>Explanation:</u>

Ms. Romito's above response on tax expense is correct. The rate change does not affect tax expense. Her response on "additional revenues" is related to the revenue increase expected for the last two months of 2001 from the rate change needed to begin to balance Multnomah County Business Income Tax collections and the Multnomah County Business Income Tax liability calculated on a stand alone basis.

<u>E-mail Statement:</u>

2) *Per your e-mail, I presume we are increasing the tax rate to .007282 to collect the increased tax expense.*

Answer: We are increasing the tax rate to pick up the under collection of taxes for 1999, 2000 based on actual tax returns filed and revised estimate for the remaining 2001.

<u>Explanation:</u>

Ms. Romito is simply describing the rate development process discussed above and **when** the under-collected monies will be recovered—2001 and 2002.

<u>E-mail Statement:</u>

3) *given items one and two, is there a timing difference between when we recognize the tax expense and increased revenue flow, such that we need to either create a reserve to capture the timing difference or to simply note that there is a timing difference in our variance analysis?*

Yes, there is a timing difference between when we recognize the tax expense and increased revenue. Usually there is not much of a difference, however with the wholesale sales activity in 2000, with some of those sales being apportioned to Multnomah Cty. We did not have that increase included in our apportionment.

<u>Explanation:</u>
This exchange makes clear that Mr. Barnes and Ms. Romito recognize that the time between the appearance of a tax expense and when the rates are changed in response to the tax expense create a "timing difference." A "timing difference" does not produce net profits as claimed by the *Willamette Week.* The "timing differences" that occur from the date tax collections occur and tax liabilities are paid net to zero over time. That is, revenues may exceed expenses during **one** period with expenses exceeding revenues during a **following** period.

4) *It's my understanding that only Multnomah county residents pay this tax. Have we allocated all of our wholesale sales to Multnomah county? If yes, then only Multnomah county residents are paying the tax for sales that benefited all our customers. I'm concerned with overcharging a subset of our customer base. Or did we somehow only allocate a portion of these sales to Multnomah county and the rest to Washington, Clackamas, etc?*

We have not allocated all wholesale sales to Multnomah County. We allocated the sales which occur in Multnomah County. Then our income is apportioned accordingly.

<u>Explanation:</u>
The above exchange was not reported in the *Willamette Week.* This exchange clearly shows that the two parties, Ms. Romito and Mr. Barnes, were concerned about setting the appropriate rate and collecting the appropriate amount of money to cover the 2000 tax liability. It further indicates that neither party was engaged in a form of subterfuge to increase the amount of money PGE could collect from customers.

Because the rate development process described above always seeks to balance Multnomah County Business Income Tax collections with the Multnomah County

Business Income Tax liability on a stand alone basis, there is no “profit” to PGE and the e-mails cannot be stretched to reach this conclusion.

Other E-mails:

The other e-mails posted on the *Willamette Week* web site (from 1999 and 2003) are all consistent with the rate development process. They are internal PGE discussions about the rate development. It should be noted that the 0.007282 rate discussed by Ms. Romito in October 2001 is not the highest rate used by PGE for this tax. The e-mails from 1999 discuss the development and implementation of a 0.00852 rate, a rate 17% higher than the rate used in November 2001.

Development of stand alone tax liability

PGE calculates its stand alone tax liability for Multnomah County Business Income Tax independently of the rate development process. Starting in mid-summer of 2001, after completion of the 2000 federal and Oregon tax returns, the PGE tax department calculated Multnomah County Business Income tax and filed the tax return by October 15, 2001 with Enron, as required at that time. The 55% referenced in the article actually refers to the portion of PGE revenue, both wholesale and retail, that was assigned to Multnomah County on the stand alone Business Income Tax calculation as a result of bookouts assigned to income generated in Multnomah County. The change in the method used to assess the location of wholesale sales led to the increase in total utility revenues assigned to Multnomah County (see PGE Response to OPUC Data Request 018).

After the 2000 return was completed, Ms. Romito used the actual taxes paid per the return as the basis for calculating the over- or under-collection from customers. Because of the significant under-collection she started inquiring into the cause-- hence the series of e-mails.

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PGE Distribution to Enron: Claims and Offsets

Creditor	Debtor	Amount
PGE	Enron (major items include:) PGC/PGH NQ Benefit Plan - $85 million Enron Merger Receivable - $73 million Income Taxes Receivable - $4.8 million	Claimed: $165,259,934[4] Offset:: $15,367,762[1] Net Claimed: $149,892,177[2]
PGE	Enron Broadband Services, Inc Administrative Services	Claimed: $29,266
PGE	EEOS Company Consulting services	Settled: $23,215
PGE	Enron North America Corp Office Support Services	Claimed: $150,736
PGE	Enron Power Marketing Power Sales/Purchases Transmission Services	Claimed: $80,397,566 Offset: $78,469,017 Net Claimed: $1,928,548[3]
World Trade Center NW	Enron Corp.	Claimed: $131,543
Salmon Springs Hospitality Group	Enron North America Corp.	Claimed: $5,092

1. According to PGE, this amount payable to Enron was reduced to approximately $14.1 million as a result of subsequent adjustments after the Proofs of Claim were filed.
2. Approximately $4.8 million was not distributed, rather it was offset against the $14.1 million above.
3. Only the net claim was distributed.
4. PGE's claim includes the approximately $85 million related to the potential claims associated with the Portland General Corp. / Portland General Holdings, Inc. Non-Qualified Benefit Plans.

Power Cost Statistics from Selected PGE Rate Cases.

	UE 100	UE 115	UE 172
Forecast Test Period	1997	Oct. 2001- Dec. 2002	2006
Cost-of-Service Load (in MWa)	2,210	2,481	2,232
Resource Contribution (in % of Load)			
Hydro	26%	20%	22%
Coal	23%	21%	22%
Natural Gas	20%	17%	4%
BPA Subscription	0%	10%	9%
Market Purchases	24%	31%	38%
Other	7%	1%	5%
Average Resource Cost (in $/MWh)			
Coal	9.70	9.74	11.21
Natural Gas[#]	11.19	38.43	26.54
Forward Purchases		85.73	53.97
Balancing Purchases	18.19	26.60	69.31
Total Market Purchases	18.19	78.26	56.36
Average Wholesale Market Prices			
Natural Gas, Sumas (in $/MMBtu)	1.29	3.03	9.35
Electricity, Mid-C 7x24 (in $/MWh)	19.04	33.50	66.18
Net Variable Power Costs (in $/MWh)	11.83	34.98	32.30

[#] Reflects PGE's hedging of natural gas price risk in UE 115 and UE 172.