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August 14, 2006

ELECTRONIC FILING

PUC Filing Center
Oregon Public Utility Commission
PO Box 2148
Salem, OR 97308-2148

Re: Docket No. AR 499

I enclose the original and one copy of Northwest Natural Gas Company's Response Comments Re Proposed Final Rule for filing in this matter.

Very truly yours,

Stephen Hall for
Marcus Wood

M-W:jlf
Enclosures
cc: Service List

BEFORE THE PUBLIC UTILITY COMMISSION OF OREGON

AR 499

In the Matter of the Adoption of Permanent Rules Implementing SB 408 Relating to Utility Taxes	**RESPONSE COMMENTS OF NORTHWEST NATURAL GAS COMPANY RE PROPOSED FINAL RULE**

I. Technical Corrections to the Proposed Final Rule: NW Natural concurs with Staff's recommendations concerning the technical corrections to the final rule that NW Natural proposed in its Opening Comments.

Northwest Natural Gas Company's ("NW Natural") Opening Comments proposed and explained several technical corrections to the proposed final rule, which corrections it thought should be noncontroversial. NW Natural understands that Staff's Response Comments will recommend inclusion of each of these proposed technical corrections, with one exception. Staff recommends an alternative to the clarification NW Natural requested in section 2(k) of the rule, to make certain that merchandizing income is not included in the calculation of "taxes paid." Staff would clarify that the exclusion of "other operating revenue as defined by FERC" should instead state "other operating income and other income as defined by FERC." This revision tracks the wording of the Federal Energy Regulatory Commission's Uniform System of Accounts and makes clear that merchandizing income is not included in the rule's definition of "revenue." NW Natural concurs with this alternative language.

II. Joint Comments: PacifiCorp has joined in and supports the Joint Comments as filed by Staff.

Staff has filed Joint Comments that describe important changes needed in the final rule. The Joint Comments address (1) protection of tax normalization benefits, (2) use of regulatory allocations, rather than situs allocations, for the three-factor test, (3) the selection of the proper unitary group for the attribution of Oregon taxes paid, (4) adjustments for non-Oregon taxes allocated, (5) the proper attribution of Oregon income taxes incurred by utilities such as NW

Natural, for which such taxes are allocated 100 percent to Oregon for rate purposes, (6) the use of a single gross revenue allocator for the Multnomah County Business Income Tax, (7) the calculation of a "floor" rate for the three-factor attribution, to avoid allocating to the utility more than 100 percent of all its affiliate tax losses, (8) the calculation of the SB 408 section 3(12)(a) cap on taxes paid on a stand-alone basis, and (9) adoption of a more realistic deadline for the utilities to submit a filing for a Private Letter Ruling from the Internal Revenue Service with respect to the final rule. While there is substantial consensus that these changes are needed, the necessary language could not be worked out and agreed to within the Reply Comment period. NW Natural will continue to work with the other parties to capture these consensus changes in the rule language and urges the Commission to keep the record open long enough to allow this important process to be completed.

III. Inclusion of Dividend Income in the "Sales" Category for the Three-Factor Test: The Commission should not depart from Oregon statutory provisions by treating dividends as sales.

The Industrial Customers of Northwest Utilities ("ICNU") urges the Commission to use the three-factor attribution, but to make an adjustment to the Oregon statutory specification of "sales" to treat dividends as if they were sales. This proposal would undermine the Commission's intent to rely on judicial approval of the state-sanctioned three-factor formula, by making an ad hoc change for the sole effect of further reducing the portion of taxes incurred that Oregon utilities can recover.

The three-factor method attributes taxes proportionally to sales, payroll and property. Dividends clearly are not sales. The effect of the proposed change would be to double-count a portion of affiliate income, by capturing all revenues through the "sales" factor, and then by recapturing a portion of the same income as "dividends" when income is distributed upsream as dividends to a parent company. By this approach, for example, if a utility had a parent company, a portion of the utility's own revenues would be attributed to the parent whenever dividends were paid. There is no defensible basis for such a deviation from the statutory three-factor formula.

IV. Inclusion of Non-Utility Tax Deduction in the Section 3(12)(a) Cap: The stand-alone taxes calculation for a utility should not be reduced by tax deductions of its parent.

ICNU's Opening Comments advanced a novel interpretation of section 3(12)(a) of SB 408. That section of the statute requires that taxes properly attributed to the regulated operations of the public may not exceed "[t]hat portion of the total taxes paid that is incurred as a result of income generated by the regulated operations of the utility." ICNU urges the Commission to change its proposed final rule to treat parent tax deductions from interest payments "supported" by utility dividends as if the deductions were incurred because of "income generated by the regulated operations of the utility." The simplest response is that such parent deductions plainly are not, as required under section 3(12)(a) of SB 408, "incurred as a result of income generated by the regulated operations of the utility," because the parent's interest tax deductions will be the same regardless of the level of income generated by the regulated operations of the utility. In addition, the deductions may relate to debt that has nothing to do with the Oregon utility; the deductions might relate instead, for example, to debt incurred for the acquisition of other companies or businesses not subject to the Commission's jurisdiction.

If ICNU thinks that in a particular rate proceeding, tax deductions of non-utility companies should be treated as if they were utility tax deductions, it can make such arguments in that rate proceeding. ICNU's attempt to fashion a generic attribution of parent company tax deductions, without consideration of the nature and purpose of the specific tax deductions, is inconsistent with the language of SB 408 and would be an unjustified modification to the final rule.

V. Procedural Right to Challenge Rate Adjustments Ordered by the Commission: The utilities are entitled to claim, based on an earnings test, that an SB 408 rate adjustment violates ORS 756.040 or other applicable law.

Section 11 of the Commission's proposed final rule permits a utility to make a claim, based on an earnings test, that a rate adjustment under the automatic adjustment clause violates ORS 756.040 or other applicable law. ICNU attacks this provision as contrary to SB 408 and poor public policy.

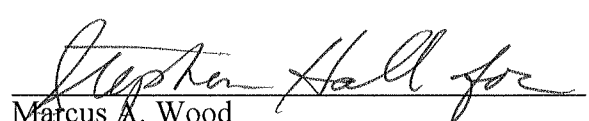
This provision is a proper application of the Commission's overall statutory obligations under ORS 756.040, as well as its obligation to comply with applicable judicial prohibitions against setting unjust and unreasonable rates. When the utilities throughout this rulemaking proceeding have sought ratemaking protections against potential "double whammy" impacts, one consistent (if inadequate) answer has been that the utilities will be able to challenge the results of any SB 408 rate adjustment if the adjustment produces unjust and unreasonable rates. ICNU now seems to be attacking the right to make such a challenge. This proposed rule change would be unreasonable and unjust.

VI. Conclusion.

NW Natural requests that the Commission adopt the utility's proposed technical corrections to the proposed final rule, as reviewed and endorsed by the Staff. NW Natural also urges the Commission to provide the parties adequate time to propose rule language that would implement the changes in the Joint Comments advanced by Staff and to reject the unjust and unreasonable changes proposed by ICNU addressed herein.

DATED: August 14, 2006.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that I served a true and correct copy of the foregoing document in Docket AR 499 on the following named person(s) on the date indicated below by electronic mail and first-class mail addressed to said person(s) at his or her last-known address(es) indicated below.

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