

**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.)

MEMORANDUM

Participants submitted issues lists on January 23, 2006. At my request, Staff prepared a consolidated issues list, which is divided into seven categories. A copy of the consolidated issues list is attached. Also attached are two pages of examples, one labeled *Taxes Paid* and one labeled *Taxes Collected*.

We are scheduled for a workshop on January 31, 2006, at 9:00 a.m., in Salem. I propose we begin with the first set of issues under *Taxes Paid – Definition of Properly Attributed*. Be prepared to describe how the methods listed in A1 would function, using the hypothetical example in A2. Then we'll proceed through each listed issue using the methods describe in A1. My plan is that we have fully developed methodologies from which to draft position papers or straw proposals.

Similarly, I propose moving through the set of issues under *Calculation of Taxes Paid* using the *Taxes Paid* example, and the *Calculation of Taxes Collected* using the *Taxes Collected* example. Again, my goal is that we fully develop the issues, reach consensus where possible, and be ready to draft position papers or straw proposals.

I hope we can also address two more categories of issues before the end of the day: the automatic adjustment clause and material adverse effect. This will only happen if participants "agree to disagree" on the issues where consensus is not possible, and move on. As it is difficult for Staff to have the dual roles of facilitator and participant, I will be moderating the process to the extent necessary.

Finally, we need to have a brief discussion about the confidentiality of the tax report documentation. Order No. 06-033, issued in the four automatic adjustment dockets, covers the information filed with the tax report. I recommend that the participants not use the actual numbers from the tax reports in this docket. However, the methodologies used by the utilities would probably be open for discussion.

Dated at Salem, Oregon, this 26th day of January, 2006.

Kathryn A. Logan
Administrative Law Judge

AR 499 Consolidated Issues List
January 26, 2006

Taxes Paid – Definition of Properly Attributed

A1. Describe the method that should be chosen for properly attributed. [All participants]

Modified Effective Tax Rate (Loss-Allocation)
Stand-alone/no allocation
Other?

A2. Show how the chosen methodology for properly attributed would be applied for each example below (use other examples in addition to these three, if desired):

	<u>Utility A</u>	<u>Utility B</u>	<u>Utility C</u>
Regulated Utility Operations (tax liability)	130	130	130
Affiliate X (tax liability)	130	65	-20
Affiliate Y (tax liability)	<u>-60</u>	<u>-95</u>	<u>-60</u>
Tax Payment to Governments	200	100	50

[ALJ Logan/Staff]

A3. Explain why the chosen attribution methodology should be used by the Commission using policy reasons to support the methodology. [ALJ Logan/Staff]

A4. What should be the contents of the tax report based on the chosen attribution method? [ALJ Logan/Staff]

A5. Should affiliates be treated as a group or individually? [Avista]

A6. How should tax losses from Oregon utility operations be treated in any “properly attributed” calculations? What happens when taxable income from affiliate operations is what allows the tax loss from Oregon utility operations to be recognized? Should affiliate operations be allowed to carry tax offset benefits forward to future years when the affiliate operations may incur a tax loss? [Avista]

A7. How should tax losses from utility operations in non-Oregon jurisdictions be treated in any “properly attributed” calculations? Any allocation of these losses to Oregon would be a violation of normalization rules. [Avista]

- A8. How are utility operations in non-Oregon jurisdictions to be treated? Are they treated as stand-alone entities? Are they treated like other affiliates? [Avista]
- A9. The Attorney General has stated that SB 408's general policy is to "more closely align taxes collected by a regulated utility from its ratepayers with taxes received by units of government." What, if any, other policies should the Commission consider when defining "proper" attribution?
- *E.g.*, consider the Commission's statutory obligation to prevent cross-subsidization between regulated and unregulated entities.
 - *E.g.*, consider the Commission's statutory obligation to set rates that are fair and reasonable. [PacifiCorp]
- A10. Is it proper to use affiliate losses to reduce rates when the amount collected in rates was in fact paid to units of government? [PacifiCorp]
- A11. Is it proper to attribute an affiliate loss to a utility when the affiliate will use that loss to offset gains within the next three years (*i.e.*, the loss creates a deferred tax asset for the affiliate)? [PacifiCorp]
- A12. Does proper attribution require a nexus between the regulated operations of the utility and affiliates? [PacifiCorp]
- A13. Which attribution methods are proper in the sense that they are more constitutionally permissible? [PacifiCorp]
- A14. Consider possible unintended consequences of various approaches to attribution. Are such consequences proper? [PacifiCorp]
- A15. Would asymmetrical application of this term (in which tax losses are apportioned but not positive tax liability) be unconstitutional? [PGE]
- A16. How do we interpret the language in SB 408 referencing "taxes paid that are properly attributed to the *regulated* operations of the public utility"? Should "taxes paid that are properly attributed to the *regulated* operations of the public utility" include:
- (a) tax benefits or tax deductions related to unregulated utility operations?
 - (b) tax benefits or tax deductions related to regulated operations in an affiliated utility?
 - (c) tax benefits or tax deduction related to unregulated operations in a utility affiliate? [PGE]

Calculation of Taxes Paid

- B1. DOJ's opinion at 15 stated 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" and "only the 'portion' of taxes paid on the utility's regulated operations is counted for purposes of subparagraph 3(12)(a)." (a) Is the amount of 3(12)(a) measured by the tax liability for Oregon results of operations? If not, what is the measurement? (b) What is the source document that provides the data for 3(12)(a)? (c) For multi-state jurisdictional utilities, should the tax liability for Oregon results of operations be calculated in the same manner as the general rate case? [Staff]
- B2. Should the tax return liability amounts be used as the taxes paid amounts to avoid differences between accruals and actual taxes and to avoid differences from estimated tax payments and actual tax liability? [Avista]
- B3. Are "taxes paid" to be determined for each period on a cash, or on an accrual, basis?
If an accrual approach is chosen, how should additional tax audit payments or refunds, or the effects of amended tax returns, be accounted for?
If a cash accounting approach to "taxes paid" is elected, we should address the following:
- a. What is the potential for utilities to create their own surcharges or refunds, based on when and in what amount they elect to make their estimated tax payments?
 - b. How should one attribute estimated tax payments among the utility and its affiliates, when in each year the consolidated taxes owed by the company and the estimated tax submissions may differ significantly? (NW Natural's tax report addresses sample problems created.) How should one then adjust such attributions if cash overpayments are carried forward and applied to subsequent year tax liabilities of entities to which the cash tax payments were not attributed?
 - c. Should there be a multi-year balancing account for differences between cash payments and taxes actually owed, to avoid rate increases followed by matching rate decreases in the subsequent year, or vice versa? [NW Natural]
- B4. Should interest on tax refunds and additional taxes due be included in the calculation of "Taxes Paid"? [Staff]
- B5. How should tax audit settlements paid in subsequent years be included in taxes paid for the year in which the payment is made? [PacifiCorp/Avista]

- B6. Does a total corporate tax payment that exceeds the Oregon standalone amount meet the test of not needing to make an adjustment to the Oregon standalone amount? [Avista]
- B7. As an adjustment to Taxes Paid, should the amount of deferred taxes reflect the amount recorded in the utility's income statement (as the year in which they apply) or the utility's tax return (which includes adjustments in prior years' amounts)? [Staff]
- B8. How can the Commission ensure that the operation of the AAC does not cause normalization violations? What procedures should the Commission require to ensure that utilities (or their taxpayers) retain the right to continue claiming accelerated depreciation? Should the rules provide for a normalization "off-ramp"? [PacifiCorp]
- B9. Are tax credits counted in the year in which the credit is used or the year in which the credit was earned? [PacifiCorp]
- B10. For purposes of calculating the AAC, should the add-backs to taxes paid include the tax effects of disallowed utility investments or utility investments that are not in rate base? [PacifiCorp]
- B11. Is Avista's approach of treating Oregon state income tax separate from federal income tax acceptable? [Avista]
- B12. How should local taxes (MCBIT) be included in the calculations? [PacifiCorp]
Should local income taxes (collected and paid) be handled through an adjustment separately from federal and state income taxes? [Staff]

Calculation of Taxes Collected

- C1. How should the Commission calculate taxes collected in rates for purposes of the AAC? The general policy of aligning taxes collected with taxes paid is undermined if taxes collected are computed based on rate case estimates but tax payments are based on actual payment history. How should differences between amounts authorized in a rate proceeding and amounts actually collected be treated for purposes of computing rate adjustments? Are limitations discussed by the Attorney General regarding use of updated expense data limited in applicability to the tax report, not the AAC? [PacifiCorp]
Section 3(6) does not require a direct comparison between the amount of "taxes paid" and "taxes authorized to be collected" as calculated in the utilities' tax

report. The Commission therefore has the discretion to use the Automatic Adjustment Clause (“AAC”) to implement good policy that comports with basic ratemaking principles. Should the AAC rely solely on rate case data, or should it use actual utility financial results? [PGE]

- C2. In the calculation of “taxes authorized to be collected in rates,” should the revenues associated with electric utility wholesale sales be included or excluded from revenues in 3(13)(e)(A) and gross revenues in 3(13)(e)(B)? [Staff]
- C3. In the calculation of “taxes authorized to be collected in rates,” should the revenues, including annual automatic adjustment clause changes, associated with electric utility net variable power costs (NVPC) and gas utility purchased gas costs be included or excluded from revenues in 3(13)(e)(A) and gross revenues in 3(13)(e)(B)? [Staff]
Should the AAC neutralize the effects of tariffs whose purpose is to collect or refund a pass-thru cost/benefit (e.g., PGA, RVM)? How, or on what basis, do we determine which tariffs should be considered pass-through? How do you distinguish between PGA and RVM, or for that matter, any utility tariff? [PGE]
[Avista: In a general rate case the base level of gas costs are reflected in the general rate schedules. Only changes in revenues to recover changes in gas costs that occur subsequent from the last general rate case need to be adjusted out of revenue in the taxes collected calculation.]
- C4. What types of pass-through expenses should be excluded from revenues in the calculation of “taxes authorized to be collected in rates”? Are exclusions consistent with using test year numbers derived from the last rate case? [PacifiCorp] In the calculation of “taxes authorized to be collected in rates,” should the revenues associated with any other cost items be excluded? [Staff]
- C5. In the calculation of ratios in 3(13)(e)(B) and (C), should interest expense be included in determining net revenues? (Staff notes that if interest expense is not deducted in determining net revenues, the net to gross ratio will be higher but the effective tax rate will be correspondingly lower.) [Staff]
- C6. What are the source documents that provide the data for:
(a) the amount of gross revenues for the net revenues to gross revenues calculation in 3(13)(e)(B); and
(b) the (actual) amount of revenues the utility collects from ratepayers in 3(13)(e)(A)? [Staff]

Automatic Adjustment Clause

- D1. In the calculation of the rate adjustment in the automatic adjustment clause, should the difference between the amount of Taxes Collected and Taxes Paid be multiplied by the Net-to-Gross Factor from the general rate case? [Staff]
- D2. What should the rate design be for any rate adjustment that may occur under the automatic adjustment clause? Uniform cents per therm or kWh for all rate schedules? Uniform percent of margin for each rate schedule? Uniform cents for all rate blocks within a rate schedule? [Avista]
- D3. Should the mechanism spread adjustments over multiple years to mitigate rate volatility concerns? [Avista] How should the AAC be structured to mitigate rate volatility? [PacifiCorp]
- D4. Is a deferral under ORS 757.259 required to implement the AAC? [PGE]

Material Adverse Effect and 756.040

- E1. How and when should issues regarding material adverse effect and ORS 756.040 be raised? How should material adverse effect be defined? [ALJ Logan/Staff/PacifiCorp]
- E2. How and when should a utility's earnings be reviewed in conjunction with the operation of the AAC to ensure that it results in rates that do not have a material adverse effect on customers and that are fair, just and reasonable for utility investors? [PacifiCorp]
 - a. What procedures should the Commission require to ensure that rate adjustments do not violate the standards articulated in ORS 756.040? Consider in particular, the timing and procedure for review and isolating Oregon impacts/earnings for a multi-state utility.
 - b. Should the Commission create objective tests or "safe harbors" that minimize AAC charges or credits to eliminate this concern?
 - c. In assessing if this standard has been met, what data will the Commission use to compare Oregon utility returns against comparable businesses?
 - d. How will the Commission assess the impact of an AAC on credit ratings and the maintenance of credit positions by the utility?

- E3. Would basing tax adjustments on rate case estimates create a *Hope* problem whereby tax-adjusted rates are skewed in a manner that prevents the utility from earning a fair rate of return? [PacifiCorp] Does a rate adjustment based on rate case net-to-gross ratio and effective tax rate achieve the goal of ensuring that utility rates reflect the taxes that are paid to units of government? In a real world in which costs will, more often than not, rise relative to revenue, does this tax-adjustment “stack the deck” against the utility and make it unlikely or impossible for the utility to earn a fair rate of return? Does this result comport with ORS 757.210 and ORS 756.040? [PGE]
- E4. Would the lowering of a utility’s credit rating be deemed to be a “material adverse effect” on customers? How would issues surrounding “material adverse effect” be addressed? [Avista]

Processing Issues

- F1. What should be the time line for processing tax reports and automatic adjustment clauses, beginning with the October 15th date? [ALJ Logan/Staff]
- F2. Should the dates in SB 408 §3(e) should be extended to the maximum? (90- to 180-days and 30- to 60-days.) See Temporary Rule §§6 & 7. [ICNU]
- F3. What is the procedure and timing for the Commission review required under ORS 757.210? [PacifiCorp]

Other Issues

- G1. For a utility using a fiscal year that is not a calendar year, should be utility also be required to provide the tax report information for the prior calendar year, so the automatic adjustment clause makes a calendar year-based adjustment (e.g., beginning with 2006 as required by the law)? [Staff]
- G2. How will income tax expense be established in a rate case? Will income tax expense be based on a stand-alone calculation? Will the establishment of Oregon state income tax reflect the apportionment percentage applied to corporate income used by the Oregon Department of Revenue in determining taxable income? [Avista]

- G3. Deferred Taxes: Should the Commission require utilities to seek a Private Letter opinion from the Internal Revenue Service before October 15, 2008? [PacifiCorp, PGE]
- G4. Is there a way to remedy the “double whammy” effect coined by Northwest Natural where collecting or rebating changes in taxes further exacerbates the over or under earning situation that created the change in the income taxes? How should we address the potential for SB 408 to create rate surcharges because utilities are overearning their allowed return, while creating rate refund obligations because utilities are failing to achieve their allowed return?
- a. What would be the implications for the Commission’s ratemaking, including the implications for allowed rates of return on investment, if the double whammy problem were not addressed?
 - b. How do the various utility tariff filings address this issue, and do such filings impact the application of SB 408 in any manner other than to correct for double whammy effects?
 - c. Are there means to address the double whammy effect that are preferable to the proposals advanced by the utilities in their tariff filings?
 - d. Is this [effect] a good outcome from a policy perspective?
 - e. If “no,” how can this effect be mitigated or eliminated?
 - f. What if the lean times become so lean that the utility’s credit rating or access to financing is impaired?
 - g. What if a utility experiences changes in the amount of taxes paid or taxes collected related to disallowed expenses or expenses not considered in the utility’s last rate case?
- [Avista/NW Natural/PGE]
- G5. How is a change of utility ownership in mid-tax year addressed? [ICNU]
- G6. How is a change in tax year addressed? [ICNU]
- G7. Are there any differences in how electric and gas utilities should be treated?
- [ICNU]
- G8. How do we maintain utility incentives for investments that may not yield dollar-for-dollar tax credits?
- Should utility customers benefit from tax deductions or other tax benefits related to a disallowed expense, or other expense that has never been in the utility’s rates? Wouldn’t this result in a net loss to the utility? [PGE]

Resolved Issues (PacifiCorp)

I. Issues Resolved by General Agreement

1. **Historic Data** – The Commission may, as a matter of law, use historic data for the automatic adjustment clause (“AAC”). Even if the Commission may, as a legal matter, use forecast data for the AAC, it should, as a policy matter, use only historic data.
2. **Rate Increases or Decreases** – Tax adjustments may result in rate increases or rate decreases.
3. **Informational Only** – The October 2005 and 2006 tax reports are for the sole purpose of determining whether there is a trigger for the AAC, not to support a rate change.

II. Issue Positions from the Attorney General Opinion

1. **“Properly Attributed”** – The Commission has discretion to define and implement the phrase “properly attributed,” subject to the general policy and specific limits of SB 408. The general policy is to more closely align taxes collected by a regulated utility from its ratepayers with taxes received by units of government. The specific limits include a cap on the maximum amount of taxes paid that the Commission may properly attribute to the utility. In any event, the result must be rates that are “fair, just and reasonable.”
2. **“Tax Credits”** – SB 408 § 3(13)(f)(B) mandates an increase of “taxes paid” for “tax savings” that arise from “tax credits” associated with capital outlays for property presently used for providing utility service to customers, but only to the extent the Commission has not addressed the expenditures for such capital outlays in a general ratemaking proceeding.
3. **“Material Adverse Effect”** – The Commission may terminate an AAC under SB 408 § 3(9) only to protect customers against rate increases that create a material adverse effect on those customers; other elements of the law limit regulated utilities’ exposure to rate reductions from the AAC.
4. **Annual Adjustments** – The Commission may allow an SB 408 AAC that requires an annual adjustment even if the utility pays estimated taxes on a quarterly basis.
5. **Rate Case Data** – In preparing the “taxes authorized” portion of the its annual tax report, a utility must use the ratio of net to gross revenues and the effective tax rate that the Commission previously determined or used in establishing rates for the utility.

SB 408 Example: Taxes Paid

<u>Line</u>	<u>Source</u>	<u>2006</u>	
TAXES PAID (Federal and State Income Taxes)			
1		30,000	Taxes Paid "properly attributed to [Oregon] regulated operations" [3(6)]
2		30,000	"[I]ncurred as a result of income generated by the [Oregon] regulated operations of the utility"(i.e., stand-alone tax liability) [3(12)(a)]
3	Tax Filings	20,000	Taxes Paid to units of government [3(12)(b) prior to 3(13)(f) adjustments]
4= 1, 2, or 3		20,000	Lowest of lines 1, 2 or 3
5=12		13,235	Adjustments to Taxes Paid
6=4+5		33,235	Taxes Paid properly attributed to regulated operations, after adjustments
<hr/>			
Adjustments to Taxes Paid [Oregon allocated]			
7	Tax filing	600	Charitable Contributions
8		39.20%	Statutory Tax Rate
9=7x8		235	Tax Effect of contributions
10	Tax filing	1,000	Tax credits not included in rates (net)
11		12,000	Deferred Taxes - regulated
12=9+10+11		13,235	Total Adjustments to Taxes Paid

SB 408 Example: Taxes Collected

(Note: All figures Oregon regulated operations)

Line Source 2006

TAXES COLLECTED (FIT & SIT)

1	FERC Form	1,100,000	Total Retail Revenues Collected
2=7	Rate Case	13.6%	Ratio of Net Revs to Gross Revs
3=9	Rate Case	26.67%	Effective Tax Rate
4=1x2x3		40,000	Amount "in rates" [3(13)(e)]

Taxes collected - Ratios used in establishing rates (from General Rate Case test period, with gross revenues adjusted for annual change in authorized power costs or purchased gas costs)

5	Rate Case	1,100,000	Total Retail Revenues*
6	Rate Case	150,000	Net Revenues (Before-Tax)
7=6/5		13.6%	Ratio of Net Revenues to Gross Revenues (Pre-tax Margin)
8	Rate Case	40,000	State & Federal Income Taxes (including deferred taxes)
9=8/6		26.67%	"Effective Tax Rate"

* Authorized revenues used on line 5 should reflect a weighted average when the Commission authorizes a change during the calendar year.