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May 3, 2006

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VIA ELECTRONIC FILING

PUC Filing Center
Public Utility Commission of Oregon
PO Box 2148
Salem, OR 97308-2148

Re: Docket AR 499

I enclose for filing Northwest Natural Gas Company's Opening Comments on Straw Proposals.
A copy of this filing has been served on all parties to this proceeding.

Very truly yours,

A handwritten signature in cursive script that reads "Marcus Wood". The signature is written in dark ink and is positioned below the "Very truly yours," text.

Marcus A. Wood

MW:knp
Enclosures
cc: Service List

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

AR 499

In the Matter of the Adoption of Permanent
Rules to Implement SB 408, Relating to
Matching Utility Taxes Paid with Taxes
Collected

**NORTHWEST NATURAL GAS
COMPANY'S OPENING COMMENTS
ON STRAW PROPOSALS**

I. OVERVIEW

Northwest Natural Gas Company ("NW Natural") supports many of the comments submitted today by other Oregon utilities on these subjects and will not reiterate them here. Instead, NW Natural will add a few relatively brief observations in two areas. First, these comments will point out certain defects in the reasoning of the Industrial Customers of Northwest Utilities ("ICNU") and Northwest Industrial Gas Users ("NWIGU") in their comments submitted on April 24, 2006 concerning NW Natural's Earnings Test straw proposal. Second, these comments will note some of the practical defects in the "properly attributed" straw proposals submitted by ICNU/NWIGU and the Citizens Utility Board ("CUB").

II. THE EARNINGS TEST

NW Natural has proposed that an Earnings Test be incorporated into the permanent rule implementing SB 408. The Earnings Test is needed in order for the rule to comply with the Attorney General's conclusions that the application of SB 408 must also satisfy the statutory requirement that Oregon utility rates be fair, just, and reasonable. In each general rate case, the Oregon Public Utility Commission (the "Commission") establishes rates that it determines will produce a fair, just, and reasonable after-tax return on utility equity. The Earnings Test is designed to avoid the undermining of this Commission determination, by allowing base rates to be adjusted upward or downward, as needed to prevent either (a) overearnings combined with an SB 408 rate surcharge or (b) underearnings combined with

1 an SB 408 refund. The Earnings Test is an adjustment for excess or deficient earnings, made
2 to the extent needed to avoid an arbitrary and capricious surcharge or refund order that would
3 undermine the Commission's determination of what constitutes a fair, just, and reasonable
4 return.¹

5 The objections of ICNU/NWIGU to an Earnings Test, stated at pages 7-8 of their
6 straw proposal, stand accepted utility ratemaking on its head. If the cost of providing utility
7 service is higher than the level allowed by the Commission, ICNU/NWIGU seek to force the
8 utility to refund the tax effect of the underrecovery, without any rate adjustment for the
9 underrecovery itself. Likewise, if the cost of providing utility service is lower than the level
10 allowed by the Commission, ICNU/NWIGU assert that the utility should surcharge the
11 additional taxes arising from its overrecovery, without any rate adjustment for the
12 overrecovery itself. Thus the ICNU/NWIGU position both (a) mismatches cost items and the
13 taxes arising from such items and (b) violates the requirement that the Commission take into
14 account the end result of its rate orders.

15 Any reversal of ratemaking principles that are uniformly accepted across the nation
16 should be considered only if required by an explicit statutory mandate. As NW Natural
17 pointed out in a previous pleading in Docket No. UM 1244, not only is there no legislative
18 statement of intent for such an application of SB 408, but additionally, if that were the intent,
19 the law and the Commission's application thereof would very clearly fail the end-result test
20 and would therefore be arbitrary and capricious. Imagine, for example, the difficulty of

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23 ¹ Although the Earnings Test would protect both public utilities and their customers
24 in a manner similar to the deferral accounting proposed by NW Natural in its filing in Docket
25 No. UM 1244, the Earnings Test is not a cost deferral mechanism and would not require
26 deferral accounting. Instead, the Earnings Test would directly provide a prospective
adjustment to base rates as needed to avoid the "double-whammy" impact that SB 408
otherwise could produce. By using the Earnings Test, the Commission would bar the public
utility from using SB 408 to double-recover any rate overrecovery of its costs and also
protect the public utility from being double-penalized for a rate underrecovery.

1 defending on appeal the following Commission finding in a rate order (for a utility with a
2 40 percent effective income tax rate):

3 “For the rate period in question, the Commission found that a
4 fair and reasonable return was 10.5 percent. However, for the
5 most recent rate year, the utility was unable to earn a
6 10.5 percent return with the rates as authorized and in fact
suffered a \$50 million earnings shortfall. The Commission
finds that the utility as the result of such earnings shortfall
should pay a \$20 million refund to its customers.”

7 Moreover, imagine the reverse situation, in which the public utility significantly overearns its
8 allowed return and, as a result, the Commission orders customers to pay the utility a
9 surcharge. These unsupportable and unsustainable determinations are precisely what ICNU
10 and NWIGU have argued are “fair” outcomes.

11 **III. THE “NEXUS” STRAW PROPOSAL OF ICNU AND NWIGU**

12 The legal and logical defects of the ICNU/NWIGU “nexus” proposal have been well
13 described in PacifiCorp’s comments. NW Natural acknowledges that the nexus test might
14 have value as a means of identifying those few affiliates of a utility whose individual tax
15 losses could possibly be related to operations of the public utility itself.² For example,
16 parties in past proceedings occasionally have raised what are in effect “double-leverage”
17 challenges relating to the capital structure of a public utility’s direct or indirect parent
18 companies. Parties also might want to examine the tax costs related to any approved cost-
19 based transaction between a public utility and its affiliate.

20 However, the only defensible purpose of applying a nexus test is to limit the scope of
21 entities to be individually examined. ICNU and NWIGU instead seek to use their nexus
22 approach as a supplement to SB 408, to summarily attribute to the public utility all the tax

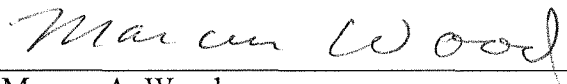
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24 ² ICNU and NWIGU for some reason want to include in the nexus group a sister
25 company of a public utility if the sister company shares a common parent with the public
26 utility, even when there is no financial relationship, contractual or otherwise, between the
public utility and the sister affiliate. The description of the ICNU/NWIGU straw proposal
does not contain a discernible rationale for including such an affiliate in the nexus group.

1 individually audit the tax returns of literally hundreds of non-regulated entities, in order to
2 apply SB 408 to only four Oregon public utilities. In addition, the proposal that tax losses of
3 individual entities be applied to generate refunds whenever a utility exceeds its allowed
4 return, with no comparable relief when the utility suffers earnings shortfalls, is inherently
5 unbalanced and inequitable.

6 DATED: May 3, 2006.

7 STOEL RIVES LLP

8 

9 Marcus A. Wood

10 Of Attorneys for Northwest Natural Gas
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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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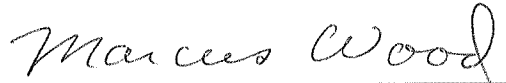
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