

May 21, 2002

Response to Snohomish Tax Analysis

1. The Filing Utilities have been aware of potential state tax issues from the beginning of their efforts to form RTO West. They have been especially aware of the issues surrounding the potential application of certain Washington State taxes --the Public Utility Tax, the Business and Occupation Tax and the Leasehold Excise Tax -- to RTO West's relationship to the Federal Columbia River Transmission System. They are also aware of the recent application of Oregon property taxes to the purchase of a capacity "share" of Federal transmission facilities. The Filing Utilities have structured their RTO West proposal to minimize additional tax burdens.

2. The Filing Utilities have reviewed the April 23, 2002 "Analysis of Tax Implications of RTO West in Washington and Oregon" prepared for Snohomish County PUD ("Snohomish tax analysis"). That analysis concluded that incorporation of the assets of the Federal Columbia River Transmission System into RTO West was "likely to create significant new tax liability" in Oregon and Washington of over \$150 million annually. The Filing Utilities believe that the Snohomish tax analysis ignores critical structural and legal characteristics of the proposed relationship between RTO West and Federal transmission facilities which, when incorporated into the analysis, lead to very different conclusions. For example:

- Public Utility Tax/Business & Occupation Tax: Under the RTO West Transmission Operating Agreement, RTO West would have "no ownership interest in the proceeds or receivables of the amounts billed by RTO West as billing agent" for the Participating Transmission Owners (PTOs), including Bonneville. (Transmission Operating Agreement, §17.3.7). RTO West will act as billing agent for Company Rates, any successor rates, Transfer Charges, External Interface Access Fees and applicable Wholesale Distribution Rates. The PTOs explicitly retain ownership of these revenues in order to continue covering their costs. RTO West would have rights only to the revenues from the Grid Management Charge and any other charges intended to cover RTO West's own costs.
 - Transmission customers will make payments of Company Rates, any successor rates, Transfer Charges, External Interface Access Fees and applicable Wholesale Distribution Rates to a Paying Agent (likely a bank) who will hold them in trust for the benefit of, and directly allocate them to, the appropriate PTO owner. (In order to avoid a bond default, BPA's net billing customers must continue to make power and transmission payments directly to Energy Northwest, as they do today, until annual net billing obligations are satisfied.
 - Thus, the bulk of the "gross revenues" or "gross income" would remain the property of the PTOs, and RTO West would have no interest in or access to these receipts. Neither the Washington Public Utility Tax nor the Business and Occupation Tax would likely be applied to RTO West with respect to revenues which remain federal property.

- Consequently, even if the Public Utility Tax or Business and Occupation Tax were applicable to RTO revenues (and the filing utilities believe neither tax may apply), the amount of taxable revenue would be minimized.
- Leasehold Excise Tax: By joining the RTO, Bonneville Power Administration will not grant an ownership or leasehold interest in federal transmission assets to RTO West. No payments will be made by RTO West to Bonneville as consideration for any ownership or leasehold interest. The legal relationship between RTO West and Bonneville would be better described as that of an independent contractor and its principal. RTO West will perform certain transmission functions for BPA as a government contractor.
 - Bonneville’s legal authority to participate in RTO West is based upon its authority to contract with others to carry out its functions. (“Bonneville Power Administration Authority to Participate in an Independent System Operator,” Memorandum of U.S. Department of Energy General Counsel, February 26, 1998). To ensure that RTO West carries out Bonneville’s functions, the contract between Bonneville and RTO West must incorporate (1) performance standards regarding implementation of its statutory, contractual and treaty obligations and (2) BPA authority to terminate the contract for RTO West’s failure to comply with its requirements.
 - Reciprocally, Bonneville would agree to accept operational and scheduling directives from RTO West. Such directives would be sent from an offsite RTO West facility to the Bonneville operators and must comply with various standards established by Bonneville and the other PTOs. Bonneville employees would continue to operate the Bonneville system in accordance with the Transmission Operating Agreement with RTO West. Bonneville retains the authority to refuse to implement the directives in specific situations, including when it believes a directive could endanger its facilities, human safety or its compliance with applicable laws or regulations.
 - The Transmission Operating Agreement is terminable by Bonneville (1) at will upon two years notice and (2) immediately for a variety of reasons.
 - Thus, RTO West would have no possessory or other legal interest in any federal poles or wires. Consequently, there would likely be no “possession and use” of PTO facilities by RTO West as is required for the application of the Washington State leasehold excise tax.
 - Even if “possession and use” of PTO transmission facilities were found to exist, the Washington tax regulations exempt “use or occupancy of public property where the purpose of such use or occupancy is to render services to the public owner . . . in furtherance of the public owner’s purposes.” (WAC 458-29A-100). RTO West would be contracting with Bonneville to carry out

Bonneville’s statutory, contractual and treaty responsibilities. Notably, RTO West is explicitly prohibited from adding any charges to a PTO’s revenue requirement, including that of Bonneville, to provide RTO West or any other party with a profit or return on the PTO’s assets. (Transmission Operating Agreement, §17.1)

- Oregon Property Tax: There would likely be no “possession” of Bonneville facilities or transmission capacity by RTO West as is required for the application of Oregon property taxes. Bonneville would transfer no ownership-like interest to RTO West like the interest it transferred to a cooperative in *Power Resources Cooperative v. Dept. of Revenue*, 330 Or 24 (2000). In that case, BPA sold a 50 MW “share” of Southern Intertie capacity under a “life of facilities” contract in exchange for payments to finance construction of that facility and annual payments of a proportionate share of the cost of operating and maintaining that facility. The cooperative was free to schedule power over that capacity for its own benefit—to import and export power owned by the cooperative or to provide wheeling services to others in exchange for payments to which it had ownership rights. The Oregon Supreme Court recently held that transfer to be subject to Oregon property taxes. Contrary to the ownership terminology used by the court in that case:
 - RTO West would not be “investing” in the system either to purchase a “share” or to purchase the entire capacity;
 - RTO West would not be obligated to pay a share of federal system costs;
 - the relationship would not be created for RTO West to transmit electricity for its “own benefit;”
 - RTO West would not be allowed to “use [the transmission capacity] in whatever manner it wishes.” It would be required to carry out its obligations for the benefit of others pursuant to the Transmission Operating Agreement, including meeting the obligations of Bonneville’s pre-existing transmission agreements with others. RTO West will not schedule power transactions for its own benefit as it is required to be independent of merchant functions.
 - receipts for wheeling services would not be owned by RTO West;
 - the Transmission Operating Agreement is “revocable” by Bonneville;
 - the restrictions and limitations of the relationship between RTO West and Bonneville are not “the kind . . . that joint owners or lessees of this kind of property would impose on themselves in the interest of orderly operation;”

3. The Filing Utilities do not agree with the Snohomish tax analysis that the Washington State use tax is likely to be applied under the “bailment” provisions. The relationship between RTO

West and Bonneville is not likely to be determined to be a bailment because RTO West will not “actually take[] possession of the property” as is required by Department of Revenue rules. WAC 458-20-211(3). Even if it were determined to be a bailment, the use tax is applied only to bailments of tangible personal property, RCW 82.12.020(1), whereas the federal transmission system is composed primarily of fixtures.

4. The Snohomish tax analysis suggests that significant new state taxes may be imposed on the Paying Agent. The Paying Agent performs an escrow function. It receives funds in trust for specified beneficiaries, but has no legal interest in revenues passing through its hands. These functions are usually performed by a bank through its trust department. These services are very low cost and unlikely to give rise to any significant tax increase.

5. The Filing Utilities believe that state taxes would more likely be applied to the much smaller amounts of (1) RTO West property (control center, office building and equipment, computer hardware, and software, etc.) and (2) those revenues to which RTO West had a right and for which there is no exception or deduction under applicable law. The Filing Utilities also agree that state taxes could apply to certain transactions of Scheduling Coordinators. Of course, the largest Scheduling Coordinator in the region is likely to be Bonneville, which would not be subject to such taxes. The next largest Scheduling Coordinators in the region are likely to be investor owned utilities who are already subject to state taxation. New businesses formed to perform Scheduling Coordinator functions may be subject to state taxes.

6. For further information, contact Steve Larson, BPA attorney, (503)-230-4999.