

Davison Van Cleve PC

Attorneys at Law

TEL (503) 241-7242 • FAX (503) 241-8160 • mail@dvclaw.com
Suite 400
333 SW Taylor
Portland, OR 97204

August 14, 2006

Via Electronically and US Mail

Public Utility Commission
Attn: Filing Center
550 Capitol St. NE #215
P.O. Box 2148
Salem OR 97308-2148

Re: In the Matter of the Adoption of Permanent Rules Implementing SB 408
Relating to Utility Taxes
Docket No. AR 499

Dear Filing Center:

Enclosed please find an original and two (2) copies of the Reply Comments of the Industrial Customers of Northwest Utilities on Proposed Rules in the above-captioned Docket.

Please return one file-stamped copy of the document in the self-addressed, stamped envelope provided. Thank you for your assistance.

Sincerely yours,

/s/ Ruth A. Miller
Ruth A. Miller

Enclosures

cc: Service List

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served a copy of the foregoing Reply Comments of the Industrial Customers of Northwest Utilities on Proposed Rules, upon the parties, on the official service list for AR 499, by causing the same to be electronically served, to those parties with an email address, as well as mailed, postage-prepaid, through the U.S. Mail.

Dated at Portland, Oregon, this 14th day of August, 2006.

/s/ Ruth A. Miller

Ruth A. Miller

R TOM BUTLER
tom@butlert.com

REP TOM BUTLER
H-289 STATE CAPITOL
SALEM OR 97310
cpatom@fmtc.com

JIM DEASON
ATTORNEY AT LAW
521 SW CLAY ST STE 107
PORTLAND OR 97201-5407
jimdeason@comcast.net

KEN LEWIS
PO BOX 29140
PORTLAND OR 97296
kl04@mailstation.com

PORTLAND GENERAL ELECTRIC CO. RATES &
REGULATORY AFFAIRS
PORTLAND GENERAL ELECTRIC COMPANY
121 SW SALMON ST 1WTC0702
PORTLAND OR 97204
pge.opuc.filings@pgn.com

AF LEGAL & CONSULTING SERVICES
ANN L FISHER
ATTORNEY AT LAW
2005 SW 71ST AVE
PORTLAND OR 97225-3705
energlaw@aol.com

ASSOCIATED OREGON INDUSTRIES
JULIE BRANDIS
1149 COURT ST NE
SALEM OR 97301-4030
jbrandis@aoi.org

ATER WYNNE LLP
LISA F RACKNER
ATTORNEY
222 SW COLUMBIA ST STE 1800
PORTLAND OR 97201-6618
lfr@aterwynne.com

AVISTA CORPORATION
DAVID J MEYER
SR VICE PRESIDENT & GENERAL COUNSEL
PO BOX 3727
SPOKANE WA 99220-3727
david.meyer@avistacorp.com

AVISTA CORPORATION
THOMAS R PAINE
1411 EAST MISSION
SPOKANE WA 99202
tom.paine@avistacorp.com

AVISTA UTILITIES
DON M FALKNER
MANAGER REVENUE REQUIREMENTS
PO BOX 3727
SPOKANE WA 99220-3727
don.falkner@avistacorp.com

AVISTA UTILITIES
RON MCKENZIE
MANAGER, REGULATORY ACCOUNTING
PO BOX 3727
SPOKANE WA 99220-3727
ron.mckenzie@avistacorp.com

AVISTA UTILITIES

KELLY O NORWOOD
VICE PRESIDENT, RATES & REGULATORY AFFAIRS
PO BOX 3727
SPOKANE WA 99220-3727
kelly.norwood@avistacorp.com

CITIZENS' UTILITY BOARD OF OREGON

LOWREY R BROWN
610 SW BROADWAY - STE 308
PORTLAND OR 97205
lowrey@oregoncub.org

CITIZENS' UTILITY BOARD OF OREGON

ROBERT JENKS
610 SW BROADWAY STE 308
PORTLAND OR 97205
bob@oregoncub.org

DEPARTMENT OF JUSTICE

PAUL GRAHAM
ASSISTANT ATTORNEY GENERAL
REGULATED UTILITY & BUSINESS SECTION
1162 COURT ST NE
SALEM OR 97301-4096
paul.graham@state.or.us

DEPARTMENT OF REVENUE

DENNIS J MAURER
dennis.j.maurer@state.or.us

IDAHO PUBLIC UTILITY COMMISSION

DAN PFEIFFER
472 WEST WASHINGTON ST
BOISE ID 83720
dan.pfeiffer@puc.idaho.gov

KAFOURY & MCDUGAL

LINDA K WILLIAMS
ATTORNEY AT LAW
10266 SW LANCASTER RD
PORTLAND, OR 97219-6305
linda@lindawilliams.net

MCDOWELL & ASSOCIATES PC

KATHERINE A MCDOWELL
520 SW SIXTH AVENUE, SUITE 830
PORTLAND, OR 97204
katherine@mcd-law.com

MIDAMERICAN ENERGY HOLDINGS COMPANY

STEVE EVANS
666 GRAND AVE
DES MOINES IA 50303
srevans@midamerican.com

CABLE HUSTON BENEDICT HAAGENSEN & LLOYD LLP

EDWARD A FINKLEA
1001 SW 5TH - STE 2000
PORTLAND OR 97204
efinklea@chbh.com

CITIZENS' UTILITY BOARD OF OREGON

JASON EISDORFER
610 SW BROADWAY STE 308
PORTLAND OR 97205
dockets@oregoncub.org

DANIEL W MEEK ATTORNEY AT LAW

DANIEL W MEEK
ATTORNEY AT LAW
10949 SW 4TH AVE
PORTLAND OR 97219
dan@meek.net

DEPARTMENT OF JUSTICE

JASON W JONES
ASSISTANT ATTORNEY GENERAL
REGULATED UTILITY & BUSINESS SECTION
1162 COURT ST NE
SALEM OR 97301-4096
jason.w.jones@state.or.us

ENERGY STRATEGIES

KELLY FRANCONI
CONSULTANT
215 SOUTH STATE ST - STE 200
SALT LAKE CITY UT 84111
kfranconi@energystrat.com

JD ANDERSON ASSOCIATES

JIM ANDERSON
910 SAHALEE CT SE
SALEM OR 97306
lobbyoregon@comcast.net

LEAGUE OF OREGON CITIES

ANDREA FOGUE
SENIOR STAFF ASSOCIATE
PO BOX 928
1201 COURT ST NE STE 200
SALEM OR 97308
afogue@orcities.org

MIDAMERICAN ENERGY HOLDINGS COMPANY

RICK TUNNING
666 GRAND AVENUE
DES MOINES IA 50303
rrtunning@midamerican.com

NORTHWEST INDUSTRIAL GAS USERS

PAULA E PYRON
EXECUTIVE DIRECTOR
4113 WOLF BERRY COURT
LAKE OSWEGO OR 97035-1827
ppyron@nwigu.org

NORTHWEST NATURAL

GARY BAUER
220 NW 2ND AVE
PORTLAND OR 97209
gary.bauer@nwnatural.com

NORTHWEST NATURAL

MARGARET D KIRKPATRICK
INTERIM GENERAL COUNSEL.
220 NW 2ND AVE
PORTLAND OR 97209
margaret.kirkpatrick@nwnatural.com

PACIFIC POWER & LIGHT

ALEX MILLER
DIRECTOR – REGULATORY AFFAIRS
220 NW SECOND AVE
PORTLAND OR 97209-3991
alex.miller@nwnatural.com

PACIFIC POWER & LIGHT

JAN MITCHELL
825 NE MULTNOMAH - STE 2000
PORTLAND OR 97232
jan.mitchell@pacificorp.com

PACIFICORP

LAURA BEANE
MANAGER, REGULATION
825 MULTNOMAH STE 800
PORTLAND OR 97232-2153
laura.beane@pacificorp.com

PACIFICORP

RICHARD PEACH
825 NE MULTNOMAH
PORTLAND OR 97232
richard.peach@pacificorp.com

PORTLAND CITY OF - OFFICE OF CITY ATTORNEY

BENJAMIN WALTERS
DEPUTY CITY ATTORNEY
1221 SW 4TH AVE - RM 430
PORTLAND OR 97204
bwalters@ci.portland.or.us

PORTLAND GENERAL ELECTRIC

PAMELA G LESH
VP RATES & REGULATORY AFFAIRS
121 SW SALMON ST 1 WTC 1703
PORTLAND OR 97204
pamela.lesh@pgn.com

PORTLAND GENERAL ELECTRIC

DAVE ROBERTSON
121 SW SALMON ST
PORTLAND OR 97204
dave.robertson@pgn.com

NORTHWEST NATURAL

GREGG KANTOR
220 NW SECOND
PORTLAND OR 97209
gsk@nwnatural.com

NORTHWEST NATURAL

ELISA M LARSON
ASSOCIATE COUNSEL
220 NW 2ND AVE
PORTLAND OR 97209
elisa.larson@nwnatural.com

PACIFIC POWER & LIGHT

LARRY O MARTIN
825 NE MULTNOMAH STE 800
PORTLAND OR 97232
larry.martin@pacificorp.com

PACIFIC POWER & LIGHT

PAUL M WRIGLEY
MANAGER – REGULATION
825 NE MULTNOMAH STE 800
PORTLAND OR 97232
paul.wrigley@pacificorp.com

PACIFICORP

SCOTT BOLTON
825 NE MULTNOMAH
PORTLAND OR 97232
scott.bolton@pacificorp.com

**PAINE, HAMBLIN, COFFIN, BROOKE & MILLER
LLP**

AUSEY H ROBNETT III
PO BOX E
COEUR D'ALENE ID 83816-0328

PORTLAND GENERAL ELECTRIC

RANDALL DAHLGREN
121 SW SALMON ST 1WTC 0702
PORTLAND OR 97204
randy.dahlgren@pgn.com

PORTLAND GENERAL ELECTRIC

RAUL MADARANG
121 SW SALMON ST
PORTLAND OR 97204
raul.madarang@pgn.com

PORTLAND GENERAL ELECTRIC

INARA K SCOTT
ASSISTANT GENERAL COUNSEL
121 SW SALMON ST
PORTLAND OR 97204
inara.scott@pgn.com

PORTLAND GENERAL ELECTRIC

BOB TAMLYN
121 SW SALMON ST
PORTLAND OR 97204
bob.tamlyn@pgn.com

PORTLAND GENERAL ELECTRIC

JAY TINKER
PROJECT MANAGER
PORTLAND GENERAL ELECTRIC COMPANY
121 SW SALMON ST 1WTC-0702
PORTLAND OR 97204
jay.tinker@pgn.com

PUBLIC UTILITY COMMISSION

JUDY JOHNSON
PO BOX 2148
SALEM OR 97308-2148
judy.johnson@state.or.us

STATE CAPITOL

SENATOR RICK METSGER
900 COURT ST NE S-307
SALEM OR 97301
sen.rickmetsger@state.or.us

STOEL RIVES LLP

MARCUS A WOOD
900 SW FIFTH AVE - STE 2600
PORTLAND OR 97204
mwood@stoel.com

PORTLAND GENERAL ELECTRIC

DOUGLAS C TINGEY
ASST GENERAL COUNSEL
121 SW SALMON 1WTC13
PORTLAND OR 97204
doug.tingey@pgn.com

PUBLIC AFFAIRS COUNSEL

MARK NELSON
PO BOX 12945
SALEM OR 97309
pacounsel@pacounsel.org

PUBLIC UTILITY COMMISSION OF OREGON

ED BUSCH
PO BOX 2148
SALEM OR 97308-2148
ed.busch@state.or.us

STATE CAPITOL

SENATOR VICKI L WALKER
900 COURT ST NE S-210
SALEM OR 97301
sen.vickiwalker@state.or.us

AR 499

The IOUs’ opening comments demonstrate that those parties continue to disagree with the basic premises of SB 408, and ICNU believes that the Commission should view the IOUs’ concerns about the Apportionment Method with that perspective in mind. The IOUs’ opening comments question many of the fundamental purposes of SB 408, and, as a result, the IOUs’ criticisms must be taken with a grain of salt. For example, Northwest Natural states that it takes issue with what it sees as a “basic premise” of SB 408, and the company complains about

the Commission's decision how to best achieve SB 408's goals. Northwest Natural Comments at 5. Portland General Electric Company ("PGE") states that SB 408 will require the Commission to reexamine its "entire body of regulatory policies and conventions" to consider the effects of the legislation, and, with respect to the Apportionment Method in particular, PGE states "We can't tell whether it satisfies statutory or constitutional standards. We don't know whether it will violate normalization rules. We don't know whether it will produce just and reasonable or confiscatory rates. Nor can we tell if it reflects good regulatory policy." PGE Opening Comments at 3, 6. Those are all the same grounds upon which the IOUs opposed SB 408 before the legislature, and those arguments were rejected. ICNU questions the IOUs' criticisms that the Apportionment Method and the rules changes that the IOUs claim are necessary to make that methodology workable. The IOUs obviously remain opposed to SB 408's basic concepts, and there is no basis to conclude that the IOUs' arguments here are any more sound than those put forth before the legislature.

ICNU addresses below some of the specific suggestions made in opening comments.

I. The Commission Should Apply the Apportionment Method on a Situs Basis

ICNU supports application of the Apportionment Method on a "situs" basis, consistent with the Oregon Supreme Court's description of the method. Examining the three amounts considered under the test on a situs basis is the most straightforward application, avoids reliance on disputed multistate allocation methods, and allows the Commission to rely on the Oregon Department of Revenue's decisions regarding the method for guidance.

ICNU opposes the suggestions of Staff and the IOUs to alter the draft rules to reflect a result that is inconsistent with the description of the Apportionment Method in Order No. 06-400. Staff Opening Comments at 2; PGE Opening Comments at 8; PacifiCorp Opening Comments at 5-6. Under Staff's proposal, the Apportionment Method would first be used to apportion federal income taxes to regulated utility operations and then the utility's authorized multi-state allocation factor would be used to determine the amount attributed to regulated utility operations in Oregon. Staff Opening Comments at 2. State income taxes would be treated in a similar manner, depending on the particular state income taxes recognized in rates. Staff provides no explanation for the proposal to change the method included in the draft rules, other than to say that Staff would support a variation of the method described in the interim order that would consider a better match between taxes paid and taxes collected. Id.

There is no basis to conclude that applying the Apportionment Method on a situs basis less successfully matches "taxes collected" and "taxes paid." The "match" that SB 408 attempts to achieve is between "taxes collected" and the amount of "taxes paid" that is "properly attributed to regulated operations of the utility." As a result, the manner in which the Commission defines "properly attributed" necessarily determines how well the two amounts are matched. Staff and the IOUs have consistently argued and supported methodologies under which no amount beyond the lesser of the utility's stand alone tax liability or the total consolidated taxes paid would be "properly attributed" to the utility. The Commission unequivocally rejected that limited interpretation of the term by adopting the apportionment method in Order No. 06-400. Given that these parties did not agree with the basic premise of Order No. 06-400 that "properly attributed" encompassed more than just the "lesser of" amounts,

the Commission should not now rely on Staff's and the IOUs' claims about how to modify the apportionment method to best achieve the "matching" that SB 408 contemplates.

Finally, certain IOUs have argued that applying the apportionment method on a situs basis would eliminate from the utility-specific property amounts generating facilities that are located outside of Oregon but nevertheless are used to serve Oregon customers. These arguments ignore the multi-purpose nature of many generating facilities. In addition to providing power to serve retail customers, many generating facilities may be used to support wholesale sales or provide other services that are unrelated to serving retail customers in Oregon. As ICNU stated in its Opening Comments, applying the three-factor Apportionment Method provides an overall result that may be imprecise, to some limited degree, in some circumstances but that is no different than many other aspects of ratemaking. Furthermore, as the Citizens' Utility Board ("CUB") pointed out in Opening Comments, the IOUs opposed other methodologies that were more precise because those methods allegedly were too complicated. The bottom line is the Apportionment Method applied on a situs basis provides a reasonable resolution of the attribution issue, and the IOUs have provided no basis to justify deviating from the Commission's order.

II. Abandoning the Apportionment Method for all Local Income Tax Purposes is Inappropriate

ICNU acknowledged in its Opening Comments that it may be appropriate in limited instances to calculate a SB 408 rate adjustment for local income taxes based on a "true up" of the amount of taxes collected from ratepayers and the amount of taxes paid to local government. It appears that this option may be workable in cases in which the utility collects amounts for local income taxes through a separate line-item charge on customers' bills and the

utility is the taxpayer that actually pays the local income tax to government. Other parties have suggested that such a true-up for local income may be appropriate in all cases, including when the utility is not the taxpayer. ICNU does not agree that a true-up is appropriate in that situation and believes that some attribution may be necessary in those circumstances. ICNU supports applying the Apportionment Method for local income tax purposes but also would support providing a limited amount of flexibility in the rules addressing local income taxes to deal with specific situations such as described above.

III. Adjustments for Deferred Taxes Should Be Narrowly Focused on Ensuring that SB 408 Rate Adjustments Comply with Normalization Requirements

PacifiCorp states that “[t]o the extent the apportionment method comprehensively allocates taxes in a consolidated group that includes regulated utilities, the approach violates IRC normalization rules.” PacifiCorp Opening Comments at 8. Although there has been discussion about whether the Apportionment Method could result in a violation of normalization requirements if a SB 408 rate adjustment included amounts related to deferred taxes associated with regulated operations outside of Oregon, it has not been shown that the method definitely violates IRC normalization rules. The Commission need not resolve this issue, however, because the draft rules provide that the utilities will request from the IRS a ruling regarding compliance with normalization requirements. ICNU supports this provision of the draft rule and believes that requesting a ruling from the IRS will go a long way toward resolving many of the concerns about normalization violations. ICNU also supports CUB’s proposed rule change that would add a provision requiring each IOU to submit to the Commission, Staff, and other interested parties a draft of the request for a letter ruling for review. CUB Opening Comments at 10. ICNU agrees

that pre-filing review is an appropriate and necessary step to ensure a fair description of the rules implementing SB 408.

ICNU believes that section 3(8) of SB 408 grants the Commission broad authority to make the necessary adjustments to ensure compliance with normalization requirements. Furthermore, any adjustment that the Commission orders under SB 408 § 3(8) or any rule changes intended to address deferred taxes should focus on ensuring compliance with normalization requirements. The objective should be to identify the minimum adjustment to a proposed surcharge or surcredit that is necessary to avoid violation of the normalization requirements. ICNU supports Staff's proposal to add a provision to the rule that would provide the opportunity for an after-the-fact adjustment in the event that deferred taxes may have been included in the calculation of the SB 408 rate adjustment. Staff Opening Comments at 4-5 (describing proposed OAR § 860-022-0041(2)(o)(D)). The Commission should thoroughly scrutinize any adjustment proposed by a utility under this subsection, however, to ensure that it relates to "adding back" deferred taxes for the purposes of complying with IRS normalization requirements.

PacifiCorp suggests that the Commission address concerns about violating normalization requirements by modifying the Apportionment Method in the draft rule to exclude all regulated entities within the affiliated group that do not have Oregon regulated operations from the computation of "current" taxes. PacifiCorp Opening Comments at 9. This overly broad proposal would affect the amount of "taxes paid" in ways that go far beyond addressing normalization issues. For example, under PacifiCorp's proposal, all income taxes related to PacifiCorp's operations outside of Oregon or all other regulated entities under the Berkshire

Hathaway umbrella (e.g., MidAmerican Energy Company, Northern Natural Gas) would be excluded even though much of the amounts that those operations contribute to overall “taxes paid” are unrelated to deferred taxes. The adjustment authorized in section 3(8) should be construed narrowly to focus on compliance with normalization requirements as applies to regulated utilities and deferred taxes. The Commission should reject attempts to expand the authority granted in the section of the statute to address other issues.

IV. SB 408 Explicitly Defines the Adjustments to “Taxes Paid”

PacifiCorp suggests that the Commission adopt rules that would adjust “taxes paid” prior to applying the Apportionment Method to reflect amounts associated with unregulated deferred taxes, tax credits, and charitable contributions. PacifiCorp Opening Comments at 9-10. The definition of “taxes paid” in SB 408 explicitly identifies that adjustments should be made for purposes of excluding the impact of charitable contributions, deferred taxes, and tax credits associated with capital investments that were not taken into account in the utility’s last ratemaking proceeding. SB 408 provides for no other adjustments, and the broad group of adjustments that PacifiCorp proposes has no basis in the statute. PacifiCorp proposes no limitations on “tax credits” and adopting such a proposal would likely require an ad hoc determination of what adjustments are appropriate. Such a result is inconsistent with SB 408’s plain language and should not be adopted.

V. The Commission Should Reject the Proposals to Indirectly Achieve the Same Result as Authorizing an Earnings Test or Deferred Account to Implement SB 408

PacifiCorp suggests modifying the Apportionment Method to address the impacts of costs incurred in between rate cases. This proposal is intended to accomplish much the same result as the earnings test and deferred account proposals that the Commission rejected in Order

No. 06-400. PacifiCorp Opening Comments at 10-11. As PacifiCorp acknowledges, the Commission rejected the earnings test and deferred account proposals because allowing adjustments based on application of those mechanisms would upset the effect that SB 408 intends the automatic adjustment clause to have. According to PacifiCorp, applying only a “slight modification” to the Apportionment Method will address its concerns without affecting the operation of the automatic adjustment clause. Id. at 9. PacifiCorp suggests increasing the amount of taxes paid that is properly attributed up to the amount of the section 3(12) cap when cost fluctuations between rate cases effect the amount of taxes paid. Id.

PacifiCorp’s proposal would achieve the same result as the earnings test or deferred account proposals made previously in this Docket, which the Commission already found to be inconsistent with the purpose of SB 408. Changes in costs likely will occur between rate cases and increasing the amount of taxes paid that is properly attributed up to the full amount of the 3(12) cap will impact the amount that flows through the automatic adjustment clause. The Commission, therefore, should not adopt a proposal that is intended to indirectly accomplish an impermissible result.

VI. Any Provision That Caps the Reduction in the Amount of Taxes Paid That Is Properly Attributed to Regulated Utility Operations Should be Narrowly-Tailored

At the August 8, 2006 workshop, the IOUs expressed concern that the Apportionment Method could reduce the amount of “taxes paid” that is properly attributed to regulated utility operations by an amount that exceeds the sum of the individual losses of the entities within the utility’s consolidated tax group. Since the August 8, 2006 workshop, the IOUs have proposed adding the following provision to the draft rules:

The amount of income taxes paid that is properly attributed to the utility shall not be less than the amount of the stand-alone federal and state income tax liabilities of the utility, reduced by the sum of all negative federal and state income tax liabilities of affiliates of the utility included in the same federal or state consolidated tax filing as the utility for the reporting period, as applicable.

ICNU does not support adopting this language to address the IOUs' concerns, and ICNU objects to this specific language as overly broad and vague. First, as written, this provision could trump the "caps" in section 3(12) by establishing a separate limit on the amount of taxes paid that is properly attributed to regulated operations of the utility that is not included in SB 408. At most, such a provision should establish a "floor" for the Apportionment method.

Second, this proposed provision posits the "stand-alone" federal and state tax liability "of the utility" as the starting point from which tax losses of other entities are subtracted. This is the wrong starting point. Instead, the reduction should be from the section 3(12)(a) amount arising from regulated utility operations.

Third, to the extent that "affiliates" may be construed as limiting, the language should clarify that the losses in the adjustment should be from all entities in the consolidated federal tax group. Finally, this proposed revision relies on determining the "negative federal and state tax liabilities" of affiliates, which is ambiguous, because an affiliate within the consolidated group has no separate tax "liability." Only the parent company that actually files the consolidated tax return has tax "liability."

VII. Conclusion

ICNU appreciates the Commission's consideration of these comments and urges adoption of the draft rules with the modifications discussed in ICNU's Opening and Reply Comments.

Dated this 14th day of August, 2006.

Respectfully submitted,

/s/ Melinda J. Davison

Melinda J. Davison

Matthew Perkins

Davison Van Cleve, P.C.

333 S.W. Taylor Street, Suite 400

Portland, Oregon 97204

(503) 241-7242 phone

(503) 241-8160 facsimile

mail@dvclaw.com

Of Attorneys for Industrial Customers
of Northwest Utilities