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Oregon Public Utility Commission
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Re: Docket No. AR 499

Enclosed for filing is one copy of the Comments of Northwest Natural Gas Company in this matter. A hard copy was served on all parties of record as indicated on the attached certificate of service.

Very truly yours,

Stephen Hall

Stephen C. Hall

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Enclosure
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	)))	Comments of Northwest Natural Gas Company re Legal Issues

Northwest Natural Gas Company ("NW Natural") will address three of the Senate Bill ("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. NW Natural appreciates the Commission's willingness to address these important issues to better ensure that the permanent rules in this proceeding carry out the intent of SB 408 in a rational and workable manner. As Governor Kulongoski noted in a letter accompanying his signing of SB 408:

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

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

The issues now have been served on the Commission's plate, and they are not easily digestible. These comments by NW Natural will address how the issues can be resolved consistently with the applicable statutory mandates and rational rate-making principles.

In responding to the issues presented, NW Natural will follow the rules of statutory interpretation as set out in PGE v. Bureau of Labor and Industries, 317 Or 606, 859 P2d 1143 (1993) (the "PGE Decision"). First, as directed in the PGE Decision, NW Natural will turn to the text of the statutory provision. In such textual analysis, the PGE Decision requires

consideration of the applicable provision in the context of other related statutory provisions, which include both other provisions of the same statute and other related statutes. In the context of SB 408, NW Natural accordingly will address the applicable provisions in SB 408 in the context of the Commission's interpretation and application of related Oregon statutes governing utility rate-making. To the extent that a review of the statutory text and context is not dispositive, the PGE Decision directs use of the legislative history to determine legislative intent.

Further, NW Natural urges the Commission to reject any proposed permanent rules that punish or otherwise create unintended consequences for utilities, such as NW Natural, that actually incur and pay taxes on the same basis that is assumed in their applicable retail rate orders. The stated purpose of SB 408 was to align the taxes collected in rates by regulated Oregon utilities with the amount of taxes actually paid to units of government by such utilities, or affiliated groups including such utilities. Therefore, the effect of SB 408 should be neutral toward a utility if the amount of taxes collected in rates is already aligned with the amount of taxes paid. In fact, as NW Natural pointed out in its comments dated September 13, 2005 in AR 498, weighing the impact of a rule on NW Natural creates a useful benchmark for evaluating any proposed permanent rule. See State v. Brandon, 35 Or App 661, 663, 582 P2d 52 (1978) (statutes must be construed "with a view to effecting the overall policy which the statutes are intended to promote"). NW Natural obtains the vast majority of its revenues from its regulated utility business and makes actual tax payments consistent with the Commission's rate-making assumptions. To the extent NW Natural has nonutility operations, those operations currently generate, and are anticipated to generate, additional actual tax payments. NW Natural does not currently benefit from reduced tax payments as a result of consolidated tax filings. As a consequence, if the permanent rules proposed in this proceeding would lead to a downward

adjustment of the rates of NW Natural and produce a disallowance of a portion of NW Natural's actual and necessary cost of service, such a reduction would reflect a defect in the proposed permanent rules.

I. How should the Commission apply the "properly attributed" standard as it appears in the individual sections of the bill?

Summary Response:

1. In SB 408, the tax payments "properly attributed" to the regulated operations of a utility are the tax payments incurred as a result of income generated by the "stand-alone" regulated operations of the utility. In other words, tax payments are "properly attributed" to the regulated operations of a utility if the tax payments are "caused" by a utility's regulated operations. A "cost-causation" approach and a stand-alone approach are synonymous and will produce identical results. Such approaches do not require the Commission's review of the tax returns of individual nonutility affiliates, but require only that the Commission determine (a) the total "taxes paid" by the affected utility's affiliated group and (b) the taxes paid by the stand-alone utility as a result of income generated by its regulated operations. SB 408 then allows the utility to receive credit for Oregon rate-making purposes only for the lesser of these two amounts.

2. Taxes paid in each year are reported on the utility affiliated group's tax returns for that year. The tax returns will show explicitly both the consolidated taxes paid by the entire affiliated group and the portion of taxes paid as a result of the income generated on a stand-alone basis by the utility that provides regulated operations in Oregon.[1]

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[1] NW Natural notes that if a utility providing regulated service in Oregon also has income from regulated operations in other states, or has income from nonutility activities, a further allocation of taxes paid by the stand-alone utility will be required. The appropriate mechanics of such allocations are beyond the scope of the questions now proposed to the Commission, but should be carefully considered in further workshops in this docket.

3. Tax returns show taxes paid in each year on an accrual, rather than a cash, basis, which is the same basis used to set utility rates and shown on the accounting books and records of the utility. The tax return approach, based on accrual accounting, is consistent with the language and intent of SB 408 and for reasons discussed below also is the appropriate rate-making approach.

A. In SB 408, the tax payments "properly attributed" to regulated operations of the utility are the tax payments incurred as a result of income generated by the stand-alone regulated operations of the utility, or as otherwise stated, the tax payments caused by the regulated operations of the utility.

The temporary rule, OAR 860-022-0039, calculates the amount of tax payments "properly attributed" to the regulated operations of the utility by comparing the relative tax liabilities of both (a) the regulated operations of the utility and (b) any nonutility affiliates in the consolidated group that have a positive tax liability. Tax losses of nonutility affiliates are ignored and treated as if the affiliates had a zero tax liability. The result is that such nonutility affiliate tax losses are allocated to the utility's regulated operations. The example given by the Commission's staff (the "Staff") in support of the temporary rule was the following:

	Stand-Alone Tax Liability	Temporary Rule Attribution
Regulated Utility	130	100
Affiliate X	130	100
Affiliate Y	-60	0
Consolidated Tax Payment	200	200

See Staff's September 7, 2005 Report in Docket AR 498 at 2-3.

Two aspects of the temporary rule's allocation of nonutility affiliate losses should be contrasted with both what the statute itself provides and what the adopting legislators stated was intended by SB 408. First, this approach requires reviews not only of the consolidated tax

liability of the affiliated group, but also of the tax liability of every nonutility affiliate of the affected Oregon utility.

Second, under the provisions of the temporary rule, the attribution to a utility of taxes paid would not be based on those taxes actually paid as a result of income generated by the stand-alone regulated operations of the utility, but instead would attempt to determine and impute to the regulated operations the tax losses of individual nonutility entities. Not only are imputed tax losses from nonutility affiliates unaffected by the level of actual tax payments required as a result of income generated by regulated operations, but they turn on the corporate organization selected for the nonutility affiliates. For example, consider the same consolidated tax filer described above, but assume that it made an election to merge its nonutility affiliates X and Y, to create new nonutility affiliate XY. The temporary rule's attribution of taxes paid would change as a result of this corporate reorganization as follows:

	Stand-Alone Tax Liability	Temporary Rule Attribution
Regulated Utility	130	100
Affiliate XY	70	70
Consolidated Tax Payment	200	200

1. The statutory language requires a stand-alone or cost-causation attribution of taxes to the regulated operations of the utility.

The key attribution mandate of SB 408 is contained in section 3(12):

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

The phrase "portion of the total taxes paid that is incurred as a result of income generated by the regulated operations of the utility" describes an attribution to the utility of "taxes paid" based solely on the stand-alone tax payments for the regulated operations, or otherwise stated, the tax obligations "caused" by receipt of income from regulated operations. Of course, the "lesser of" qualifier reduces the "taxes paid" if the affiliated group's consolidated taxes are lower than the utility's stand-alone taxes.

Section 3(12) states that the attribution of taxes paid to the utility "may not exceed" the lesser of consolidated or stand-alone tax payments. NW Natural heard speculation during the temporary rulemaking hearing as to whether the "may not exceed" language implied that the amount of taxes attributed under section 3(12) could be an amount lower than both the consolidated and stand-alone tax payments amounts. NW Natural points out that no provision of SB 408 describes any such lower alternative attribution to the utility of taxes paid. The "may not exceed" language simply emphasizes the stated purpose of the statute: to ensure that tax expenses that exceed the lesser of the two measures of taxes paid set out in section 3(12) are not charged to utility customers. This reading is confirmed in the legislative history, as cited below.

2. A stand-alone or cost-causation attribution of taxes to the regulated operations of the utility best comports with the Commission's interpretation and application of its other statutory rate-making mandates.

In setting rates, the Commission has generally interpreted and applied the applicable statutes by use of cost-causation principles. The Commission generally allows recovery of costs prudently incurred to provide utility service. The Commission generally disallows costs not prudently incurred to provide utility service.

Except in the circumstance in which the total amount of taxes paid by a utility's affiliated group is less than the utility's stand-alone tax payments, a utility is required, because of the

income generated by its regulated operations, to pay the amount of taxes represented by its stand-alone tax payments; absent such income from regulated operations, the affiliated group's taxes paid would have been lower by the full amount of the utility's stand-alone tax obligation. Thus, if the Commission in applying SB 408 refused to allow recovery of the utility's full stand-alone tax payments on income from regulated operations (not to exceed the taxes paid by the utility's affiliated group), the Commission would be electing to deny recovery of tax expense prudently incurred and required to provide regulated utility service.

3. The legislative history confirms the reading of section 3(12) as providing for a stand-alone or cost-causation attribution of taxes to the regulated operations of the utility.

The legislators who addressed the "properly attributed" standard in the legislative record made clear that they meant for the section 3(12) mandate to be applied as written. Those legislators repeatedly stated that "properly attributed" meant that the Commission was to attribute to the utility its stand-alone tax liability, but not to exceed the total consolidated tax liability of the affiliated group.

The chair of the Senate Business and Economic Development Committee, Senator Rick Metsger, most forcefully declared during committee hearings that taxes were to be properly attributed to a utility based solely on the stand-alone results of that utility's regulated operations. He added that the "properly attributed" calculation was to be made based only on the regulated operations and that the tax liabilities or losses as calculated for other individual utility affiliates were not relevant to a proper attribution of taxes paid to the utility. The relevant exchange follows:

> "Bolton: Thank you Chair. For the record, my name is Scott Bolton, I represent PacifiCorp. Very simply, Senate Bill 408 will hurt ratepayers and hurt utilities. In the most simplest explanation, it's because this bill will erode the fundamental regulatory ring

fencing that the Oregon Public Utility Commission and 41 other state public service or public utility commissions have employed for years. Ratepayers would pay more if the consolidated group is profitable. Section 4 of this bill says that if a public utility's actual taxes are more than estimated, the PUC shall adjust the rates the utility recovers with interest any amount of tax actually paid that is greater than the estimated amount of taxes. Income taxes generally are tied to profits. Actual taxes generally will exceed estimated taxes if the consolidated group is more profitable than anticipated. The results of this can be Oregon ratepayers would pay more because profits earned by affiliates, even those in other states, regardless of the cost of providing electric utility service, would occur.

"Chair: I'm going to interrupt you right there. Um, because on page 3 I think you're reading about the taxes, it's talking about the affiliated group that is properly attributed to the utility, not the consolidated other affiliates that you're referring to.

"Bolton: So, I'm not sure I understand the question.

"Chair: **Do you have the memo, on page 3, lines 12 through 15, the amount of taxes paid by the utility in the previous fiscal year that was paid by the affiliated group and that is properly attributed to the utility. Not, you're talking about hurting taxpayers because of other nonaffiliated groups, but these are the taxes that are only attributed to that utility, even if they are part of a consolidated group.**

"Bolton: So then the effect of this amendment Chair, if I may ask a question, is that the Oregon Department of Revenue will no longer collect any taxes attributed to a consolidated group that has a utility affiliate?

"Chair: **No, what it means is, in adjusting the rates for taxes that when they file the report with the commission, it will be those taxes which are attributable only to the operations of that utility, even if you have multiple other affiliates. That's going to have to be figured in the tax report that in this case PacifiCorp would have to file, is to then break that down.**

"Lesh: Mr. Chairman, if I could ask a question. **Would that work for the losses then as well if the other corporations had had losses and those are offset, would this tax report...**

"Chair: **It has nothing to do with other corporations, it's only the utility itself. No other affiliations are affected by this.**

It would be your responsibility to delineate the utility in filing the report with the PUC, what their actual costs were, what their taxes are. It has nothing to do with any other affiliates you have. And that would be your responsibility is to have to extract that cost just like you did in your scenarios, but to actually be able to do that. I'm sorry to interrupt but I wanted to bring that out.

"Bolton: That's fine, this is a good discussion, Senator Metsger. I guess our thoughts on this would be is that it is very unclear as Oregon taxpayers what our responsibility would be under the current consolidated tax rules with the –7 amendments.

"Chair: You can consolidate all you want, but you're not going to be allowed to collect other than the taxes that you owe on this particular, in this case, in the rates that you are collecting for the operation of actually that utility."

Senate Business and Economic Development Committee SB 408 Work Session, May 31, 2005 at 9-11, SB 408 Legislative History at 97-99 (emphasis added) (available at edocs.puc.state.or.us/efdocs/HAH/ar499hah103348.pdf).

The following excerpts from the House debate demonstrate that the representatives equated the proper attribution of taxes paid with a stand-alone approach:

"Boquist: * * * One legal opinion says no that under the legislation, the consolidated tax liability is only used to set the tax expense and rates when doing so would cause the tax rates to go down. However, another legal opinion including the one sitting with me says yes, although only in the cases where the **standalone tax liability** would also cause rates to go up. * * *

"* * * * *

"* * * In some cases when a consolidated group's tax liability is higher than the utility's **the standalone** * * * method would be used.

"* * * * *

"Butler: What would happen if the consolidated group's tax liability is lower than the **utility standalone liability**?

"Man: * * * Now, if you'll just read that section you'll see that you always must use the lesser of one, the consolidated, or two, **the standalone**."

House Chamber SB 408, July 30, 2005 at 8-9, 12, SB 408 Legislative History at 348, 349, 352 (emphasis added).

B. The rate-making treatment of consolidated tax treatments in other jurisdictions cited by the legislators differs depending on the jurisdiction cited, and no other jurisdiction's treatment resembles the approach taken in SB 408.

The decisions in those other jurisdictions that have considered consolidated tax filings take differing approaches. Moreover, as discussed below, SB 408 contains unique features that are radically different from the approaches taken anywhere else. As a result of these unique features in SB 408, none of the approaches used elsewhere would produce defensible results. Accordingly, the decisions elsewhere provide little, if any, useful guidance.

The legislative history evinces a belief that consolidated taxes were taken into account in a number of other states, but does not indicate any attempt to model SB 408 after the rules of any particular state. Perhaps the most comprehensive listing of states used as examples appeared in a statement by Senator Metsger as part of the Senate debate on SB 408. The senator identified seven states as looking at consolidated tax results:

> "There are other states that take into account the taxes. Connecticut, this is from the Public Utility Commission in their white paper and their investigation. The study that was done. Connecticut, Florida, Indiana, Pennsylvania, Tennessee, Virginia and West Virginia, report that they do consider the savings from the consolidated returns and recognize those for the rate making purposes. Additionally, the Pennsylvania PUC, consistent with the state supreme court decisions, applies this same actual taxes paid standard by including a utility's share of federal taxes benefits when they do set the rates."

Senate Chamber SB 408, June 8, 2005 at 23, SB 408 Legislative History at 190.

The jurisdictions named by Senator Metsger employ no common method in their treatments of consolidated taxes. Some of the jurisdictions evaluate only the utility's and its corporate parent's tax liabilities. Others use methods that are not well explained in the applicable orders. Only three of the jurisdictions cited in the above quotation—Connecticut,

Pennsylvania and West Virginia—appear to have considered the entire consolidated tax filing and to have stated the method applied.

The only two jurisdictions in which rate decisions appear to be consistent with Oregon's temporary rule approach are Pennsylvania and West Virginia. On the other hand, Connecticut has determined that the utility should be allowed its stand-alone tax liability, except when its consolidated nonregulated affiliates in the aggregate have net tax losses:

> "In the future, [United Illuminating Company ("UI")] shall continue to file two tax calculations using consolidated and stand alone tax rates. Ratepayers should pay the taxes that the Company pays, but no more that [sic: than] that amount. Therefore, if an affiliate has a loss and UI's taxes are less than they would be using stand alone rates, ratepayers should pay less. However, if there are no net affiliate losses, then UI and its ratepayers should pay the UI stand alone rate."

Re United Illuminating Company, No. 01-10-10, 2002 WL 31720159 at *46 (Conn DPUC Sept. 26, 2002). The approach advanced by NW Natural in the temporary rule-making process mirrored the Connecticut approach.

In addition, decades ago, the predecessor of the Federal Energy Regulatory Commission ("FERC") used consolidated tax results in rate-making. The relevant FERC decision is Federal Power Com'n v. United Gas Pipe Line Co., 386 US 237, 87 S Ct 1003, 18 L Ed 2d 18 (1967) ("United Gas"). United Gas also used a "net loss" approach. The decision in United Gas was summarized in a Department of Justice memorandum from Jason W. Jones to the Commission, dated March 22, 2005 ("DOJ Memorandum"):

> "In this case, United Gas Pipe Line Co. ('United') was a member of a group which filed consolidated federal income tax returns. The Federal Power Commission ('FPC'), the predecessor to the Federal Energy Regulatory Commission, applied a formula that it had developed to calculate United's tax allowance. The FPC formula first applies the losses of unregulated companies to the gains of other unregulated companies, then applies any remaining losses to reduce the taxes of the regulated companies, and finally

allocates the consolidated taxes among the regulated companies in proportion to their taxable income."

DOJ Memorandum at 2.

Of greater importance, however, SB 408 contains unique features that defy application of any other state's consolidated tax filings attribution rules. First, SB 408 is a tax "look back" statute, which computes what it deems the taxes in a year should have been. Each of the jurisdictions discussed above looks (or at some point in the past looked) at all or part of consolidated tax impacts in projecting tax liabilities in future rate periods, without any after-the-fact adjustment. Second, SB 408 includes payments "determined without regard to the tax year for which the taxes were paid," which NW Natural believes is best applied by incorporating in any year the results of postaudit amended or supplemental tax returns. Third, the statute adjusts for deferred taxes, charitable contributions, and nonrecognized utility investments. Fourth, the statute applies not only to utilities that file consolidated tax returns, but also to utilities that may file stand-alone returns. The Commission is faced with the need to incorporate a unique statute into its overall rate-making mandate in a manner that is readily administrable and as consistent as possible with its other rate-making calculations. The decisions in other states do not provide much useful guidance as to how to properly incorporate SB 408's unprecedented requirements.

C. Taxes paid in each year are fully reported and are fully attributed to the regulated utility in the utility's tax returns for that year.

The Commission is not required to engage in esoteric speculation about how much tax a utility's affiliated group paid in any year, or about what portion of such taxes paid is properly attributable to the utility. The consolidated tax returns of the affiliated group for the applicable year will provide this information directly. Amended or supplemental tax returns will provide any additional tax adjustments for earlier audited periods.

The taxes paid as reported in the tax return for a year match the requirements of section 3(12) as to how taxes paid are to be calculated. That section describes the taxes paid by the stand-alone utility as being those taxes "incurred as a result of income generated by the regulated operations of the utility." The tax return for each year provides precisely this number. Other "cash" approaches to taxes paid, that might use, for example, estimated tax submissions,[2] do not correspond with taxes "incurred as a result of income generated." In fact, estimated tax submissions may prove to be greatly different from the actual taxes paid in a year based on the actual income generated.

SB 408 also states, in section 3(1)(a), that taxes paid should be reported in the tax report "without regard to the tax year for which the taxes were paid." This statement is consistent with the accrual approach to taxes paid, as reflected in tax returns. In addition to the tax return that is filed each year to show the taxes paid in the prior year, a utility routinely files amended or supplemental returns based on audits going back a number of years. These additional returns may produce either supplemental tax payment requirements or tax refunds. Rather than requiring retroactive rate-making in which prior-year rate adjustments are reopened, SB 408 permits additional taxes or tax refunds from amended or supplemental returns to simply be treated by the Commission as taxes paid in the year in which the amended or supplemental return is filed.

Use of the tax-return approach to show actual taxes paid not only is consistent with the language of SB 408, but also represents a superior regulatory policy for the Commission. The advantages of this approach include:

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[2] Although the term "estimated taxes" is used on occasion in the legislative history of SB 408, the speakers generally seem to be describing the future tax payments as estimated in utility rate proceedings, and not the estimated tax submissions made by the utilities each year.

Rate-making and accounting consistency: All utility revenue requirements for rate case purposes are calculated on an accrual basis, and all utility books also are kept on an accrual basis. Likewise, the "revenues the utility collects from ratepayers in Oregon," as used to compute "taxes authorized to be collected in rates," is accounted for and will be provided on an accrual basis.

Consistency within section 3(13)(f) of SB 408: This section of the statute requires three specific adjustments to taxes paid. Each of the adjustments is an accrual adjustment, not an adjustment reflecting the timing of cash payments.

Avoidance of perverse attribution results: Although tax returns tell the Commission directly the total amount of taxes paid by the utility company, there is no such obvious way to tell which portion of estimated-tax submissions are so attributable. For example, consider the following:

Estimated-tax submissions in 2007:	10,000
Utility's tax payments from final 2007 tax return:	1,000
Affiliates' tax payment from final 2007 tax return:	1,000

If cash-basis attribution were used, how much of the 10,000 in estimated-tax submissions should the Commission attribute to the utility? If the estimated-tax submissions were attributed by the ratio of the utility's and the affiliates' tax payments from the 2007 return, does this mean that the utility is to be allowed a rate increase to collect 5,000, even though its tax return shows its taxes paid requirement for the relevant year was only 1,000?[3]

[3] The question of whether SB 408 provides for rate increases for tax overpayments has not been presented to the Commission, because no party in the AR 499 workshop disputed that SB 408 is designed as a "two-way" adjustment. However, just in case there is any doubt as to what the legislators intended, Attachment A provides a listing of explicit confirmations that the adjustment may provide for either a rate increase or a rate refund.

Avoidance of utility rates based on the utility's estimated-tax submission elections: The utility may choose to make its estimated-tax submission in December or on the following January 1. The utility also may be more or less conservative in the amounts of its estimated-tax submissions. Should utility rates differ because of a utility's choice of how large an estimated-tax submission to make or in which calendar year such a submission should be made? NW Natural thinks that it is better rate-making policy to base rate adjustments on, to again quote SB 408 section 3(12)(a), those taxes paid as actually "incurred as a result of income generated by the regulated operations of the utility." The accrual approach based on the actual tax returns makes the proper match to taxes paid.

Ease of administration: Use of numbers from the actual tax returns allows the Commission to do with ease just what the legislators quoted above expected: determine the lesser of the taxes paid as a result of the income generated on a stand-alone basis by the utility that provides regulated operations in Oregon or the total taxes paid on a consolidated tax return by the utility's affiliated group. Under the method here proposed, no analysis of nonutility affiliate returns is required, and the Commission does not need to seek highly confidential tax information that has nothing to do with either the total taxes paid by the affiliated group or the taxes "incurred as a result of income generated by the regulated operations of the utility."

II. What did the legislature intend in adoption of section 3(13)(f)(B)?

Summary Response:

Section 3(13)(f)(B) provides that taxes paid should be

> "[i]ncreased by the amount of tax savings realized as a result of tax credits associated with 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 last general rate-making proceeding[.]"

1. The Commission should clarify that this provision would allow NW Natural to add back to taxes paid the annual impacts of its Business Energy Tax Credits ("BETCs").

2. Section 3(13)(f)(B) gives the Commission discretion to adjust taxes paid for tax savings arising from expenditures that were made in NW Natural's regulated operations, but that were not taken into account in rate-making.

A. Under section 3(13)(f)(B), NW Natural is entitled to increase its taxes paid each year by the amount of its BETCs.

NW Natural has a policy of purchasing BETCs from its commercial and industrial customers. These purchases pay part of the cost of natural gas and energy conservation investments that are encouraged by both State of Oregon and Commission policies. BETC acquisitions thus are investments by NW Natural made in connection with and in furtherance of its regulated operations. However, the costs of BETC purchases are borne by NW Natural's stockholders and are not included in NW Natural's rates.

NW Natural needs a confirmation by the Commission that under SB 408 the amounts of its BETCs will continue to be added into the computation of taxes paid, pursuant to section 3(13)(f)(B). Otherwise, NW Natural must cease purchasing BETCs, and thus must cease assisting its customers by contributing to the types of investments that BETCs encourage. NW Natural cannot continue to make BETC investments at shareholder expense, unless the shareholders can continue to receive tax benefits from the BETC investments.

As discussed above, an important benchmark for evaluating any proposed permanent rule is to ask whether that rule adversely affects utilities that are incurring and paying taxes on the same basis as assumed in applicable rate orders. Excluding BETCs from the computation of taxes paid would fail such a test. NW Natural incurs and pays taxes on the same basis as provided in its applicable rate orders. Yet, excluding BETCs from the computation of taxes paid

would force NW Natural to discontinue its existing practice of spending stockholder dollars to invest in natural gas and energy conservation. In addition, this interpretation would take away the tax benefits from BETCs currently held by NW Natural. Not only would such an interpretation be inconsistent with the stated intent of SB 408, but it would be contrary to existing policies of both the state of Oregon and the Commission regarding conservation.

B. Section 3(13)(f)(B) also allows NW Natural to increase its taxes paid for tax savings arising from any expenditure in its regulated operations that was not taken into account in rate-making.

The key interpretative question with regard to section 3(13)(f)(B) is whether the terms "tax credit" and "investment" are to be used in a narrow technical sense or are to be given a broader generic meaning. In other words, does "tax credit" mean only the items listed as "credits" in the Internal Revenue Code of 1986, as amended, or does it refer to anything in that code that gives rise to tax savings? In addition, does "investment" mean only "capital investment," or can the term apply to any expenditure on utility service?

Section 3(13)(f)(B) is confusing by any standard. Moreover, NW Natural cannot find any explanation in the legislative history about what the purpose of this provision was. A textual analysis of section 3(13)(f)(B) suggests that the drafters intended a broad application of this provision, and intended generic—not the more narrow technical—interpretations of "tax credit" and "investment."[4] In any event, the Commission needs to interpret this provision in a manner

[4] The legislative history does include a number of references to "tax credits" and "investments." Often, these terms are used in a technical, and not a generic, sense. Such references, however, are related to discussions having nothing to do with section 3(13)(f)(B) or the intent of the legislators in including this provision. The terms "tax credits" and "investment," when used in the description of section 3(13)(f)(B), only repeat what the words of the provision are. Thus the Commission is provided with little other than the text and context of this provision in making its interpretation.

that constitutes rational rate-making policy in the context of the Commission's other statutory rate mandates.

Based on a close textual analysis of SB 408, as well as reasonable rate-making policy, the Commission should read section 3(13)(f)(B) as allowing adjustments to taxes paid for the full tax impacts of any utility expenditures that have not been taken into account in utility rates. First, section 3(13)(f)(B) contains language that is necessary only if "tax credits" is intended to mean any tax item that gives rise to a tax savings. Note that pursuant to the statutory language, taxes paid are not simply increased by the amount of tax credits to the extent that such tax credits have not been taken into account for rate-making purposes. Instead, the statute provides that taxes paid are "[i]ncreased by the amount of tax savings realized as a result of tax credits" to the extent that "tax savings resulting from the tax credits have not been taken into account" for rate-making purposes. (Emphasis added.) The only apparent reason for such additional language is that the drafters were using "tax credits" in a generic sense to mean anything in the tax code that gives rise to tax savings. In other words, the language suggests that "tax credits" is intended to include not only items that are themselves tax reductions, but also items, such as tax deductions, that produce tax savings when applied.

If there is to be an adjustment for tax savings in connection with investments in regulated operations but not allowed in rates, there appears to be no rational distinction between various types of tax savings. The generic interpretation of "tax credits" thus prevents a conclusion that the protection of the utility with respect to such investments is in fact largely illusory.[5]

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[5] Given a choice of a construing section 3(13)(f)(B) in a manner that would protect the utility from a "taking" and one in which the takings protection would be largely illusory, the Commission should adopt the interpretation that does not make section 3(13)(f)(B) constitutionally questionable. Easton v. Hurita, 290 Or 689, 694, 625 P2d 1290 (1981)

Likewise, a textual analysis of section 3(13)(f)(B) strongly suggests that "investment" is meant to include any expenditure on utility service. The section refers both to "investment by the utility" and to the "expenditures giving rise to" tax savings. For example, NW Natural is allowed in rates to recover about $6 million to $7 million per year for its pension contributions. NW Natural needed to substantially increase the amounts set aside, to reflect the actuarial fact that its employees were projected to live longer and to ensure that the plan remained adequately funded. NW Natural thus made a $20 million investment in the pension fund in 2005, for the 2004 plan year. This additional investment, set aside to meet future obligations to utility employees, obviously produced substantial tax savings. To the extent such pension investment has not been recoverable in rates, then the tax savings from such investments should be within the intended scope of section 3(13)(f)(B).

In interpreting one of the most confusing provisions of SB 408, the Commission thus faces a policy choice. NW Natural urges the Commission to interpret the provision in a manner that does not discourage the types of additional expenditures that it wants a utility to make between general rate proceedings. The pension funding example represents just one type of expenditure that the Commission should retain the discretion to recognize in the annual tax calculations under SB 408. A rational application of section 3(13)(f)(B) would be good regulatory policy, in line with the Commission's overall statutory obligations to set rates in a thoughtful and reasoned manner.

Finally, such an interpretation of section 3(13)(f)(B) would assist in the defense of SB 408 against the claim that it permitted an unconstitutional taking of utility property, through what has been referred to as the "double whammy" effect. Utilities sometimes are required to make

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(explaining that statutes that are "somewhat ambiguous" must be interpreted in such a manner as to "avoid any serious constitutional problems").

substantial expenditures for utility service that are not recoverable in rates. If the tax adjustment required by SB 408 failed to recognize such expenditures in regulated operations that had not been allowed in rates, then the utility could in fact be required to make a rate refund to customers precisely because it had depressed utility earnings as the result of such unrecognized investments.

III. Section 3 of SB 408 requires the Commission to establish an automatic adjustment clause within 30 days (or later date, established by rule, not to exceed 60 days) once a determination is made regarding the $100,000 trigger amount. Section 4 states that if an automatic adjustment clause is established, it applies only to taxes paid to units of government and collected from ratepayers on or after January 1, 2006. If a utility pays quarterly estimated taxes, must the automatic adjustment clause be applied quarterly, or does the law allow it to be applied yearly?

Summary Response:

The rate adjustment under SB 408 is to be applied no more often than annually.

NW Natural first points out that at no point in either SB 408 or its legislative history is there a reference to a quarterly rate adjustment. Moreover, for the following reasons, a quarterly rate adjustment under the statute is not feasible:

1. Quarterly estimated-tax submissions are not taxes paid: As pointed out above, estimated taxes may be submitted in a year in which the utility turns out not to have any taxes paid. Estimated-tax submissions for a quarter also may turn out to have been overstated or understated when the actual amount of taxes paid is known. Estimated-tax submissions are not the same as taxes paid.

2. Taxes paid are not known by the Commission until after annual tax reports are filed: Section 3(1) of SB 408 requires annual tax reports, due each October 15. The tax reports are needed in order for the utility to furnish the tax return information, as well as the accounting for deferred taxes, charitable contributions, and utility investments not included in rates, that the Commission needs to calculate any SB 408 rate adjustment.

3. "Taxes authorized to be collected in rates" are not calculated by the Commission on a quarterly basis: SB 408 requires a comparison of "taxes paid" with "taxes authorized to be collected in rates." Revenue requirements, and related tax allowances, are computed by the Commission on an annual rather than quarterly basis. NW Natural has substantially varying gross and net revenues in different calendar quarters. If the adjustment clauses somehow could be applied quarterly, and if the formula of SB 408 were applied to calculate "taxes authorized to be collected through rates," the result for NW Natural would be major rate increases for low-energy-consumption quarters, followed by major rate refunds for high-energy-consumption quarters.

Respectfully submitted,

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ATTACHMENT A

Excerpts from Legislative History on Senate Bill 408

"The amount of the utility fee adjustment for consumers is indeterminate and in the future utility rate adjustments could be a decrease or increase over the current rate setting calculation taken by the PUC."

Revenue Impact of Proposed Legislation, June 3, 2005, SB 408 Legislative History at 36.

"The amount of the utility fee adjustment for consumers is indeterminate and in the future utility rate adjustments could be a decrease or increase over the current rate setting calculation taken by the PUC."

Revenue Impact of Proposed Legislation, July 27, 2005 at 1-2, SB 408 Legislative History at 37-38.

"Johnson: * * * [S]o that there isn't a one-way street here. If in fact the utilities taxes that they collected through rates or otherwise, but the estimated taxes were actually less than the amount they paid, they will get an adjustment in their favor. So, the other language kind of assumed a one-way street, and that has now been eliminated. * * *

"* * * * *

"* * * Mr. Chair, that is correct. I think the previous language probably worked as is, but this makes it a little bit clearer on its face that it is a two-way street that we are talking about here."

Senate Business and Economic Development Committee SB 408 Work Session, May 31, 2005 at 3-4, SB 408 Legislative History at 131-32.

"Walker: * * * [B]ut I think at the last hearing you folks testified that you didn't think that automatic adjustment clause was two-way, but I think we have testimony on the record from Mr. Johnson and his excellent skills at drafting have indicated that it's two way, so what is your objection?

"Miller: Senator Metsger and Senator Walker, they actually changed the language to make sure it was two way, that was a change between the –7 and the –8. So, I believe it is two way now. I'm not sure it was in the –7.

"Walker: OK. So, you don't object to that part, anymore.

"Miller: No, we don't.

"Walker: Well, that's good. We're making progress. I'm not quite sure we are every [sic] going to get there with you folks, though, because I think what is important to the rate payers and the public at large is that you are not allowed to collect taxes that you don't owe and that you don't pay * * *."

Senate Business and Economic Development Committee SB 408 Work Session, May 31, 2005 at 17, SB 408 Legislative History at 145.

"Fisher: * * * It is reciprocal now, so that if, you know, the utilities can no longer complain as Pamela did, that they would undercollect and then be left holding the tax bag * * *."

Senate Business and Economic Development Committee SB 408 Work Session, May 31, 2005 at 26, SB 408 Legislative History at 154.

"[Walker]: * * * [T]hen it shall create what's called an automatic adjustment clause in utility's rate structure so that charges to ratepayers for income taxes are no more or no less than the taxes actually paid to the government entities."

Senate Chamber SB 408, June 8, 2005 at 14, SB 408 Legislative History at 181.

"Shepherd: Continues explanation of the examples in EXHIBIT E. Points out that rates can go up or down."

House State and Federal Affairs Committee SB 408 Work Session, July 15, 2005 at 2, SB 408 Legislative History at 235.

"Shepherd: * * * But clearly the bill does permit rates to go up, as well as down * * *."

House State and Federal Affairs Committee SB 408 Work Session, July 15, 2005 at 7, SB 408 Legislative History at 250.

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 email and first-class mail addressed to said person(s) at his or her last-known address(es) indicated below.

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