

# TESTIMONY ON SB 967

before the House Committee on Business and Labor  
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The Utility Reform Project (URP) opposes SB 967, as it would revert ratemaking in Oregon to its pre-2005 situation: allowing the Oregon Public Utility Commission (OPUC) to authorize utilities to charge ratepayers for hundreds of millions of dollars for local, state, and federal "income taxes" that the utilities in fact do not pay.

As I testified to the Oregon Legislature in 2005:

Oregon private utilities are currently charging Oregon ratepayers over \$100 million per year for "federal income taxes" and "state income taxes" that in fact those utilities are not paying. PGE alone has been charging ratepayers \$92.6 million per year for such phony "taxes," which neither PGE nor its corporate parent, Enron, has paid to any level of government. This unpaid taxes, charged to ratepayers, now total over \$730 million for PGE alone.

A more complete description of the situation in 2005 is presented in the attached op-ed article by Senators Rick Metsger and Vicki Walker, published THE OREGONIAN on July 7, 2005. It notes that the private utilities had been charging Oregon ratepayers \$150 million per year for "income taxes" never paid to any government. Among the newspaper editorials endorsing SB 408 (2005) were those in THE OREGONIAN, STATESMAN-JOURNAL, ALBANY DEMOCRAT-HERALD, and DAILY ASTORIAN.

PGE continued to charge Oregon ratepayers, at the same rate of nearly \$100 million per year, until January 1, 2006, when the automatic adjustment clause feature of SB 408 (2005) became effective. Since then, PGE has not been allowed to charge ratepayers for "income taxes" it does not actually pay to a unit of government. The result has been a net refund to PGE ratepayers of \$40 million, a number that will nearly double if Utility Reform Project and Ken Lewis prevail in a case now before the Oregon Court of Appeals. The other result is that PGE has since 2006 has actually been paying income taxes to the State of Oregon, as have the other non-consolidated utilities, as SB 408 (2005) removed the incentive to avoid doing so (keeping the money for shareholders).

You will hear that SB 408 (2005) was complicated and "yielded unintended costs to Oregonians." The reason is that the OPUC sabotaged the implementation of SB 408 (2005). First, the OPUC refused to adopt the automatic adjustment clauses required by SB 408 (2005) until it was ordered to do so by the Marion County Circuit Court in a suit brought by Utility Reform Project and Ken Lewis.

Second, the OPUC adopted a methodology for attributing income taxes paid by parent corporations (such as Berkshire Hathaway) to the subsidiary utility (such as PacifiCorp), so that the subsidiary utility receives credit for income taxes paid by the parent corporation (the consolidated filer), even if the utility pays zero in income taxes itself. Such a methodology is not objectionable per se, but the one adopted by the OPUC is absurdly complex and relies on confidential information about the worldwide operations of the parent corporation and all of its other subsidiaries (such as worldwide sales revenue, worldwide payroll, and worldwide value of property owned) that no party in any Oregon rate proceeding can check for accuracy. It is this methodology that has allowed PacifiCorp to impose \$53.5 million in surcharges on Oregon customers. David Cay Johnston, the Pulitzer Prize-winning former tax reporter for the NEW YORK TIMES, described this methodology in STATE TAX NOTES (February 28, 2011) (attached):

Customers had to pay \$53.5 million in surcharges for taxes not collected [from ratepayers]. The problem is that no one really know if that is reality or just gifts to [Warren] Buffet and friends . . .

Buffett's lobbyists have now persuaded the Oregon legislature that he needs lawmakers to relieve him from [SB 408 (2005)] by ordering the PUC to scrap its current approach and try a new one. Think of it as the Warren Buffett and friends personal tax relief act. Let's call it the Tax Heists Enriching Financial Titans Act, or THEFT for short.

The Oregon PUC proposal is pretty much a PacifiCorp dream come true.

SB 967 repeals not only the complicated part of SB 408 (2005) but also its very simple and central policy statement: "Utility rates that include amounts for taxes should reflect the taxes that are paid to units of government to be considered fair, just and reasonable." That central policy statement, combined with the prohibition on rates that are "not fair, just and reasonable" (ORS 757.210(1)(a)), created a requirement that the private utilities operating in Oregon not charge ratepayers for taxes that they do not actually pay to government.

Instead, SB 967 allows utilities to charge ratepayers for income taxes that are never paid to any unit of government. It allows such charges to be "based on estimated revenues derived from the regulated operations of the utility" and contemplates that charges are to be based on "the utility's estimated income tax expense." This returns to the pre-2005 system of basing "income taxes" on estimates, not reality. The problem then was that the OPUC wanted to allow the utilities to charge ratepayers for

purely hypothetical "income taxes" that were never paid. The OPUC itself vehemently opposed SB 408 (2005). Under SB 967, the Commission would have the opportunity to return to the pre-2005 regime.

Note that nowhere in SB 967 is there any requirement that the utility must actually pay the "income taxes" it charges to ratepayers. Instead, that requirement (ORS 757.267, noted above) is repealed by SB 967.

Section 1(2) of SB 967 includes various other criteria, all of which were also within the Commission's authority prior to SB 408 (2005) and none of which prevented the Commission from allowing the utilities to charge over \$1 billion to Oregon ratepayers for "income taxes" that were never paid.

Section 1(3) of SB 967 merely states that the Commission "may adjust the utility's estimated income tax expense based upon" three criteria, none of which are mandatory upon the Commission.

The appropriate response of the Legislature is not to repeal SB 408 (2005) but to simplify the OPUC's implementation of it by specifying in law adoption of the Pennsylvania methodology for attributing some part of the income taxes paid by a parent corporation to its subsidiary utility. HB 3462 does that and should be adopted instead of SB 967.

### **Comments on Testimony of Commissioner Susan Ackerman**

Commissioner Ackerman's testimony implies that SB 967 does not allow the Commission to return to its pre-2005 practice of allowing utilities to charge ratepayers for "income taxes" based on estimates and not actual payments to units of government. But SB 967 repeals the SB 408 (2005) requirement that rates may include charges only for those "taxes that are paid to units of government." There is nothing in SB 967 that reestablishes that requirement.

Commissioner Ackerman states that the workgroup "achieved an uncommon amount of consensus." Such consensus was achieved only by entirely disregarding my input. She says that "the stakeholders in the workgroup are satisfied with [her] testimony," which is true only if "stakeholders" is defined to exclude anyone who disagrees with it.

## **Stop the giveaway of ratepayers' utility taxes**

Rick Metsger  
Vicki Walker

Thursday, July 07, 2005  
The Oregonian

The electricity and gas utilities regulated by the Oregon Public Utility Commission have for years been charging Oregon ratepayers hundreds of millions of dollars for state income taxes and federal income taxes that have not been paid to any government. The best estimate of these charges for phony taxes is \$150 million a year.

The PUC simply allows the utilities to charge ratepayers wildly inflated "estimates" of state and federal income taxes. These estimates are not based on any review of a utility's actual tax payments or past tax returns. Instead, the PUC simply applies the statutory income tax rate to the utility's estimated net income. For example, if the rates are designed to earn PGE \$200 million in net income a year, then the amount included in rates to pay PGE's federal income taxes is \$70 million because that is \$200 million times the nominal federal income tax rate of 35 percent.

But these estimates are wrong. We know that PGE has charged Oregon ratepayers, since being acquired by Enron in 1997, more than \$750 million for state and federal income taxes that in fact neither PGE nor Enron has paid or ever will pay to any government.

PacifiCorp charged Oregon ratepayers more than \$88 million for state and federal income taxes in 2002 but paid the state only \$10 in state income taxes, which strongly implies that PacifiCorp also paid little or nothing in federal income taxes that year.

The utilities' tax returns are confidential. It is fair to say, however, that Oregon ratepayers during the past eight years have almost certainly paid these utilities more than \$1 billion for federal and state income taxes not paid to any government.

The Oregon Department of Revenue reported that, during the years 2000-03, the six largest regulated energy utilities paid in the aggregate only \$1.5 million to \$5 million a year in state income taxes. But these utilities charged Oregon ratepayers nearly \$30 million for state income taxes in each of those four years. So about 90 percent of this \$30 million a year is charged to ratepayers but never actually paid to a government. The same is likely true for their federal income taxes charged to ratepayers.

Charging these phony income taxes to ratepayers is a profit center for the utilities and has the effect of increasing their financial returns on investment to absurd levels. The income taxes retained by PGE and Enron added about 9 percentage

points to PGE's authorized return on equity, nearly doubling it from 10.5 percent to 19.5 percent.

Senate Bill 408 will end this scam in Oregon. It requires each regulated utility (except water utilities) to file an annual tax report with the PUC, stating the amount of income taxes actually paid to government by the utility or by its consolidated group and properly attributed to the utility. It requires the PUC to create automatic adjustment clauses in the utilities' rates, so that the charges to ratepayers for income taxes are no more and no less than the income taxes actually paid to governments.

In 19 other states that we know of, the legislature or PUC has taken actions to stop utilities from charging ratepayers for income taxes that the utilities actually do not pay, and all of their actions have been upheld against challenges in court.

Oregon needs to do the same.

Rick Metsger represents Welches and Vicki Walker represents Eugene in the Oregon Senate. Both are Democrats.

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## Is There Bliss in Ignorance Of the Tax Law?



**The Strained Logic of Satellite Taxes**

**Licensing Software: *Microsoft v. Franchise Tax Board***

**Warren Buffett Wants Your Taxes**

**Schizophrenia Around the Nation**

**Forced Combination in North Carolina**

**Arizona Enacts Corporate Tax Cut, Single Sales Factor**

# Warren Buffett Wants Your Taxes

by David Cay Johnston

*David Cay Johnston is a former tax reporter for The New York Times and teaches at Syracuse University Law School. He is also the author of two books about taxes, *Free Lunch* and *Perfectly Legal*.*

*Johnston looks at the latest effort by corporate-owned utilities to divert federal and state taxes built into the rates customers pay into corporate profits instead of turning the money over to the government.*

Legendary Omaha investor Warren Buffett loves stuffing tax dollars into his pockets, which means that money never gets to schools, police, and libraries. Now it looks as if he is about to defeat an Oregon law intended to ensure taxes go for public purposes, not private gain.

Events transpiring in Salem, Ore., give us a perfect real-world economic experiment, one that shows how a simple change in tax law could stop the growing practice of capturing tax dollars for private gain. It also shows a major reason why the use of holding companies is damaging to utility customers and taxpayers and why requiring all utilities to be stand-alone companies would reduce costs, streamline expensive regulatory proceedings, create transparency, and stop the conversion of tax dollars into private profits.

Americans pay billions of dollars each year to cover the corporate income taxes of legal monopolies — electric, gas, water, cable, and other utilities. The taxes are built into the regulated prices that utilities charge, prices set by the Federal Energy Regulatory Commission for interstate operations like pipelines and by state agencies like the Oregon Public Utility Commission (PUC) for intrastate utilities.

Diverting taxes for private gain was a story that hit Oregon with a wallop nine years ago when I revealed that Enron, which owned the state's biggest electric utility, Portland General Electric (PGE), did not pay income taxes for years. Close to

\$1 billion of federal and state taxes built into PGE rates never got to government.<sup>1</sup>

In 2005 the Oregon Legislative Assembly passed a law (SB 408) requiring the state's four corporate-owned utilities to either turn over to government the taxes built into the rates they charge or give the money back to customers.

**Requiring all utilities to be stand-alone companies would reduce costs, streamline expensive regulatory proceedings, create transparency, and stop the conversion of tax dollars into private profits.**

The next year Buffett bought Oregon's other corporate electric utility, PacifiCorp. It is a subsidiary of his MidAmerican Energy Holdings, which operates utilities from Iowa to Utah to Oregon.

As soon as PacifiCorp became part of Buffett's empire, his lawyers and lobbyists set out to undermine the tax true-up law. They fought to get unworkable rules at the Oregon PUC, and they sought repeal of the law.

The law has worked pretty well at two of the utilities, PGE and Northwest Natural Gas. The reason is that they are stand-alone companies that file their own tax returns, making everything transparent.

PGE customers got back \$39.9 million in the first three years, while Northwest Natural Gas customers had to pay \$12.5 million more because the

<sup>1</sup>Available at <http://www.nytimes.com/2002/01/17/business/enron-s-collapse-the-havens-enron-avoided-income-taxes-in-4-of-5-years.html?scp=1&sq=enron+and+tax+and+david+cay+johnston&st=cse&pagewanted=all>.



taxes embedded in their bills were that much less than the taxes the company paid over to government.

The problem was with PacifiCorp, because it is part of a consolidated tax return filed by its corporate parent. Customers had to pay \$53.5 million in surcharges for taxes not collected. The problem is that no one really knows if that is reality or just gifts to Buffett and friends, because it is not a stand-alone company and the Oregon PUC did not make it prepare a dummy tax return as if it were a stand-alone.

Buffett's lobbyists have now persuaded the Oregon legislature that he needs lawmakers to relieve him from the 2006 law by ordering the PUC to scrap its current approach and try a new one. Think of it as the Warren Buffett and friends personal tax relief act. Let's call it the Tax Heists Enriching Financial Titans Act, or THEFT for short.

The Oregon PUC proposal is pretty much a PacifiCorp dream come true.<sup>2</sup>

Here's how Dan Meek, a consumer lawyer who for years has exposed sweetheart deals the utility commissioners gave to those they are supposed to regulate, describes the new plan:

The PUC commissioners sabotaged SB 408 from the beginning. They did not follow the law, requiring establishment of automatic adjustment clauses, until I sued the Commission in early 2007 and got a court order in January 2008.

The new move merely repeals the law and replaces it with very vague language that will again allow the Oregon PUC to do what it has always wanted to do — allow the utilities to charge ratepayers for income taxes, regardless of whether those income taxes are actually paid to government.

They adopted an absurd formula to determine how much of a consolidated corporation's income taxes would be "attributed" to the utility subsidiary. The formula compares the consolidated corporation's worldwide sales, property, and payroll amounts to those three items for the utility for its Oregon service area. All of the worldwide numbers are, of course, not only secret but completely unverifiable by any party in any rate case.

Ann Fisher, a utility lawyer who was involved in implementing SB 408 but not in the current fight over its repeal, says that "the dirty little secret" is that the law was bound to fail because "the commission did not want to do it" and tried to find ways to make sure it would fail as quickly as possible. The

commission never sought advice from Oregon state or federal tax authorities, which Fisher sees as a sign of this bad faith.

"We spent a lot of time trying to work through perceived roadblocks that the commission and the utilities set up," Fisher said, "but at no time was there any thought about a simpler approach, such as the utility taking all of the tax dollars it collected and putting them into escrow and then being able to petition for the money back to cover actual taxes."

Fisher said the fairest way to think about the issue is to ask "whether the PUC would have let the companies suffer if they collected too little from customers to pay their taxes." Of course not, she said, adding that the reverse should also be true — that utilities cannot collect more than they need to pay their current taxes.

Even if the Oregon authorities could audit Mid-American, the expense would be enormous, especially compared with treating it as if it were a stand-alone. The results so far suggest that PacifiCorp customers are much worse off than if the law had not been passed and that those surcharges are just extra money going to Buffett and friends, but of course conditions could change and money might flow back to customers as refunds, something PacifiCorp lobbyists regard with horror.

The one consumer advocate who favors a rewrite is Bob Jenks, an economist who is executive director of the Oregon Citizens' Utility Board, which represents homeowners and other small customers. He thinks the existing law is unworkable when a holding company is involved and dislikes the surcharges, which result in big swings in utility rates from one year to the next, making it hard for most people on budgets to pay for electricity.

**Any tax dollars the utility or its parent keep create what is by definition an unjust and unreasonable rate of return.**

If all rate-regulated utilities were stand-alone companies, the only issue about taxes embedded in their rates would be accounting for the time value of tax money that gets paid monthly by customers, but is delayed going to the government for years because of differences in book and tax accounting.

Taxes collected now and turned over to government are a form of forced loan from customers that must be endured only by corporate-owned utilities. Municipal utilities do not pay profits taxes and have no high-cost equity to sustain, explaining much of the reason their rates overall tend to be 15 to 30 percent lower.

Dealing with the forced loan balances, known as phantom taxes, was an easy problem to solve. The

<sup>2</sup>For the Oregon PUC SB 408 proposal, see *Doc 2011-3712*.



2006-2009 SB 408 True-Up Law Results Federal and Oregon State Income Taxes													
	2006			2007			2008			2009		Total	Per Company Implementation
	Per Company Filing	Resolu- tion*	Per Company Filing	Resolu- tion*	Per Company Filing	Resolu- tion*	Per Company Filing	Resolu- tion*	Per Company Filing	Resolu- tion*	Total		
<b>Portland General Electric</b>													
Taxes Paid	\$34,200,000		\$75,261,000		\$49,000,000		\$57,333,324						
Taxes Collected	\$71,300,000		\$60,397,000		\$57,700,000		\$60,040,028						
Surcharge/ (Refund)	\$(37,100,000)	\$(37,496,000)	\$14,864,000	\$14,934,000	\$(8,700,000)	\$(9,403,000)	\$(2,706,704)			(7,944,299)	\$(33,642,704)		\$(39,909,299)
<b>PacifiCorp</b>													
Taxes Paid	\$87,000,000		\$85,728,000		\$120,800,000		\$98,413,398						
Taxes Collected	\$54,400,000		\$81,954,000		\$82,300,000		\$68,979,188						
Surcharge/ (Refund)	\$32,600,000	\$34,500,000	\$3,774,000	\$3,774,000	\$38,500,000	\$1,791,000	\$29,434,210			\$13,474,662	\$104,308,210		\$53,539,662
<b>Northwest Natural</b>													
Taxes Paid	\$32,200,000		\$35,074,000		\$31,700,000		\$35,881,988						
Taxes Collected	\$30,500,000		\$29,546,000		\$31,500,000		\$30,752,103						
Surcharge/ (Refund)	\$1,700,000	\$1,658,000	\$5,528,000	\$5,527,000	\$200,000	\$179,000	\$5,129,885			\$5,126,585	\$12,557,885		\$12,490,585
<b>Avista</b>													
Taxes Paid	\$3,200,000		\$2,255,000		\$3,047,000		\$4,628,000						
Taxes Collected	\$4,300,000		\$4,237,000		\$3,897,000		\$3,728,000						
Surcharge/ (Refund)	\$(1,100,000)	\$(1,500,000)	\$(1,982,000)	\$(1,982,000)	\$(850,000)	\$(850,000)	\$900,000			\$(1,024,000)	\$(3,032,000)		\$(5,356,000)
Total Taxes Paid		\$156,600,000		\$198,318,000		\$204,547,000				\$196,256,710			
Total Taxes Collected	\$160,500,000		\$176,134,000		\$175,397,000		\$163,499,319						
Total Surcharge/ (Refund)	\$(3,900,000)	\$(2,838,000)	\$22,184,000	\$22,253,000	\$29,150,000	\$(8,283,000)	\$32,757,391			\$9,632,948	\$80,191,391		\$20,764,948

\* All resolutions by stipulated agreement between companies and Oregon Public Utilities Commission.

Source: Dan Meek from Oregon PUC filings.

money is simply treated as zero-cost capital, reducing the amount of equity capital a utility gets to earn a return on. In Oregon, PacifiCorp's government-set return on equity is 10 percent, while stand-alone Portland General Electric gets an eighth of a point more.

Chuck Sheketoff, executive director of the Oregon Center for Public Policy, says the proper approach to this issue is to track tax dollars and make sure they get to government.

"We need more transparency in corporate taxes generally — that's why I'm an advocate of public disclosure of state taxes actually paid," Sheketoff told me.

Paul Vogel, the PacifiCorp spokesman, told the *Oregonian* newspaper that the system "is so over-

blown that it has created another layer of government and cost and waste with little or no benefit to our customers."

Another "layer" of government? A whole layer? Oh my, what tall tales the spokespeople for the Wizard of Omaha get paid to tell these days just so your tax dollars can get diverted from public purposes to private gain.

The real problem here is simple. The state sets a "just and reasonable" rate of return for electric utilities. Any tax dollars the utility or its parent keep create what is by definition an unjust and unreasonable rate of return. There is another word for pocketing tax dollars: theft. ☆