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

May 19, 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 Matching Utility Taxes Paid with Taxes Collected
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 and Northwest Industrial Gas Users on the Properly Attributed and Taxes Collected/Earnings Test Straw Proposals 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 and Northwest Industrial Gas Users on the Properly Attributed and Taxes Collected/Earnings Test Straw Proposals, 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 19th day of May, 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

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

CITIZENS' UTILITY BOARD OF OREGON
JASON EISDORFER
610 SW BROADWAY STE 308
PORTLAND OR 97205
dockets@oregoncub.org

CITIZENS' UTILITY BOARD OF OREGON
ROBERT JENKS
610 SW BROADWAY STE 308
PORTLAND OR 97205
bob@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
PAUL GRAHAM
ASSISTANT ATTORNEY GENERAL
REGULATED UTILITY & BUSINESS SECTION
1162 COURT ST NE
SALEM OR 97301-4096
paul.graham@state.or.us

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 FRANCONE
CONSULTANT
215 SOUTH STATE ST - STE 200
SALT LAKE CITY UT 84111
kfrancone@energystrat.com

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

KAFOURY & MCDOUGAL
LINDA K WILLIAMS
ATTORNEY AT LAW
10266 SW LANCASTER RD
PORTLAND OR 97219-6305
linda@lindawilliams.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

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

MIDAMERICAN ENERGY HOLDINGS COMPANY
RICK TUNNING
666 GRAND AVENUE
DES MOINES IA 50303
rrtunning@midamerican.com

MIDAMERICAN ENERGY HOLDINGS COMPANY
STEVE EVANS
666 GRAND AVE
DES MOINES IA 50303
srevans@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
GREGG KANTOR
220 NW SECOND
PORTLAND OR 97209
gsk@nwnatural.com

NORTHWEST NATURAL
MARGARET D KIRKPATRICK
INTERIM GENERAL COUNSEL.
220 NW 2ND AVE
PORTLAND OR 97209
margaret.kirkpatrick@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
JAN MITCHELL
825 NE MULTNOMAH - STE 2000
PORTLAND OR 97232
jan.mitchell@pacificorp.com

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

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

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

PACIFICORP
BLAIR LOFTIS
825 NE MULTNOMAH
PORTLAND OR 97232
blair.loftis@pacificorp.com

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

PAINE, HAMBLEN, COFFIN, BROOKE & MILLER LLP
AUSEY H ROBNETT III
PO BOX E
COEUR D'ALENE ID 83816-0328

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

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

PORTLAND GENERAL ELECTRIC
DAVE ROBERTSON
121 SW SALMON ST
PORTLAND OR 97204
dave.robertson@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
DOUGLAS C TINGEY
ASST GENERAL COUNSEL
121 SW SALMON 1WTC13
PORTLAND OR 97204
doug.tingey@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

PUBLIC UTILITY COMMISSION
KATHRYN LOGAN
ADMINISTRATIVE HEARINGS DIVISION
PO BOX 2148
SALEM OR 97308-2148
kathryn.logan@state.or.us

PUBLIC UTILITY COMMISSION OF OREGON
ED BUSCH
PO BOX 2148
SALEM OR 97308-2148
ed.busch@state.or.us

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

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

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

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.	REPLY COMMENTS OF THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES AND NORTHWEST INDUSTRIAL GAS USERS ON THE PROPERLY ATTRIBUTED AND TAXES COLLECTED/EARNINGS TEST STRAW PROPOSALS

The Public Utility Commission of Oregon ("OPUC" or the "Commission") and the Oregon Attorney General have both recognized that Senate Bill ("SB") 408 changed the Commission's policy of setting utility rates based on a utility's stand-alone income tax liability to require consideration of the actual taxes paid to government by the utility or its affiliated group. Despite this change, OPUC Staff, PacifiCorp, Portland General Electric Company ("PGE"), Avista Corporation, and Northwest Natural Gas Company generally recommend in their opening comments that the Commission revert to stand-alone principles to implement SB 408's provisions regarding the amount of taxes paid that is "properly attributed to the regulated operations of the utility." The Industrial Customers of Northwest Utilities ("ICNU") and Northwest Industrial Gas Users ("NWIGU") respectfully request that the Commission reject these proposals in favor of rules that will give effect to the legislature's intent.

In considering rules to implement SB 408, ICNU and NWIGU urge the Commission to keep one overriding principle in mind: The legislature passed SB 408 to protect customers. Customers proposed SB 408, customers supported the bill in the legislature, and customers have continued to support the Commission's full and effective implementation of SB 408 in this

proceeding and others. Both Staff and the investor-owned utilities ("IOUs") have resisted changing the stand-alone policy for a variety of reasons, and the legislature unequivocally rejected the continued use of the stand-alone policy despite those concerns.

ICNU and NWIGU propose that the Commission adopt rules that implement the "properly attributed" language by applying the "caps" in sections 3(12)(a) and (b) of SB 408 and the "Proportionate Share" attribution methodology (or some variation of this methodology) to the consolidated tax group. As a compromise, ICNU and NWIGU have proposed that the Commission adopt rules that apply the "Proportionate Share" methodology to only a specified sub-group within the larger consolidated group. Staff and the IOUs have alleged that the ICNU and NWIGU proposals are unworkable. ICNU and NWIGU disagree, as explained below.

I. PacifiCorp's "Lesser-Of" and "With and Without" Proposals Effectively Reach the Same Inappropriate Result

The IOUs (except Avista) and Staff[1/] support PacifiCorp's "With and Without" proposal to calculate the amount of "taxes paid" that is "properly attributed" to regulated utility operations, but this approach is little more than restating PacifiCorp's "Lesser-Of" approach in a new form. PacifiCorp's proposals effectively reach the same result of defining the portion of "taxes paid" that is "properly attributed" to the utility as the maximum amount of either the stand-alone tax liability attributed to regulated operations or the total taxes paid by the consolidated group. Such a result does not reflect the legislature's intent. PacifiCorp's description of the principles supporting its approach deviates significantly from the policies embodied in SB 408.

[1/] Staff proposes some additional considerations for the "With and Without" approach.

A. The Attorney General Specifically Concluded that the Legislature Did Not Contemplate Defining "Properly Attributed" According to SB 408 § 3(12)

PacifiCorp proposes two different ways to define "taxes paid that are properly attributed to the regulated operations of the public utility." First, in the "Lesser-Of" proposal, PacifiCorp defines "properly attributed" as the "lesser of the standalone tax liability resulting from Oregon regulated operations and the amount of taxes paid to the government by the utility or its affiliated group." PacifiCorp "Lesser-Of" Straw Proposal at 1. This proposal would define "properly attributed" according to the standard in SB 408 § 3(12):

> [T]axes paid that are properly attributed to the regulated operations of the public utility may not exceed the lesser of:
>
> (a) That portion of the total taxes paid that is incurred as a result of income generated by the regulated operations of the utility; or
>
> (b) The total amount of taxes paid to units of government by the utility or by the affiliated group, whichever applies.

The Attorney General specifically concluded that this was not the result that the legislature contemplated in SB 408:

> Significantly, subsection 3(12) does not state that "taxes paid that are properly attributed to regulated operations ***are*** the lesser of * * *." Had the Assembly used that formulation, then subsection 3(12) arguably would have circumscribed the Commission's options in the application of the phrase "properly attributed to." Instead, the Legislative Assembly said that taxes paid and properly attributable to regulated operations "may not exceed" certain amounts.

Op. Att'y Gen. at 13 (Dec. 27, 2005) (emphasis in original).

Second, PacifiCorp's "With and Without" proposal defines "properly attributed" as the "portion of the affiliated group's actual tax payments that 'but for' the existence of the utility in the affiliated group, the affiliated group would not have incurred." PacifiCorp "With and Without" Straw Proposal at 1. The primary problem with PacifiCorp's "With and Without"

proposal is that subsection 3(12)(a) already defines this "but for" amount. Indeed, the Attorney General explicitly found that "paragraph 3(12)(a) addresses those taxes that would not have been received by units of government 'but for' the existence of the regulated operations." Op. Att'y Gen. at 15 (Dec. 27, 2005). Under these circumstances, both the "With and Without" and "Lesser-Of" attributions lead the Commission to the same inappropriate result. The proposals rewrite subsection 3(12) to read that the "taxes paid that are properly attributed to regulated operations ***are*** the lesser" of the amounts in (a) or (b) instead of stating that the taxes paid that are properly attributed "may not exceed" the amounts in (a) or (b). Op. Att'y Gen. at 13 (Dec. 27, 2005) (emphasis in original). The "With and Without" proposal is simply PacifiCorp's proposed implementation of the section 3(12)(a) cap without any further accounting for affiliate losses unless the total tax liability of all affiliates is a net negative. PacifiCorp has not moved off its "Lesser Of" bookend proposal with regard to affiliate losses, because the "With and Without" proposal treats affiliate losses no differently than that "bookend." As the Attorney General found, SB 408's plain language contemplates more than this. Id.

B. SB 408 Addresses More Than the "Enron Problem"

PacifiCorp argues that "the legislative history of SB 408 makes clear that the bill was a reaction to the fact that, under Enron ownership, [PGE] paid far less taxes to government than were collected from ratepayers." PacifiCorp Opening Comments at 4. According to PacifiCorp, the "With and Without" proposal solves the "Enron problem." Id. First, PacifiCorp has never publicly demonstrated that the inequity associated with a regulated utility collecting millions of dollars for income taxes that are never paid to government was not a "ScottishPower problem" as well. We believe it was.

Second, section 3(12)(b) explicitly solves the "Enron problem," and the "With and Without" proposal adds nothing more to address affiliate losses. The Commission noted in its order in UE 170 that SB 408 had a broader focus than merely addressing the Enron problem. Tax savings associated with parent company debt, credits for generating resources that a utility acquires from an affiliate, and other issues can result in the mismatch between taxes paid and taxes collected that the legislature passed SB 408 to correct. The Commission should not implement SB 408 with PacifiCorp's limited focus on the Enron problem in mind.

One purpose of SB 408 was to give Oregon customers permanent protection from corporate raiders seeking to acquire Oregon utilities through highly leveraged acquisitions. SB 408 must be implemented so that taxes collected through rates cannot be used to help finance a leveraged buy-out of an Oregon utility. The "Proportionate Share" method advocated by ICNU and NWIGU will ensure that creative lawyers and investment bankers cannot design a corporate structure that enables an acquiring entity to use taxes collected in rates to help finance the leveraged buy-out of an Oregon utility. In contrast, the "With and Without" method invites acquiring entities to design a corporate structure that would still allow the buyer to use ratepayer dollars to help finance an acquisition.

PacifiCorp cites a number of statements by legislators identifying the Enron problem as an example of the issues that SB 408 addresses. Id. at 4-5. Those statements do not, however, define the whole problem. PacifiCorp also cites a memorandum prepared by ICNU and the Citizens' Utility Board to correct PacifiCorp's misrepresentations about the bill in the legislature, but the Company fails to cite the most relevant passage: "SB 408-C is very moderate in its approach and *is not a reaction to the Enron bankruptcy*, although customers do not want that situation to occur again. The Enron bankruptcy simply brought the problem to light."

Memorandum of ICNU and CUB, "Utility Customers Ask for Fairness and Equity: Taxes Collected Must Align With Taxes Paid, Vote Yes on SB 408-C" (emphasis added). The Commission should not allow utilities that opposed SB 408 and its principles to frame what the debate covered and the law addresses.

C. Defining "Properly Attributed" in a Manner That Is "Consistent" with Stand-Alone Principles Undermines SB 408

PacifiCorp also argues that the Commission's implementation of SB 408 should be "consistent" with the Commission's statutes and existing policies. PacifiCorp Opening Comments at 6. PacifiCorp's citation of ORS § 757.646(2)(c) as somehow restraining the Commission's ability to implement SB 408 is misplaced. Id. ORS § 757.646(2)(c) deals with eliminating barriers to competitive retail electric markets and requires a code of conduct to prevent utility market abuses and anti-competitive practices. Giving full effect to the legislature's intent by allocating each affiliate in a consolidated group its fair share of the total consolidated tax liability in no way runs afoul of these requirements.

As a more general matter, both PacifiCorp and Staff argue that rules that result in cross-subsidization between the utility and affiliates violate the stand-alone principles upon which the Commission has always established income taxes in rates. Id.; Staff Opening Comments at 2. Moving away from stand-alone principles for purposes of determining income tax expense is precisely what the legislature mandated in SB 408. Furthermore, cross-subsidization of regulated and unregulated operations is what the owners of PGE and PacifiCorp accomplish by filing consolidated tax returns. SB 408 requires the Commission to acknowledge that fact and implement the appropriate adjustments to rates. The Pennsylvania courts have addressed suggestions such as PacifiCorp's and Staff's that the Commission should define "properly

attributed" through allocation methodologies that adhere as closely as possible to stand-alone principles in order to minimize the recognition of unregulated losses:

> [T]his analysis ignores the point that the purpose of filing consolidated tax returns is to accomplish a form of subsidization of some members of the group by other members by means of the shifting of losses to offset unrelated gains. The idea that such offsetting should be minimized to the extent that it works to the benefit of utility ratepayers is a self-serving overlay upon the theory of consolidated tax returns.

Barasch v. Penn. Pub. Util. Comm'n, 548 A.2d 1310, 1315 (1988).

The legislature enacted SB 408 to require the Commission to consider the actual taxes paid by a utility or its consolidated group rather than strictly examining stand-alone operations. Implementing SB 408 based on adherence to these stand-alone principles is inconsistent with the legislature's intent.

II. Staff's Criteria for Supporting PacifiCorp's "With and Without" Proposal Is Based on Adhering as Closely as Possible to Stand-Alone Principles

Staff determined the appropriate methodology for determining "properly attributed" according to three criteria: 1) it should account for the amount of the affiliated groups' tax liability that is directly attributable to the revenues and expenses of the utility; 2) it should reflect other income tax effects that the Commission, in a utility's general rate case, has determined are related to a burden borne by customers; and 3) it should be administratively practical. Staff Opening Comments at 3.

A. Staff's "Directly Attributable" Criterion Reflects Establishing Income Taxes Based on Stand-Alone Principles That SB 408 Moves Away From

Staff's first criterion is an obvious step back toward determining income tax costs based on stand-alone operations. By its express terms, Staff's first criterion narrows the determination regarding the amount of taxes paid that is "*properly* attributed to the regulated operations of the

utility" to consideration of the amount that is "*directly* attributable to the revenues and expenses of the utility." Id. (emphasis added). Notably, Staff's focus on calculating taxes based solely on the utility's expenses and revenues is almost exactly how Staff described the stand-alone methodology in its February 2005 "White Paper." White Paper at 1 ("This method calculates taxes based on the regulated revenues and operating costs of the utility itself.").

The Attorney General's opinion specifically discusses that "properly attributed" is a delegative term that reflects "a need to make a judgment as to what constitutes a 'proper' allocation of income taxes." Op. Att'y Gen. at 8 (Dec. 27, 2005). Staff's first criterion does not require the Commission to exercise any judgment; it merely uses the utility's stand-alone tax liability as the basis for determining the amount of any consolidated tax liability that is "properly attributed" to regulated utility operations.

B. Staff's Adherence to Stand-Alone Principles Provides Little Encouragement That Staff Will Support Tax-Related Rate Case Adjustments

Staff suggests that the "properly attributed" determination should be a product of the adjustments to income tax expense that the Commission orders in a general rate case. Staff Opening Comments at 4. Staff opposes "automatically" reducing the properly attributed tax liability and passing to customers the tax savings that result from affiliate losses or debt at the parent level. Id. Staff states that "if the Commission has found in a general rate case that, as a factual matter, the utility is affected by any factors that are not reflected in a stand-alone calculation of the utility's taxes, the corresponding ratemaking adjustment to income taxes should be carried forward in determining the amount of 'properly attributed' taxes paid." Id. Staff uses the Commission's adjustment to PacifiCorp's income tax expense in UE 170 as an example of a rate case decision that would reduce the annual calculation of the "properly attributed" amount. Id.

Staff's proposal to shift to a general rate case the determination of what amounts of taxes paid are "properly attributed" to the utility turns SB 408 on its head. ICNU and NWIGU agree that the Commission must carry forward prospective income tax adjustments made in a rate case in determining a SB 408 adjustment, but the determination of the amount of taxes paid that is properly attributed to the utility must not be limited to only those rate case adjustments. It must also consider the information that the utility provides in the tax report. Indeed, SB 408 plainly contemplates that the Commission would make the "properly attributed" determination once the utility has provided the tax report and other necessary information and the amount of taxes paid is a known value. This is an after-the-fact determination made in association with establishing and implementing an automatic adjustment clause. Under Staff's proposal, the amount of taxes paid that is properly attributed to the regulated utility operations would equal the utility's stand-alone tax liability unless the Commission ordered a tax adjustment in a prospective rate case. A rate case adjustment, however, is based on a forward looking examination of the utility's test year costs. This is not the basis for the properly attributed determination contemplated in SB 408.

Staff's proposal also creates a significant opportunity for utilities to undermine SB 408. Utilities are not required to file general rate cases, and there is no assurance that such an adjustment would be made to effectuate SB 408's intent. Staff's proposal also provides no ability to take into account changes in corporate structure that might be made between rate cases. The Commission should not leave to a rate case an examination that SB 408 plainly contemplates will occur on an annual basis. SB 408 prohibits this approach.

In addition, Staff provides no assurance that it would not oppose such a rate case adjustment. Staff generally recommends that the Commissions continue to adhere as closely as

possible to stand-alone principles in making the "properly attributed" determination, notwithstanding SB 408's policy change. Staff states that "[a]ttributing income taxes on a stand-alone basis is consistent with the *fundamental principle* of basing utility rates on utility costs and revenues, and prohibiting cross-subsidization between utility and non-utility operations." Id. at 2 (emphasis added). Staff also believes that stand-alone attribution is fair to the utility:

> Attributing taxes paid to the utility's regulated operations using its stand-alone tax liability is fair to the utility. PGE, for example, made cash payments to Enron based on its stand-alone tax liability under the terms of the corporate tax allocation agreement. *It would be unreasonable not to recognize as taxes paid (again, limited by the caps in subsection 3(12)) those payments, made for purposes of income taxes, when they are a genuine cost, at least for the utility itself.*

Id. at 3 (emphasis added). Staff's reference to PGE and Enron as an example of fairness to any party is disturbing, given that this issue was one of the most highly publicized problems that the legislature passed SB 408 to address. The legislature has explicitly determined that the stand-alone approach is not "fair," and that paying taxes to a corporate parent is not equivalent to paying taxes to government. Given Staff's perspective that stand-alone attribution is consistent with "fundamental" ratemaking principles and "fair," it appears that Staff would not support an adjustment in a rate case that, in Staff's view, violated these principles.

Staff's reference to the Commission's adjustment in UE 170 is a good example of ICNU and NWIGU's concern. PacifiCorp requested reconsideration of the Commission's tax adjustment in UE 170, and Staff has not participated in the reconsideration proceeding. Staff has not taken a position on the adjustment, supported the Commission, or indicated that it agrees that the adjustment was reasonable or legal.

C. Disregarding Information That the Legislature Intended the Commission to Obtain Is Not Administrative Practicality

Staff emphasizes the administrative practicality of PacifiCorp's "With and Without" proposal, even though that proposal renders superfluous SB 408's provisions providing the Commission with authority to obtain tax information from the utilities. PacifiCorp states that its proposal "relies upon the consolidated tax returns . . . for virtually all the data needed to conduct the attribution analysis" and that it "can be applied by running a single set of calculations to remove the utility from the affiliated group's consolidated return." PacifiCorp "With and Without" Straw Proposal at 1. The Staff White Paper prepared prior to SB 408 stated that the Commission did not have access to detailed tax information that would be necessary to implement an adjustment that allocated each affiliate its proportionate share of the total consolidated tax liability. White Paper at 11. The legislature gave the Commission access to such information in section 3(2) of SB 408 by requiring every public utility to "obtain and provide to the commission any other information that the commission requires to review the tax report and to implement and administer this section and ORS 757.210." The fact that PacifiCorp's "With and Without" proposal does not require the Commission to obtain or review any of this detailed information in making the "properly attributed" determination indicates that the legislature was not contemplating such an approach to attribution in SB 408.

Staff states that an attribution method that requires review of the confidential financial and tax records of numerous utility affiliates "over which the Commission has no regulatory authority would seem to be questionable public policy," but Staff provides no reason to conclude that the legislature did not intend that very process to occur. Staff Opening Comments at 3. SB 408 provides the Commission broad information gathering power regarding income taxes, recognizes that tax information is commercially sensitive, and includes specific provisions

regarding access to that information. SB 408 §§ 2(1)(g), 3(2), 3(3). Given these specific provisions governing access to and review of the tax information, it would seem that the legislature contemplated thorough scrutiny of sensitive tax information by the Commission, Staff, and intervenors rather than a "type of pro forma analysis commonly conducted among tax professionals and accountants." PacifiCorp "With and Without" Straw Proposal at 1.

Staff agrees that determining the portion of taxes paid that is properly attributed to the utility requires factual determinations but suggests that the Commission make those determinations in a rate case. Staff Opening Comments at 4. As described above, SB 408 contemplates that the Commission would make the "properly attributed" determination once it has the information regarding the amount of "taxes paid" and is establishing and implementing an automatic adjustment clause. ICNU and NWIGU disagree that making such determinations as part of that process is unworkable. ICNU and NWIGU believe that, once the Commission has the information that SB 408 requires the utilities to provide, determining the proportionate shares of the total taxes paid should be relatively simple and straightforward. Regardless, however, the utility and its parent company control the complexity of the corporate structure and whether the utility pays taxes on a stand-alone basis or as part of a consolidated group. The fact that a parent company has created a complex corporate structure or included the utility in a consolidated tax group that will have to be thoroughly examined to ensure that taxes collected match taxes paid provides no basis to reject the "Proportionate Share" methodology.

PacifiCorp and PGE argue that ICNU and NWIGU's proposal to apply the "Proportionate Share" allocation to a "sub-group" of the consolidated tax group could be more burdensome than the conventional "Proportionate Share" methodology. PacifiCorp Opening Comments at 12; PGE Opening Comments at 6. First, ICNU and NWIGU continue to support applying the

"Proportionate Share" allocation to the entire consolidated group. The sub-group proposal was merely an attempt to address certain parties' concerns. Second, ICNU and NWIGU anticipate that the sub-group would be relatively small and easy to identify. If the sub-group is large or nebulous, it likely will be because the parent company established a complex holding company structure or the utility engaged in numerous affiliate transactions. The fact that SB 408 provided the Commission access to the information and the authority necessary to make the "properly attributed" determination in those situations indicates that the legislature intended the Commission to thoroughly scrutinize the tax impacts of such arrangements.

D. Staff's Interpretation of the Section 3(12)(a) Cap Is at Odds with SB 408's Plain Language

Staff disagrees with ICNU and NWIGU that the "cap" in section 3(12)(a) requires the Commission to adjust the portion of "taxes paid" by a consolidated group that is "properly attributed" to regulated utility operations to reflect tax liabilities or credits that are supported, directly or indirectly, by regulated operations. Section 3(12)(a) states that "taxes paid that are properly attributed to the regulated operations of the public utility may not exceed the lesser of: (a) That portion of the total taxes paid that is incurred as a result of income generated by the regulated operations of the utility . . . ." The Attorney General explained this subsection as follows:

> Putting the dictionary meanings of "result" and "of" together, the phrase "as a result of income" appears to mean something that directly occurs or is caused by the income from regulated operations. Therefore, paragraph 3(12)(a) addresses those taxes that would not have been received by units of government "but for" the existence of regulated operations. The amounts specified in paragraph 3(12)(a) cannot include taxes reaching units of government as a result of profits earned by a utility from unregulated business operations; only the "portion" of taxes paid on the utility's regulated operations is counted for purposes of subparagraph 3(12)(a).

Op. Att'y Gen. at 15 (Dec. 27, 2005). Staff argues that the Attorney General's statement that "only the 'portion' of taxes paid on the utility's regulated operations is counted for purposes of subparagraph 3(12)(a)" indicates that this subparagraph refers to the utility's stand-alone tax liability. Staff disregards the Attorney General's conclusion that section 3(12)(a) established a distinction between taxes reaching units of government as a result of profits from regulated or unregulated operations *within the utility*, i.e., profits on regulated income earned by the utility versus profit from an unregulated division of the utility. The Attorney General's conclusion does not address tax liability of an affiliate arising from debt supported by utility income.

III. The Suggestions Regarding an Earnings Test and "Taxes Charged" Have No Basis in SB 408

ICNU and NWIGU agree with Staff that including an earnings test or a definition of "taxes charged" has no basis in SB 408. SB 408 does not call for an earnings test, as proposed by PGE and Northwest Natural, and no such test is required to ensure that an adjustment to rates under SB 408 complies with statutory or constitutional requirements. The earnings test would focus on adjusting one element of rates in order to address utility earnings that are affected by a host of factors. SB 408 was not intended to act as a financial buffer for the utilities.

PGE's proposal to establish a separate definition of "taxes charged" that essentially would replace SB 408's explicit definition of "taxes collected" also has no basis in the law. Using actual results to determine the amount of "taxes collected" would undermine SB 408 by disregarding the amount of taxes that the Commission authorized for collection. Both SB 408's plain language and the Attorney General's explicit conclusion that the utility should use test period data previously approved by the Commission to determine the "taxes authorized to be

collected in rates" contradict PGE's claims about the basis for a "taxes charged" definition. Op. Att'y Gen. at 28 (Dec. 27, 2005).

IV. Conclusion

Staff's and the IOUs' support for the "Lesser-Of" or "With and Without" approaches is based on adhering as closely as possible to stand-alone principles that the legislature required the Commission to move away from when determining the income taxes to include in rates. It is the very rejection of this policy for the purposes of including income taxes in rates that resulted in the creation and enactment of SB 408. Adopting methodologies that merely extend the mismatch between taxes collected and taxes paid undermines the consumer protections in SB 408. The "Proportionate Share" approach implements the policies of SB 408 and ensures a matching of taxes collected with taxes paid.

Dated this 19th day of May, 2006.

Respectfully submitted,

/s/ Matthew Perkins
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

/s/ Ed Finklea
Ed Finklea
Chad Stokes
Cable, Huston, Benedict, Haagensen & Lloyd LLP
1001 S.W. Fifth Avenue, Suite 2000
Portland, Oregon 97204
(503) 224-3092 phone
efinklea@chbh.com
Of Attorneys for Northwest Industrial Gas Users