

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  
NORTHWEST NATURAL GAS  
COMPANY RE LEGAL ISSUES

In opening comments, Northwest Natural Gas Company (“NW Natural”) addressed three of the four Senate Bill 408 (“SB 408”) legal issues, as designated for briefing to the Oregon Public Utility Commission (the “Commission”) by Administrative Law Judge Kathryn A. Logan in her Memorandum in this docket issued October 5, 2005. Only one of these issues generated any significant comment from the non-utility parties. Therefore, these reply comments will be restricted to this one issue: *“How should the Commission apply the ‘properly attributed’ standard as it appears in the individual sections of the bill?”*

**I. Introduction: SB 408 calls for attribution of taxes paid to a utility based on the income generated by the regulated operations of that utility.**

In its opening comments, NW Natural explained that under SB 408, the tax payments “properly attributed” to an Oregon utility are the tax payments incurred as a result of income generated by the “stand-alone” regulated operations of the utility, but not to exceed the taxes paid by the utility’s affiliated group.<sup>1</sup> This stand-alone approach is synonymous with attributing to a utility the amount of tax payments that are “caused” by the utility’s regulated operations. NW Natural also pointed out that the level of tax payments attributable to an Oregon utility can be readily calculated from the consolidated tax returns of the utility’s

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<sup>1</sup> Of course, a stand-alone attribution of taxes under SB 408 would differ greatly from “stand-alone” tax allocations as previously applied by the Commission because the attribution would be limited to the amount of taxes paid by the affiliated group. As a result, what was referred to by the legislators as the “Enron problem” could not occur under any of the attribution methods advanced in this proceeding.

1 affiliated group for the applicable year, and the Commission does not need to audit or  
2 otherwise determine the proper tax liabilities of individual non-regulated utility affiliates.  
3 NW Natural explained that this stand-alone, or cost-causation, attribution of taxes paid is  
4 called for in SB 408, explained that other approaches advocated in this rulemaking  
5 proceeding would lead to arbitrary and capricious results, and demonstrated that all  
6 references by legislators in the legislative history supported the stand-alone, or cost-  
7 causation, approach.

8 **II. The alternative method for attributing taxes paid advanced in this proceeding,**  
9 **the “loss allocation” approach, appears to be based on misconceptions about the**  
10 **impact of utility regulated operations on taxes paid under a consolidated tax**  
11 **return.**

12 Some of the opening comments argue that SB 408 calls for an allocation of the tax  
13 losses of individual non-regulated affiliates of a utility (the “loss allocation” approach). This  
14 approach to attribution of taxes paid seems to be based on fundamental misconceptions about  
15 the impact of regulated operations on taxes paid by a utility’s affiliated group, is not  
16 supported by statutory language, and is contrary to all statements of legislators in the  
17 legislative history. Also, as pointed out in NW Natural’s opening comments, the proposed  
18 loss-allocation departure from the attribution requirements of SB 408 is poor public policy in  
19 that (1) this approach would require the Commission to engage in invasive audits of the tax  
20 liability of every non-utility affiliate of an affected Oregon utility and (2) Oregon utility rates  
21 would be set not in accordance with actual underlying costs of service, but rather in  
22 accordance with how the utility elected in its corporate structure to combine its tax-gain and  
23 tax-loss affiliates.

24 The Citizens’ Utility Board of Oregon’s (“CUB”) Opening Brief, at page 8, illustrates  
25 the misconceptions about the impact of regulated operations on taxes paid by a utility’s  
26 affiliated group. CUB gives the following example:

1		<u>Stand-Alone</u>
2		<u>Tax Liability</u>
3	Utility	\$100 million
4	Affiliate A	\$100 million
5	Affiliate B	\$ -50 million
6	Parent	<u>\$ -40 million</u>
7	Taxes Paid	\$110 million

8 In this example, CUB applies its loss allocation approach to attribution in order to allow the  
9 utility to recover only \$55 million of the \$100 million in taxes actually paid as a result of its  
10 regulated operations.

11 Consider, however, the actual impact on taxes paid when a consolidated entity  
12 consisting of Parent, Affiliate A and Affiliate B in CUB's example acquires the Utility in the  
13 same example.<sup>2</sup> We know the pre-acquisition tax liabilities of both the acquiring group and  
14 the Oregon utility: The acquiring group (Parent, Affiliate A, and Affiliate B) would have  
15 taxes paid of \$10 million. The Utility would have taxes paid of \$100 million. After the  
16 acquisition, the new consolidated tax filer would have taxes paid of \$110 million, which  
17 would be identical to the combined taxes paid by the acquiring group and the Utility before  
18 the acquisition. The pre- and post- acquisition taxes paid would thus be:

19		<u>Pre-Acquisition Taxes</u>	
20		(millions)	
21		<u>Acquiring Group</u>	<u>Stand-Alone Utility</u>
22	Affiliate A	\$100	\$100
23	Affiliate B	\$-50	
24	Parent	<u>\$-40</u>	
25	Total	\$ 10	\$100 = \$110

26 <sup>2</sup> NW Natural suspects that by distinguishing a utility's parent from its affiliates, CUB  
may be largely concerned with the treatment of the cost and tax deductions related to any  
acquisition debt issued by a parent company to acquire a utility. The particular issues related  
to acquisition debt currently are being heard on reconsideration in PacifiCorp Docket  
UE 170. NW Natural will leave to the PacifiCorp and other dockets the special case of how  
both the cost and the tax deductions related to acquisition debt should be treated in rates,  
under varying fact situations, and with or without application of SB 408. The discussion to  
follow thus assumes the absence of new acquisition debt issued in connection with  
acquisition of Oregon utility.

Post-Acquisition Taxes  
(millions)

Utility	\$100
Affiliate A	\$100
Affiliate B	\$-50
Parent	<u>\$-40</u>
Total	\$110

**In other words, if an affiliated group with net positive taxes paid acquires an Oregon utility, the acquisition will produce no tax savings; the taxes paid by the post-acquisition affiliate group will be identical to the taxes paid by the two pre-acquisition tax filers.**

Moreover, NW Natural points out that under the loss allocation approach, the attribution of taxes paid to the Utility in CUB's example would change dramatically if Utility's Parent and Affiliates merged. After such merger, there would remain only a single Parent or a single Affiliate with taxes paid of \$10 million. After the change in corporate structure, the loss allocation methodology would allocate to the Utility \$100 million of the \$110 million in taxes paid, rather than the \$55 million such methodology would allocate before the merger. The restructured entity would consist of:

Restructured Consolidated Entity Taxes Paid  
(millions)

	<u>Taxes Paid</u>	<u>Taxes Attributed</u>
Utility	\$100	\$100
Merged Non-Regulated Entity <sup>3</sup>	<u>\$ 10</u>	<u>\$ 10</u>
Total	\$110	\$110

<sup>3</sup> Affiliate A, Affiliate B, and Parent.

1 Thus, although taxes paid would be unchanged, and the operations and earnings of the  
2 affiliated group also would be unchanged, the Utility's rates would change by \$45 million.<sup>4</sup>

3 Accordingly, major arguments in the CUB Opening Brief simply are mistaken. CUB  
4 argues:

5 "First, we see no rational reason a utility should be more  
6 valuable to shareholders in a holding company than it would be  
7 as an independently-traded company. Second, by regulating  
8 taxes in the manner proposed by PacifiCorp, we encourage the  
absorption of Oregon utilities into massive holding companies,  
and actively discourage investors from purchasing them as  
independently-traded utilities."

9 (CUB Opening Brief at 11.)

10 As noted above, so long as the taxes paid by the affiliated group are equal to or greater than  
11 the tax obligations of the utility, the acquisition of the utility will provide no reduction in tax  
12 payments and thus will create no tax-related value to shareholders. Likewise, because no  
13 reduction in the pre-acquisition taxes paid will occur as a result of the acquisition, the stand-  
14 alone attribution of taxes paid will not encourage holding company acquisitions.<sup>5</sup>

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17 <sup>4</sup> CUB's Opening Brief provides a second example in which an affiliated group  
18 consisting of (1) a non-Oregon utility with a taxes paid of \$50 million, and (2) non-regulated  
19 entities with taxes paid of \$-50 million acquires an Oregon utility with stand-alone taxes paid  
20 of \$100 million. This situation is no different from the one just described. Before the  
21 acquisition, the acquiring group would have taxes paid of \$0, and the non-Oregon utility  
22 member of the acquiring group would receive whatever tax allowance in rates its own state  
23 regulators thought proper. As a result of the acquisition, the new consolidated entity would  
24 incur an additional \$100 million in taxes paid, which would be equal to the prior stand-alone  
tax requirements from the regulated operations of the acquired Oregon utility. The  
acquisition of the Oregon utility thus would produce no tax savings for the affiliated group.  
Moreover, if the acquiring group merged its multiple corporate entities, a single company  
with a \$0 tax liability then would acquire the Oregon utility, and even CUB in this  
economically indistinguishable case would attribute to the Oregon utility its full \$100 million  
in stand-alone taxes paid; thus corporate form again would trump economic reality if the loss  
allocation approach were used.

25 <sup>5</sup> Of course, if the acquiring group has a net tax loss position on its tax return, the  
26 acquisition of the Oregon utility would produce net tax savings. This would be the so-called  
"Enron" situation and was the situation that SB 408 was designed to address. All attribution  
methods proposed in this rulemaking proceeding would allocate such savings to ratepayers.

1 Moreover, as described above, CUB’s “loss allocation” approach to attribution of  
2 taxes paid would be profoundly unfair in the very situation described by CUB. CUB gave an  
3 example in which an acquirer with a net \$10 million in taxes paid acquired a utility that had  
4 taxes paid of \$100 million. As a result of the acquisition, the consolidated taxes paid would  
5 increase by \$100 million (from \$10 million to \$110 million), but the loss allocation method  
6 would allow recovery of only \$55 million of the \$100 million cost the utility imposed on  
7 taxes paid under the consolidated return. Stated another way, the acquisition would produce  
8 no tax savings, but the loss allocation method nevertheless would attribute a \$45 million  
9 annual acquisition tax benefit to customers.

10 **III. The stand-alone, or cost-causation, attribution of taxes paid is the method called**  
11 **for in SB 408.**

12 The attribution method for taxes paid is explicitly described in, and only in,  
13 section 3(12) of SB 408. That section specifies a tax attribution to the utility based on the  
14 income generated by the regulated operations of the utility:

15 “For purposes of this section, taxes paid that are properly  
16 attributed to the regulated operations of the public utility may  
not exceed the lesser of:

17 “(a) That portion of the total taxes paid that is incurred as a  
18 result of income generated by the regulated operations of the  
utility; or

19 “(b) The total amount of taxes paid to units of government by  
20 the utility or by the affiliated group, whichever applies.”

21 Notwithstanding this one clear attribution method in the statute, and the absence of  
22 any reference in SB 408 to allocation of tax losses, some of the opening comments attempt to  
23 infer a loss allocation approach from other provisions of the statute. For example, the CUB  
24 Opening Brief argues that if a stand-alone method were mandated, there would be no reason  
25 for section 3(12) to include the phrase “properly attributed to the regulated operations of the  
26 public utility”:

1 “It is also important to note that, under PacifiCorp’s proposed  
2 interpretation of the bill there is no reason for the bill to say  
3 ‘properly attributed to the regulated operations of the public  
4 utility.’ Under PacifiCorp’s proposal, the proposal is between  
5 a utility’s stand-alone tax liability and the consolidated tax  
6 liability of the consolidated company.”

7 (CUB Opening Brief at 7.)

8 CUB is mistaken. The phrase it quotes appears in the introduction to section 3(12),  
9 which section unmistakably specifies a stand-alone attribution. The introductory phrase  
10 simply recognizes that taxes paid that are “properly attributed” to the utility may be less than  
11 the total taxes paid. This phrase is totally consistent with, and in fact supports, the stand-  
12 alone attribution interpretation.

13 Additionally, several comments argue that section 3(7) of SB 408 somehow implies  
14 that a loss allocation approach to attribution is required, notwithstanding that section 3(12)  
15 specifies a stand-alone attribution approach. For example, the Industrial Customers of  
16 Northwest Utilities’ (“ICNU”) Opening Legal Comments state that the reference in  
17 section 3(7) to taxes “properly attributed” to an unregulated affiliate or parent of the utility  
18 has such a result. In an example, ICNU asserts that the utility and all its affiliates must have  
19 the same tax attribution applied to them, and claims the following required result if one  
20 affiliate has a tax loss:

	“Stand-alone Tax Liability	Amount of Taxes Paid and Properly Attributed [according to ICNU]
21 “Affiliate X (Regulated Utility)	\$130	\$100
22 “Affiliate Y	\$130	\$100
23 “Affiliate Z	\$ 0 <sup>a</sup>	\$ 0
24 “Consolidated Tax Payment	\$200	\$200

25 “a. This example assumes that Affiliate Z lost \$60. Thus Affiliate Z’s stand-alone tax  
26 liability was zero, but the consolidated tax liability was \$200. [ICNU footnote.]”

27 (ICNU Comments at 8-9.)

1 This example contains a glaring inconsistency. As ICNU’s footnote reveals, and as  
2 the consolidated tax return would show, Affiliate Z did not have a tax liability of \$0, but  
3 instead had a tax liability of \$-60. Thus the actual tax attribution, as analysis of the tax return  
4 would reveal, is:

5	Affiliate X	\$130
6	Affiliate Y	\$130
	Affiliate Z	\$-60

7 A negative tax attribution to Affiliate Z should not be surprising, and cannot simply  
8 be ignored. Indeed, no provision of either the loss allocation or the stand-alone approach  
9 prevents a negative tax attribution of taxes paid for the utility itself (which attribution then  
10 must be adjusted as specified in Section 3(13)(f)). For example, a utility might have a tax  
11 payment of \$5 million and a tax refund of \$10 million in the same year. Taxes paid as  
12 attributed to the utility would then be \$-5 million, before the specified adjustments. Why  
13 then should we treat non-regulated affiliate tax losses as if they did not exist? In other words,  
14 where does section 3(7) authorize the Commission to restate negative affiliate tax attributions  
15 as if they were \$0 attributions, instead of the negative attributions that the consolidated tax  
16 returns would show?<sup>6</sup>

17 **IV. The legislative history convincingly establishes that legislators were told by their**  
18 **colleagues that SB 408 provided for a stand-alone, or cost-causation, attribution**  
**of utility taxes paid.**

19 The loss allocation approach to attribution advocated in some of the initial comments  
20 is based on “stealth” legislative history. Legislative support of the loss allocation approach

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23 <sup>6</sup> The Comments of Portland General Electric Company (“PGE”) argue, with  
24 substantial persuasiveness, that this entire attribution discussion under section 3(7) is beside  
25 the point. PGE points out that “properly attributed” is not a defined term or formula to be  
26 applied to each affiliated entity. Rather, “properly attributed” describes the result of applying  
the “lesser of” test to the utility, as set out in Section 3(12) of SB 408. This means that any  
taxes not attributed to the utility under Section 3(12) are then treated as attributed to a non-  
utility affiliate.



1 remained invisible throughout the actual legislative process, only to suddenly appear during  
2 the rulemaking proceedings.

3 NW Natural's initial comments ("NW Natural Comments") cited every statement it  
4 was able to locate by a legislator addressing how the attribution of taxes paid was to be made.  
5 Each comment, including an extended exchange by Senator Rick Metsger, as well as the  
6 house floor colloquies by Representatives R. Tom Butler, Brian Boquist, and an unidentified  
7 representative (*see* NW Natural Comments at 7-10), confirm that the legislators'  
8 understanding was that taxes paid should be attributed to utilities on a stand-alone basis.

9 Remarks of Senators Metsger and Vicki Walker, cited in CUB's Opening Brief at 15-  
10 16 in support of its loss allocation approach, do not even address the appropriate approach to  
11 attribution (although as noted above, Senator Metsger did address the matter decisively in a  
12 portion of the legislative history that CUB did not cite).

13 The newfound reasoning for a loss allocation approach is particularly intriguing, as it  
14 comes from parties that themselves represented to legislators during the legislative process  
15 that SB 408 provided for a stand-alone attribution. Outside of the loss allocation position  
16 advocated by Dan Meek and quoted by CUB, in the legislative history no party even  
17 advocated for such an approach. For example, CUB's Opening Brief at 17-18 quoted ICNU  
18 representative Michael Early. Again, in CUB's quote, Mr. Early did not advocate, or even  
19 imply, a loss allocation approach to attribution. However, CUB failed to quote the portion of  
20 the legislative record in which Mr. Early actually described on behalf of ICNU, in detail, how  
21 the attribution of taxes paid was to be applied to a utility. During the legislative work session  
22 on the subject, Mr. Early, representing ICNU, explained that the attribution to the utility was  
23 to be that portion of total taxes attributable to the utility's regulated operations in Oregon.  
24 During the House State and Federal Affairs Committee's work session, Mr. Early explained:

25 "What's different about our bill, is our bill gets to the heart of  
26 the question. In that same fact situation, what we're truing-up  
is, we're saying is we want to match the dollars collected from

1 rate payers with the tax dollars by the utility and attributable to  
2 regulated operations. So, the Commission looks at the \$500  
3 million and asks itself what portion of that \$500 million was  
4 attributable to regulated operations in Oregon and that answer's  
5 going to be \$50 million. So, then it says, well, it did collect  
and pay to taxing authorities the amount of taxes collected. So,  
in that case, the adjustment is, there would be no adjustment,  
because in fact what was expected to happen, did happen. It  
collected \$50 million and it paid \$50 million."

6 (House State and Federal Affairs Committee SB 408 Work Session (July 26, 2005), SB 408  
7 Legislative History at 329.)

8 NW Natural attaches, as Exhibit A to these reply comments, the total statement of and  
9 examples used by ICNU to explain to the legislators how the SB 408 attribution would work.  
10 (SB 408 Legislative History at 252-57.) The theme of each example given was that the  
11 utility would be attributed the lesser of its stand-alone taxes paid and the taxes paid by the  
12 affiliated group. ICNU states in Exhibit A, in the its introduction to its examples:

13 "The utility is authorized to recover in rates from ratepayers the  
14 costs of taxes attributed to regulated utility operations and paid to  
15 governmental units. The problem arises when the amount of  
16 revenues collected from ratepayers for this purpose is less than the  
taxes actually paid to governmental units and, thus, ratepayer  
monies are diverted to other purposes."

17 Finally, NW Natural thinks it only fair to note how CUB itself described to legislators  
18 the attribution of taxes paid under SB 408. In a letter to legislators dated October 28, 2005  
19 and attached as Exhibit B to the Joint Comments of Avista Corporation and PacifiCorp(the  
20 "CUB Letter"), CUB made no mention of a loss allocation approach. To the contrary, the  
21 CUB Letter described the goal of SB 408 as ensuring that taxes collected by a utility  
22 reflected tax payments actually made with respect to the utility service.

23 "Having a utility report how much they collect in taxes, having  
24 them report how much they paid in taxes and making sure  
25 those two amounts are closely aligned does not result in  
26 confiscatory rates . . . . But making sure that taxes collected in  
rates are actually paid does not prevent that opportunity [to  
earn a fair and reasonable return] in any way. Investors should  
not be able to increase their profit margins by simply keeping

1 taxes collected in rates . . . However, for taxes collected in  
2 rates, SB 408-C asks only that the utility report the amount it  
3 collected for taxes in its rates, based on activities ‘properly  
4 attributed to the utility, and how much was actually paid to  
5 governmental entities. If there is a difference—either up or  
6 down—then there needs to be a true up.”

7 (CUB Letter at 1-2.)

8 **V. Conclusion.**

9 Some parties in this proceeding are attempting to expand the intended scope of  
10 SB 408 through rulemaking, so that it will be applied in a manner that denies actual costs of  
11 providing regulated service. The Commission, however, is charged by statute with assuring  
12 that rates are fair, just, and reasonable, both to the utilities and to their customers. As  
13 Governor Kulongoski noted in a letter accompanying his signing of SB 408:

14 “[T]he legislation does not address many of the concerns raised  
15 by various stakeholders during numerous public hearings, work  
16 sessions and other meetings on this subject. In fact, much of  
17 that hard work was ignored and the final version of the bill  
18 defers many of the difficult questions about the impact and  
19 implementation of SB 408 to the Oregon Public Utility  
20 Commission (OPUC).”

21 Letter from Governor Theodore R. Kulongoski to Secretary of State Bill  
22 Bradbury (Sept. 2, 2005).

23 SB 408 simply does not require a utility to allocate tax losses of unregulated  
24 affiliates, if the affiliated group actually paid at least as much in taxes as the utility was  
25 allowed in rates. As noted above, SB 408 also does not require a utility to allocate benefits  
26 from joining in a consolidated tax return if in fact there are no such benefits. If taxes paid by  
an affiliated group, for example, actually are increased by \$100 million as a result of income  
generated by the regulated operations of the utility, no provision of SB 408 states, and no  
legislator in the legislative history of SB 408 stated, that the Commission was to allow only a  
portion of this \$100 million cost of Oregon utility service. NW Natural seeks here only an

1 interpretation of SB 408 that allows it to recover its actual taxes paid as a result of regulated  
2 operations.

3 DATED: November 10, 2005.

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