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**Re: Docket No. AR 499**

Enclosed for filing are the original and one copy of Northwest Natural Gas Company's Opening Comments Re Proposed Final Rule.

Very truly yours,

Marcus Wood

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 | **OPENING COMMENTS OF NORTHWEST NATURAL GAS COMPANY RE PROPOSED FINAL RULE** |

On July 14, 2006, the Oregon Public Utilities Commission (the "Commission") issued an Interim Order proposing a new approach to the "proper attribution" of taxes paid pursuant to Senate Bill ("SB") 408. The Commission also addressed the much-discussed "double whammy" problem that arises if a utility is required to make tax refunds solely because it underearns its allowed equity return. The Interim Order invited further comments by the parties on any issue raised therein.

On July 25, 2006, the Commission's staff (the "Staff") issued a proposed final rule, OAR 860-022-0041, to implement SB 408. The proposed final rule included a number of provisions agreed to by the parties as the result of the workshop process in this docket, as well as the Commission's proposed resolutions in the Interim Order.

These Opening Comments of Northwest Natural Gas Company ("NW Natural") will address three areas of concern related to the Interim Order and the Staff-proposed final rule.

1. Technical Corrections: NW Natural proposes a few clean-up changes to the proposed final rule. NW Natural believes these changes will clarify the rule consistent with the expressed intent of the workshop parties.

2. The "Properly Attributed" Methodology: NW Natural explains why the Commission's newly proposed "properly attributed" methodology, as currently drafted, would produce tax attribution inequities not previously sought by any party and would violate both statutory and judicial requirements applicable to unitary tax allocation. NW Natural proposes modifications to the Commission's proposal that would meet the Commission's goal of using the

three-factor approach to simplify administration of the SB 408 tax attribution, but that would eliminate otherwise serious implementation problems.

3. NW Natural proposes with respect to the double whammy problem, either that the Commission reconsider the merits of the type of cost-recovery deferral filing that NW Natural filed in Docket No. UG-170, or that the final order in this proceeding set out the need for a simple statutory revision that would eliminate the double whammy effect.

## I. Technical Corrections to the Proposed Final Rule: NW Natural proposes to clarify Staff's proposed final rule.

Staff's proposed final rule incorporates well both the agreements reached in the workshop process and the provisions of the Interim Order. Therefore, NW Natural proposes only a few technical corrections to section 2 of the proposed final rule, each of which it hopes will prove to be non-controversial. Section 2 of Staff's proposed final rule, edited with the technical corrections described below, is attached as Exhibit A to these comments.[1]

A. Section 2(d) of the proposed final rule provides two different definitions of the term "income." The rule does indeed use different definitions for this term in different places. However, the section does not explain when one definition applies and when the other definition applies. NW Natural believes that the second definition ("regulatory taxable income") applies only when reporting or computing the stand-alone tax liability resulting from a utility's regulated operations. The proposed change so clarifies.

B. Section 2(e) of the proposed final rule defines "investment" to be utility property "used" to provide regulated service to customers. Section 2(o)(B) provides for the addition to taxes paid of tax credits for "investment" in the regulated operations of the utility not taken into account in the utility's most recent rulemaking proceeding. Section 9(f) provides that the automatic adjustment clause must not operate in a manner that allocates to customers any portion of the benefits of deferred taxes resulting from accelerated depreciation or other tax treatment of

[1] Exhibit A does not include the changes to sections 3 and 4 of the proposed final rule that NW Natural addresses in Section II of these comments with respect to the application of the three-factor method to "properly attribute" taxes paid.

utility "investment" or regulated affiliate "investment" required to ensure compliance with the normalization method of accounting or any other requirements of federal tax law.

When so used in the rule, the definition of "investment" should track the statutory definition of the types of investments that are considered public utility property, namely, investments that are "necessary or useful" in providing regulated service. *See* ORS 757.480. This distinction between "used" and "necessary or useful" is particularly important in connection with conservation investments, which are appropriate investments for regulatory recovery because they are necessary or useful in the provision of regulated service. However, if the statutory definition of regulatory investments is not used, parties may argue that conservation investments must be excluded in applying the rule because such investments are not directly "used" to provide electricity or natural gas.

C. Section 2(k) of the proposed rule defines "revenue." NW Natural clarifies the definition to exclude from "revenue" amounts received by it from retail ratepayers but not included in utility revenue requirements or in supplemental rate schedules, such as revenue from appliance sales. Such revenue is not included in NW Natural's revenue requirements in rate cases and thus under the rule should not be included in computing either taxes authorized to be collected in rates or taxes paid.

D. Section 2(o)(B) of the proposed rule provides for taxes paid to be increased by the amount of tax credits associated by investment by the utility in the regulated operations of the utility, to the extent the expenditures giving rise to the tax credits and tax savings resulting from the tax credits have not been taken into account by the Commission in the utility's most recent general ratemaking proceeding. This section clarifies that such credits include tax credits associated with renewable electricity production. In the July 21 workshop, NW Natural understood from other parties that Oregon business energy tax credits, or BETCs, also were included, to the extent that the related conservation expenditures had not been included in computing utility rates. The proposed change makes this clarification explicit.

E. Section 2(o)(C) of the proposed rule provides an option for a utility to report its deferred taxes either based on its results of operations report or based on its actual tax return for the applicable year. The added language makes clear that the utility may use the tax return if the results of operations report does not reflect the deferred taxes "used to compute taxes paid" for the applicable year. NW Natural has requested the right to tie its deferred taxes used in computing taxes paid to the amounts in its tax returns rather than to the amounts booked in a year for accounting purposes. Deferred taxes are added to tax liabilities to determine taxes paid, and NW Natural seeks to be able to add back each year the actual amount deducted in each year from its tax liability.

During the workshops, NW Natural explained that use of the tax return's deferred taxes (if done consistently from year to year) will not change the total amount of deferred taxes claimed over time, but only may impact whether an amount is allocated to a specified tax year to an immediately adjacent tax year. No party objected to allowing a utility the option to match its deferred taxes to the amounts claimed on its tax returns for the year in question. NW Natural believes that by tying deferred taxes to its tax return amounts each year, it is less likely to have back-to-back years in which a rate surcharge is followed by a comparable rate refund, or vice versa. The proposed change clarifies its right to do so.

## II. The Proposed "Properly Attributed" Methodology: The Commission's proposed approach to proper attribution of taxes paid could penalize Oregon utilities far beyond levels proposed by any party and could produce results impossible to sustain under current judicial precedent. However, the new problems can be eliminated by reasonable modifications to the proposed three-factor attribution methodology.

Most of the workshop parties (including NW Natural) have made proposals in this proceeding that initially seemed to them compelling, but upon testing by other workshop parties were shown to have serious problems. The Commission now has presented a novel approach to determining how to "properly attribute" taxes paid that has not yet been subjected either to testing by other parties or to analysis as to impact and reasonableness in the context of utility ratemaking. As explained below, testing of this new approach reveals serious defects, sufficient

in NW Natural's view to make application of the approach as currently worded highly unlikely to withstand judicial review. As further explained below, however, most of the intended benefit of the new approach, in simplifying the process for properly attributing taxes paid, can be achieved through a modification of the approach to remove some of its most serious problems. NW Natural thus proposes that if the proposed method is retained, sections 3 and 4 of the proposed final rule be modified as set forth in Exhibit B.

The usual disclaimers: NW Natural's proposed revised rule language related to "properly attributed" will leave in place other features that it thinks are unjust and unreasonable. For example, NW Natural takes issue with the basic premise of SB 408 that taxes can be divorced from the revenues and expenses that give rise to the taxes and with the proposition that utility customers are entitled to the benefit of tax losses of non-utility entities. NW Natural also thinks that any "with and without" test tax benefits from use of a consolidated return should be apportioned among all consolidated entities, rather than be allocated entirely to utility ratepayers. Finally, NW Natural thinks the "with and without" test, combined with the requirement that a utility's taxes paid be the lesser of its taxes paid or the consolidated taxpayer's taxes paid, allocates to ratepayers all possible benefits to the utility from the filing of a consolidated tax return, making any further allocation of tax expense away from the utility particularly unreasonable. However, these issues have previously been briefed, and NW Natural here focuses only on the unique problems raised by application of the three-factor test to the attribution of taxes for utility rate purposes.

### A. The proposed application of the three-factor test can allocate taxes in a manner contrary to all substantial evidence as to taxes actually incurred and paid by the utility.

Unless modified, the three-factor test as set out by the Commission in the Interim Order can (and likely will) produce rate results that NW Natural thinks could not be defended as rational ratemaking. NW Natural urges the Commission to consider whether it really wants to prescribe rate results such as the following:

1. When a utility affiliate incurs a tax loss, the proposed final rule can allocate that loss to the utility multiple times. Neither the temporary rule nor any party in this proceeding has proposed allocating to the utility as a tax benefit more than the full amount of an affiliate's tax loss. This effect is reflected in the following example:

| | Tax Liability | 3-Factor Allocation | Temporary Rule Attribution | Interim Order Attribution |
|---|---|---|---|---|
| Utility | 50 | 25% | 40 | 10 |
| Affiliate | -10 | 75% | 0 | 30 |
| Total | 40 | | | |

In this example, the utility undeniably incurred all of the consolidated taxes paid of 40. Under SB 408 and the temporary rule, all benefit of the affiliate's tax loss under the consolidated return would be passed through as a tax expense refund to utility ratepayers. Under the rule as proposed in the Interim Order, however, the affiliate tax loss of -10 would translate into a tax expense refund of 40, or four times the total effect of the affiliate loss on the consolidated tax return. The rule would achieve this result because it would allocate 75 percent of the consolidated taxes paid to the affiliate that produced the tax loss.

2. Even when every member of the consolidated tax group has a positive tax liability, the proposed rule can reallocate taxes without regard to undeniable evidence as to which entities incurred which taxes. Because of the "with and without" methodology's cap on taxes allocated to the utility, such a disparity between taxes as incurred and taxes as attributed never can favor the utility; the disparity can, however, deny the utility recovery of taxes indisputably incurred because of, and only because of, the provision of regulated utility service. Neither the temporary rule nor any party in this proceeding has proposed denying a utility the opportunity to recover the taxes paid to provide utility service, in the situation in which all members of the consolidated tax group have a positive tax liability. This effect is reflected in the following example:

| | Tax Liability | 3-Factor Allocation | Temporary Rule Attribution | Interim Order Attribution |
|---|---|---|---|---|
| Utility | 50 | 25% | 50 | 25 |
| Affiliate | 50 | 75% | 50 | 75 |
| Total | 100 | | | |

In this example, the utility and its affiliate each undeniably incurred and paid a tax of 50, producing a consolidated tax payment of 100.[2] The reallocation of taxes produced by the Interim Order's methodology is achieved by attributing to the affiliate a tax payment much greater than the entity undeniably incurred, thereby attributing to the utility a tax payment much less than the level the utility undeniably incurred.

**B. The United States Supreme Court, as well as the Oregon legislature and the Oregon Supreme Court, have barred application of the three-factor test to impute to a utility hypothetical tax liabilities different from amounts that are objectively demonstrated.**

The three-factor allocation of taxable net income was designed by states to address a particular problem: When a business operates in multiple states, it usually it is not possible to identify the contribution of operations in each state to the unified business net income. For example, if a manufacturing plant is located in state A, a distribution center in state B, and retail operations in state C, what is the contribution of each state to the total net income of the business? As the U.S. Supreme Court explained in *General Motors Corp. v. District of Columbia*, 380 US 553, 560-61, 85 S Ct 1156, 14 L Ed3d 68 (1965) (quoting *Underwriter Typewriter Co. v. Chamberlain*, 254 US 113, 120-21, 41 S Ct 45, 65 L Ed 165 (1920)):

> The profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other states. In this it was typical of a large part of the manufacturing business conducted in the state. The Legislature, in attempting to put upon this business its fair share of the burden of taxation, was faced with the impossibility of

[2] Although it is possible in this example that the consolidated entity might pay slightly less than the sum of the two stand-alone tax liabilities of 50 each, the Commission's "with and without" cap on taxes paid already captures all such benefit for the utility ratepayers.

> allocating specifically the profits earned by the processes conducted within its borders.[3]

By contrast to the reason for employing the three-factor test for interstate taxation – the impossibility of determining directly what part of net income is fairly attributable to operations in each individual state – the Commission will know exactly the net income and the tax liability of the utility within its consolidated group.

The U.S. Supreme Court further has explained that even when the actual net income cannot be determined on a state-by-state basis, it still will bar use of the three-factor allocation if such allocation fails to reasonably reflect the in-state contribution to unitary net income. According to the Court in *Container Corp. of America v. Franchise Tax Bd.*, 463 US 159, 164, 170, 103 S Ct 2933, 77 L Ed 2d 545 (1983):

> In the case of a more-or-less integrated business enterprise operating in more than one State, however, arriving at precise territorial allocations of "value" is often an elusive goal, both in theory and in practice. * * * * Nevertheless, we will strike down the application of an apportionment formula if the taxpayer can prove "by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted * * * * in that state,' * * * 'or has led to a grossly distorted result' * * *.[4]

In Oregon, the rules for application of a three-factor allocation to a public utility (or to a financial organization) are even stricter. ORS 314.280 provides a special rule for such entities, and requires the Oregon Department of Revenue to use a segregated method of reporting if such method more fairly and accurately reflects the net income of the business done within the state. The Oregon Supreme Court has held that if a public utility makes a showing that its net income is not fairly and accurately reflected in a three-part apportionment, the Department of Revenue

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[3] In *General Motors*, the Court disallowed an allocation of net income based on sales of the company in the jurisdiction, because this allocation did not fairly apportion the net income based on the actual operations of the company.

[4] In accordance with this principle, the Supreme Court has struck down apportionments that the taxpayer demonstrated were clearly out of line with the actual value of the business within the state. *See, e.g., Hans Rees' Sons v. State of North Carolina*, 2836 US 123, 51 S Ct 385, 75 L Ed 978 (1931), and *Norfolk and W. Ry. Co. v. Missouri State Tax Com'n*, 390 US 317, 88 S Ct 995, 19 L Ed 2d 1201 (1968).

*must* employ a segregated approach. In *Fisher Broadcasting, Inc. v. Dept. of Rev.*, 321 Or 341, 898 P2d 1333 (1995), the taxpayer appealed the application of the three-factor test to it, based on a showing that the test did not fairly and accurately reflect its net income from business done within the State of Oregon. The Department of Revenue argued that it had broad discretion in applying the three-factor test, despite the showing by the taxpayer. The Oregon Supreme Court disagreed:

> Application of the inconsistent standards and goals of OAR 150-314.670-(A) to taxpayer's claim has caused the department and the Tax Court to fail to grasp taxpayer's central argument, which is that the apportionment method of reporting does not "accurately" reflect the "net income of [Fisher Broadcasting Corporation] done in this state...

*Id.* At 358 (brackets in original).

The potential misapplication of the three-factor test to public utilities in the proposed rule is much more extreme than the misapplication struck down for Fisher Broadcasting Corporation under the requirements of ORS 314.280.[5] Fisher Broadcasting could not precisely calculate the allocation of its net income by state, but it did demonstrate that the three-factor test was not a reasonable approximation of such allocation. The proposed final rule would go much further than the Department of Revenue attempted with Fisher Broadcasting, in that it would apply the three-factor test to create new hypothetical tax liabilities for various entities in a consolidated tax group that were different from, and unrelated to, the undisputed actual tax liabilities that can be demonstrated for the various entities.

In summary, the courts have not permitted states to use the three-factor allocation to replace a known and demonstrated tax liability with a hypothetical and inaccurate tax liability.

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[5] Even for entities to which ORS 314.280 does not apply, the Oregon Courts have stricken down the applications of the three-factor test that failed to reflect a fair proportion of value allocated to the state. See, for example, Southern *Pacific Transportation Co. v. Dept of Rev*, 302 OR 582 (1987). A very recent decision of particular interest is *Stonebridge Life Insurance Co v. Dept of Rev*, 2006 WL 1042175 (Or Tax Magistrate Div, Feb 22, 2006), in which the use of the three-factor test was disallowed when the Court found that the apportionment formula created a "grossly distorted" value and that the actual income figures were "easily sourced."

NW Natural believes that such replacement of demonstrated taxes (or tax losses) with fictional taxes would be reversible under the review standards of ORS 183.482(8)(c), which requires the Court to set aside or remand an order that "is not supported by substantial evidence in the record," with "substantial evidence" defined as evidence that will "support a finding of fact when the record, viewed as a whole, would permit a reasonable person to make that finding."

### C. The Commission's proposed approach can be modified to preserve the three-factor test concept, as well as most of the benefits as proposed by the Commission, while avoiding the serious defects described above.

NW Natural thinks that the three-factor approach can be modified to achieve the Commission's stated purposes of simplifying the application of the "properly attributed" concept, while avoiding the creation of new problems and inequities. To appropriately modify the approach, however, we first should recall the dispute that the approach addressed. That dispute related to the treatment of tax losses of individual entities in the utility taxpayer's consolidated tax group and of tax losses of non-regulated operations of the utility itself.

The utilities argued that once SB 408's "lesser of" test was applied to provide the utility the lower of its tax liability or the consolidated return's tax liability, and the "with and without" test then was applied to strip the utility of any remaining benefits of consolidation, no further allocation of individual entity tax losses should be made. Some other parties noted, however, that tax losses of individual entities would cause the consolidated tax payment to be lower than the sum of the stand-alone tax payments of the members of the consolidated group with positive tax liabilities; these parties argued that individual entity tax losses should be allocated in some manner to reduce the taxes paid of each of the entities with positive tax liabilities, which would further lower the utility's "properly attributed" taxes paid. No party, however, advocated reallocation of taxes among members of the consolidated group when there were no tax-loss entities, and no party advocated attributing taxes paid to affiliates of the utility that were themselves tax-loss entities.

The utilities objected to the proposed reallocation of tax losses of individual entities in a consolidated tax group because (a) the result would be an allowance of taxes lower than additional taxes the utility operations actually imposed on the consolidated group, and (b) any proposed reallocation based on relative taxes paid by each member of the consolidated group would require production and auditing of hundreds of entity tax returns.

The Interim Order gave short shrift to the first of these utility arguments, but the Commission expressed concern with the administrative challenge of dealing with literally hundreds of affiliate tax returns. The Interim Order described the use of the three-factor methodology as a means of simplifying the tax attribution procedure.

To the extent that the three-factor methodology simplifies tax attribution, it can achieve a similar benefit if applied to the issue in dispute among the parties: the allocation of individual entity tax losses. As so applied, the three-factor methodology would determine the allocation of such tax losses. NW Natural thus proposes to modify the proposed attribution method to apply the three-factor methodology to the allocation of the tax losses incurred by individual members of the consolidated group, or by the non-regulated activities of the utility, rather than to create hypothetical taxes paid unrelated to any actual tax liabilities of the utility or its affiliates. Beyond the information already required by the proposed rule, the proposed modification will require the utility to produce some additional tax information, but only with respect to tax-loss entities within the consolidated group.

The parties also appeared to achieve greater levels of agreement than the Interim Order recognized. The proposed rule should be modified to reflect these areas of agreement. For example:

1. Intrastate Allocation of a Utility's Taxes. The parties disputed how tax losses should be allocated to the utility. The parties appeared to agree, however, that once an appropriate attribution of taxes paid had been made to the utility, those taxes should be allocated among the state jurisdictions served by the utility through a method consistent with the Commission's interstate allocation principles. Otherwise, the utility would not be allowed to

recover in Oregon the portion of its total taxes paid that the Commission had found in a general rate case to be properly allocable to Oregon. The proposed modifications call for the intra-utility allocation of taxes paid to conform with the Commission's rate case findings as to the proper interstate allocation of costs.

2. Tax Normalization Requirements. The parties agreed that the final rule should not violate tax normalization requirements (even though the parties may have had differing understandings of what those requirements were). As other parties will explain in their comments, the proposed approach to "properly attributing" costs reallocates tax expenses so as to impermissibly flow through normalized tax benefits. The Interim Order found that the three-factor attribution provided a cap on taxes paid that was in addition to SB 408's minimum requirements; therefore, the Commission cannot fail to comply with SB 408 by assuring that this additional cap is adjusted for deferred tax impacts. NW Natural's proposed final rule revisions allocate the benefits of individual entity tax losses, but only after adjusting such tax losses for any applicable deferred taxes, in order to prevent violation of tax normalization requirements.

3. Local Taxes. The parties agreed that accounting for the differences between local taxes authorized and local taxes collected should be a straightforward matter. The utilities collect such taxes from their customers by separate schedule. The surcharged or refunded amount for local taxes should be, by county, the positive or negative difference between taxes paid by the utility to the county and taxes collected by the surcharge with respect to such county. This consensus was reflected in Staff's May 17, 2006 version of the proposed final rule. NW Natural's proposed final rule revisions restore Staff's local tax language.

**D. Examples of the operation of the three-factor approach, as modified.**

The following examples illustrate the effects of NW Natural's proposed modification of the three-factor methodology:

1. Utility whose only affiliate has a tax loss.

| | Tax Liability | 3-Factor Allocation | Interim Order Tax Attribution | Modified 3-Factor Tax Attribution[6] |
|---|---|---|---|---|
| Utility | 50 | 25% | 10 | 40 |
| Affiliate | -10 | 75% | 30 | 0 |
| Total | 40 | | | |

2. Utility with tax-loss affiliate, but with higher consolidated taxes paid than utility taxes paid.

| | Tax Liability | 3-Factor Allocation | Interim Order Tax Attribution | Modified 3-Factor Tax Attribution |
|---|---|---|---|---|
| Utility | 50 | 25% | 15 | 40 |
| Affiliate A | 30 | 25% | 15 | 20 |
| Affiliate B | -20 | 50% | 30 | 0 |
| Total | 60 | | | |

3. Intrastate allocation of utility taxes.

Assume: Stand-alone utility (with no affiliates) operating in Oregon and in one other state.
Taxes assumed in last general rate case = 100
Interstate allocation of tax expense to Oregon (in general rate case) = 50
Three-factor allocation to Oregon regulated operations = 40
Actual taxes paid = 100

| | Rate Case Allocation | 3-Factor Allocation | Interim Order Attribution | Modified 3-Factor Attribution |
|---|---|---|---|---|
| Utility (Oregon) | 50 | 40% | 40 | 50 |
| Utility (other state) | 50 | 60% | 60 | 50 |
| Total | 100 | | | |

## III. The Double Whammy Effect: Either the Commission or the Oregon legislature should eliminate the double whammy effect in the application of SB 408.

The Commission has expressed sympathy for what NW Natural believes are unintended double whammy impacts of SB 408. Depending on whether the utility underearns or overearns its allowed return, these impacts will be unfair either to the utility or to its customers.

[6] This modified three-factor tax attribution is the same attribution as advocated by all workshop parties for the situation depicted in this example. Allocation of deferred taxes under the modified attribution could not change the result, because in this situation the utility is limited to recovering the amounts of taxes paid by the consolidated taxpayer.

NW Natural believes that the double whammy problem is an unintended problem created by SB 408. The Commission has the power under its deferred cost-recovery authority to adjust utility cost-recovery so as to implement SB 408 in the manner NW Natural thinks was intended by the Oregon legislature. NW Natural urges the Commission to exercise the authority that it has under Oregon law to avoid arbitrary double whammy ratemaking.

If, however, the Commission believes itself unable to correct the double whammy problem, or if it is unwilling to do so without further legislative action, the legislature still needs the benefit of the Commission's views on this issue. NW Natural in such case urges the Commission to address the need for modification to the legislation to correct the double whammy problem. The required statutory revision is remarkably simple. Section 3(13)(e)(B) of SB 408 need only be revised as follows:

> (B) The ratio of the net revenues from regulated operations of the utility to gross revenues from regulated operations of the utility, ~~as determined by the commission in establishing rates~~ for the applicable tax year; and

This simple change would align taxes and net revenues of the utility within each tax year and would eliminate the double whammy problem. The tax allocation provisions of the statute would be otherwise unaffected. NW Natural urges the Commission in its final order to describe the double whammy problem and to explain how easily this problem can be remedied by the legislature.

DATED: July 31, 2006.

Respectfully submitted,

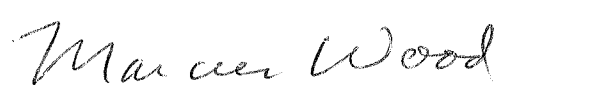

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Exhibit A – Proposed Redlined Technical Corrections to Section 2 of the Proposed Final Rule

**860-022-0041**

**Annual Tax Reports and Automatic Adjustment Clauses Relating to Utility Taxes**

. . . .

(2) As used in this rule:

(a) "Affiliated group" means the group of corporations of which the utility is a member and that files a consolidated federal income tax return.

(b) "Deferred taxes" for purposes of the utility means the total deferred tax expense of regulated operations as reported in the FERC deferred tax expense accounts that relate to the year being reported in the utility's results of operations report or tax returns.

(c) "FERC" means the Federal Energy Regulatory Commission.

(d) "Income" means taxable income as determined by the applicable taxing authority ~~or~~, except that income means regulatory taxable income when reporting or computing the stand-alone tax liability resulting from a utility's regulated operations.

(e) "Investment" means capital outlays for utility property ~~used to provide~~necessary or useful in providing regulated service to customers.

(f) "Local taxes collected" means the total amount collected from customers under the local tax line-item of customers' bills calculated on a separate city or county basis.

(g) "Pre-tax income" means the utility's net revenues before income taxes and interest expense, as determined by the Commission in a general rate proceeding.

(h) "Properly attributed" means the share of taxes paid that is apportioned to the Oregon regulated operations as calculated in section (3) of this rule.

(i) "Regulated operations of the utility" means those activities of a utility that are subject to rate regulation by the Commission.

(j) "Results of operations report" means the utility's annual results of operations report filed with the Commission.

(k) "Revenue" means retail revenues from ratepayers in Oregon as defined by FERC, excluding other operating revenues as defined by FERC, ~~and~~ supplemental schedules not included in the utility's revenue requirement, and retail revenues not received pursuant to rate schedules, and adjusted for any rate adjustment imposed under this rule.

(l) "Revenue requirement" means the total revenue the Commission authorizes a utility an opportunity to recover in a general rate proceeding or other general rate revision, including an annual automatic adjustment clause under ORS 757.210.

(m) "Tax" means a federal, state or local tax or fee that is imposed on or measured by income and that is paid to a unit of government, but does not include a franchise fee or privilege tax.

(n) "Taxes authorized to be collected in rates" means the following for federal and state income taxes:

(A) The amount calculated by multiplying the following three values:

(i) The revenue the utility collects, using information from the utility's results of operations report;

(ii) The ratio of the net revenues from regulated operations of the utility to gross revenues from regulated operations of the utility, calculated using the pre-tax income and revenue the Commission authorized in establishing rates and revenue requirement; and

(iii) The effective tax rate used by the Commission in establishing rates for the time period covered by the tax report as set forth in the most recent general rate order or other order that establishes an effective tax rate, calculated as the ratio of total income tax expense in revenue requirement to pre-tax income.

(B) For purposes of paragraph (2)(m)(A), when the Commission has authorized a change during the tax year for gross revenues, net revenues or effective tax rate, the amount will be calculated using a weighted average of months in effect.

(o) "Taxes paid" means net amounts received by units of government from the utility or from the affiliated group and properly attributed to regulated operations of the utility, adjusted as follows:

(A) Increased by the amount of tax savings realized as a result of charitable contribution deductions allowed because of the charitable contributions made by the utility;

(B) Increased by the amount of tax credits on the tax return that are associated with investment by the utility in the regulated operations of the utility, which may include, but are not limited to, tax credits associated with renewable electricity production and the Oregon Business Energy Tax Credit, to the extent the expenditures giving rise to the tax credits and tax savings resulting from the tax credits have not been taken into account by the Commission in the utility's most recent general ratemaking proceeding; and

(C) Adjusted by deferred taxes related to the regulated operations of the utility. The utility must initially use its results of operations report to establish the amount of deferred taxes. If the utility does not believe that the results of operations report sufficiently reflects the amount of the utility's deferred taxes used to compute taxes paid for the applicable tax year, the utility may also use its tax returns for the tax year as a supplemental source for calculating the deferred

taxes adjustment as a separate submission. Deferred taxes do not include deferred tax items related to an adjustment under section (9) of this rule.

(p) "Taxpayer" means the utility or the affiliated group that files income tax returns with units of government.

(q) "Units of government" means federal, state and local taxing authorities.

Exhibit B – Proposed Redlined Revisions to Sections 3 and 4 of the Proposed Final Rule
(Re Calculation of Taxes Paid as "Properly Attributed")

(3) The amount of income taxes paid that is properly attributed to regulated operations of the utility will the amount of federal and state income taxes attributed to the utility under this section, allocated to Oregon regulated operations in each case in the same manner as in the most recent general rate order or other order making such allocation.

(a) The income taxes attributed to the utility shall be (i) the amount of stand-alone federal and state income taxes liabilities of the utility, (ii) reduced by an attributed portion of any negative federal and state income tax liability of affiliates of the utility, to the extent that such entities had negative tax liabilities for the reporting period after adding back any deferred taxes applicable to such entities, and (iii) reduced by an attributed portion of any negative federal and state income tax liability of unregulated activities of the utility, to the extent such activities had negative tax liabilities after adding back any deferred taxes applicable to such activities ("negative income tax liabilities").

The attribution of negative tax liabilities to the utility will be calculated as follows:

(~~a~~b) The amount of ~~federal income taxes paid to units of government that is~~federal allocated negative income tax liability properly attributed to the ~~regulated operations of a~~ utility will be the product of the following two figures:

(A) The total amount of federal negative income tax~~es paid by the taxpayer~~ liabilities; and

(B) The average of the ratios calculated for the utility's property, payroll and sales, as defined in ORS 314.650 through 314.675, using amounts for ~~regulated operations of~~ the utility ~~in Oregon~~ in the numerator and amounts for all affiliates of the taxpayer (including if applicable the taxpayer) that had positive tax liabilities in the denominator.

(~~b~~c) The amount of ~~state~~ allocated negative Oregon income tax~~es~~ liability ~~paid to units of government that is~~ properly attributed to the ~~regulated operations of a~~ utility will be the product of the following two figures:

(A) The total amount of Oregon negative income tax~~es that is paid by the taxpayer~~ liabilities; and

(B) The average of the ratios calculated for the utility's property, payroll and sales, as defined in ORS 314.650 through 314.675, using amounts for ~~regulated operations of~~ the utility in Oregon in the numerator and amounts in Oregon for the affiliates of the taxpayer (including if applicable the taxpayer) that had positive tax liabilities in the denominator.

~~(c) The amount of local income taxes paid to units of government that is properly attributed to the regulated operations of a utility will be the product of the following two figures for each local taxing authority in Oregon:~~

~~(A) The total amount of income taxes paid by the taxpayer to the local taxing authority; and~~

~~(B) The average of the ratios calculated for the utility's property, payroll and sales, as defined in ORS 314.650 through 314.675, using amounts for regulated operations of the utility in the local taxing authority in the numerator and amounts for the taxpayer in the local taxing authority in the denominator.~~

(4) By October 15 of each year, each utility will file a tax report with the Commission. The tax report will contain the following information for each of the three preceding fiscal years:

(a) For the taxpayer affiliates (including the taxpayer) that had a negative tax liability for the reporting period, and for the unregulated activities of the utility, if such activities produced a negative tax liability:

(A) The total of the federal and state negative tax liabilities of such affiliates and activities,

(B ) The contribution, if any, of deferred taxes to such negative tax liabilities, and

(C) The applicable amounts of the taxpayer's property, payroll and sales produced by such affiliates and activities, as needed for the calculations required by this rule.

(b) The amount of federal and state income taxes paid to units of government by the taxpayer;

(~~b~~c) The amount of the federal and state income taxes paid that is incurred as a result of income generated by ~~the Oregon regulated operations of~~ the utility, calculated as the difference between the taxpayer's tax liability computed with and without the ~~regulated~~ operations of the utility, with such utility tax liability then allocated to Oregon regulated operations in the same manner as in the most recent general rate order or other order making such allocation;

(~~c~~d) The amount of federal and state income taxes paid to units of government by the taxpayer that is properly attributed to the Oregon regulated operations of the utility, as calculated in section (3) of this rule;

(~~d~~e) The amount of federal and state taxes income taxes authorized to be collected in rates for the Oregon regulated operations of the utility;

(~~e~~f) The amount of the difference between the amount in subsection (4)(d) of this rule and the lowest of the amounts in subsections (4)(a), (4)(b) and (4)(c), after making the adjustments defined in subsection (2)(o) of this rule;

(g) The amount of local income taxes paid to units of government by the utility of its affiliated group that is incurred as a result of income generated by the regulated Oregon operations of the utility, by county;

(h) The amount of local income taxes collected from Oregon customers, by county;

(i) The proposed surcharge or surcredit rate adjustments to charge or refund customers the amount of the differences in sections 3(g) and 3(h) of this rule;

~~(f) The amount of local income taxes paid to units of government by the taxpayer, by local taxing authority;~~

~~(g) The amount of local income taxes paid to units of government by the taxpayer that is incurred as a result of income generated by the regulated Oregon operations of the utility, calculated as the difference between the taxpayer's tax liability computed with and without the regulated operations of the utility, by local taxing authority;~~

~~(h) The amount of local income taxes paid to units of government by the taxpayer that is properly attributed to Oregon regulated operations of the utility, as calculated in section (3) of this rule, by local taxing authority.~~

~~(i) The amount of local income taxes collected from Oregon customers, by local taxing authority;~~

~~(j) The amount of the difference between the amount in subsection (4)(i) of this rule and the lowest of the amounts in subsections (4)(f), (4)(g) and (4)(h) after making the adjustments defined in subsection (2)(o) of this rule, by local taxing authority;~~ and

(~~k~~j) The proposed surcharge or surcredit rate adjustments for each customer rate schedule to charge or refund customers the amount of the differences in subsections (4)(e) and (4)(~~j~~i) of this rule.

## 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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