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**VIA E-FILING & FIRST CLASS MAIL**

Oregon Public Utility Commission
Attn: Filing Center
550 Capitol St. NE, Suite 215
P. O. Box 2148
Salem, OR 97308-2148

Re: *AR 499*

Attention Filing Center:

Enclosed for filing in the above-referenced docket are the original and five copies of Portland General Electric Company's Opening Comments on the Interim Order and Draft Rules. This document is being filed electronically per the Commission's eFiling policy to the electronic address PUC.FilingCenter@state.or.us, with copies being served on all parties on the service list via U.S. Mail. A photocopy of the PUC tracking information will be forwarded with the hard copy filing.

Very truly yours,

Leslie Hurd, Legal Assistant to
David F. White

/ldh
Enclosure
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**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 | **PORTLAND GENERAL ELECTRIC COMPANY'S OPENING COMMENTS ON THE INTERIM ORDER AND DRAFT RULES** |
|---|---|

## I. INTRODUCTION

The Interim Order reaches several important conclusions regarding the SB 408 automatic adjustment. In implementing the SB 408 adjustment, the Commission will:

- Calculate "taxes collected" using fixed rate case ratios, not actual utility costs and revenues for the tax year;
- Apply no earnings test;
- Review deferred accounting applications with a "skeptical eye;" and
- Attribute "taxes paid" using a three-factor apportionment test.

The implications for Oregon utilities are evident and acknowledged in the Interim Order:

1. Increased Utility Earnings Volatility. The SB 408 automatic adjustment will substantially increase earnings volatility for utilities. When a utility incurs fewer expenses than expected or receives revenues higher than forecasted in the last rate case, the SB 408 automatic adjustment will surcharge customers and increase the utility's earnings on these utility services. Conversely, when a utility incurs more expenses than expected or receives less revenue than forecasted in the last rate case, the SB 408 automatic adjustment will require the utility to issue a refund to customers and decrease the utility's earnings on these utility services. The Commission acknowledged this "double whammy" effect but concluded that it lacked the authority to adopt an earnings test or net-to-gross ratio based on actual costs and revenue, either

of which would have mitigated the adjustment's unavoidable effect of moving a utility's earnings away from the authorized level.

The increase in volatility will only harm customers. Even if the utility's average earnings remain constant, which is unlikely given the biased structure of SB 408, investors and lenders will demand higher returns or interest. Customers will pay for this increase in the cost of capital.

2. Disincentives for Necessary and Beneficial Expenditures and Investments. The adoption of a fixed ratio method for calculating the amount of taxes collected in rates will discourage utility expenditures and investments. For every dollar not spent between rate cases, SB 408 provides a tax surcharge to customers of 40% by passing through the tax effect (higher taxes paid) of additional income. This is because the fixed ratio approach excludes all variances between rate cases but captures the tax consequences through the comprehensive calculation of taxes paid. Expenditures, including depreciation on new construction, not included in a test year cause a tax refund to customers. Any investment the Commission ultimately concludes is imprudent will now include an additional SB 408 penalty for the tax impact. In addition, utilities are unlikely to engage in programs that provide tax credits, such as Oregon's BETCs, or other credits available for affordable housing, if the tax benefits for those credits are lost through the SB 408 automatic adjustment.

3. More Frequent Rate Cases and Regulatory Filings. Utilities will likely file more frequent rate cases to ensure that the fixed net-to-gross ratio reflects more accurate and current cost and revenue information. In addition, utilities and stakeholders may file more frequent deferred accounting applications given that SB 408 amplifies the financial impact of unexpected variations in costs and revenues.

The Commission concluded that the language and intent of SB 408 mandated the principal structure of the automatic adjustment. It found that the Legislature did not give it the authority to mitigate these regulatory consequences through interpretation of "taxes collected" or

direct ratemaking tools such as an earnings test. As we have made clear throughout this proceeding, we respectfully disagree.

At this point we focus not on those disagreements, but rather on the implications of the Commission's Interim Order. In making future ratemaking decisions, the Commission must consider the SB 408 impacts in each and every instance. The Commission has statutory and constitutional obligations other than SB 408, including the responsibility to set "fair and reasonable rates" and ensure that customers receive safe and reliable service. ORS 756.040; ORS 757.030. SB 408 did not change this. The Commission will need to consider how it sets "fair and reasonable rates" in light of the SB 408 automatic adjustment.

The Interim Order observes that the Commission "will consider the tax effects when evaluating issues in other dockets, such as power cost adjustments," confirming the need to consider the consequences of the SB 408 automatic adjustment. Interim Order at 9. The issue runs even deeper still. The Commission currently uses an entire body of regulatory polices and conventions for dealing with recurring ratemaking issues. Although PGE may not agree with each and every one, we agree that these policies and conventions made sense only in a pre-SB 408 regulatory context. Because of the far-reaching effects of the SB 408 true-up of a derivative expense—income taxes—the Commission will need to revisit each policy and convention to make adjustments as necessary. The SB 408 automatic adjustment clause requires the Commission to change its approach in at least the following areas:

1. Cost of Capital. As noted above, the SB 408 automatic adjustment will substantially increase utilities' earnings volatility. The Commission will need to consider this in the quantitative and qualitative methods it uses to establish a return opportunity that meets the requirements of ORS 756.040(1)(a) and (b). Investors and lenders will require higher returns as compensation for the increased risk that the rates set will not provide adequate revenues to cover operating expenses as well as a return on investment that is (a) commensurate with the returns available for other companies having a similar risk profile and (b) sufficient to insure confidence in the financial integrity of the utility.

2. Power Cost Recovery Mechanisms. As we noted above, the Interim Order recognizes that SB 408 affects the Commission's approach to recovery of power costs by electric utilities. Electric utilities earn nothing on power costs, just as gas utilities earn nothing on their costs of purchased gas. The SB 408 automatic adjustment clause, however, would treat variances in these costs as variances in taxes collected[1] that trigger surcharges or refunds. Power costs are presently approximately 50% of PGE's costs and the most volatile of all such costs. The Commission could substantially mitigate the rate and earnings volatility associated with the effect of SB 408 on power costs by permitting electric utilities to pass these actual expenses through to customers. In this docket, PGE provided an example showing that a comprehensive PCA reduced the earnings impact of SB 408 from 100 basis points to 20 basis points. *See* PGE Reply Comments at 5 (May 19, 2006); PGE's Opening Comments, Exhibit A (May 3, 2006, as amended on May 5, 2006).

3. Commission Disallowances. The Commission will need to consider the appropriate ratemaking treatment for disallowed expenses in the ratemaking process. If left unchecked, customers avoid paying for disallowed expenses but receive under SB 408 the tax benefit of such expenditures. This benefit comes from shareholder equity. The Commission could remedy this violation of the traditional benefit-burden rule by revising its disallowance policy to tax-adjust the disallowed amounts so that the party that incurs the cost is the same as the party that receives the tax consequences.

4. Property Sales. SB 408 will have unexpected impacts on property sales. Sales that result in a profit will result in tax surcharges because the taxes paid will reflect the extra income tax paid but the taxes collected side will not. Similarly, sales of property that result in a loss to the utility will cause a further SB 408 tax penalty. The Commission will need to adjust its handling of property sales to address this impact.

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[1] As PGE noted at the June 7, 2006 workshop, allocating revenues first to taxes is directly contrary to GAAP. Under GAAP, revenues first cover expenses; what is left over is taxable income.

5. Deferred Accounting. The Commission has recently applied a "financial impact test" to deferred accounting applications for certain costs or expenses. In determining the financial impact, the Commission must now consider not only the cost or revenue variance, but also the SB 408 tax impact on the utility of the variance. SB 408 will impose a 40% amplifying impact to the cost or revenue variation in either direction.

6. Interim Rate Orders. In declining to adopt an earnings test, the Commission noted that the "law provides ample opportunities to adjust rates if there are over or under earnings." Interim Order at 8. Given the extremely short time allotted between the filing of the Tax Report and implementation of the SB 408 adjustment, the Commission and parties will be required to process rates cases in four or five months or provide for interim rate relief in order to make the promise of "ample opportunities" to change rates a reality.

## II. INTERIM ORDER'S PROPERLY ATTRIBUTED TEST

We have not had adequate time to review all the potential implications of the proposed three-factor apportionment method (the "Apportionment Method"). Our initial review raises doubts regarding whether such an approach will lead to stable and sustainable ratemaking adjustments. There are several reasons for this conclusion.

First, the Apportionment Method is untested by any other utility commissions or the parties in this docket. While states may have adopted the three-factor formula to allocate taxable income among states, it is not "well established" in utility ratemaking. In fact, it has no precedent in the utility ratemaking arena.

Second, in some circumstances, the Apportionment Method exceeds one end of the bookends by attributing less in "taxes paid" to the utility than the interim rule. The Apportionment Method will allocate taxes paid to affiliated groups with no taxable income. Such an outcome violates fundamental tax and accounting standards. Apportionment of taxes paid should begin with the premise that only entities with taxable income should be apportioned some portion of "taxes paid."

Third, the underlying goals of the multi-state tax system and ratemaking for utility taxes are very different. The primary goal of the multi-state tax system is to avoid double taxation and to allocate taxable income to states in a fair way over time. The Commission's charge is to set fair, just and reasonable rates so that customers are not charged for more in taxes than the taxes paid. That requires an accurate calculation of taxes collected and a fair allocation of taxes paid. The Commission has not satisfied the requirement of "properly attributing" taxes paid by simply allocating in any fashion 100% of the taxes paid to the utility and other members of the consolidated group.

Fourth, fluctuations in the apportionment of taxes will not balance out over time. SB 408 caps the allocation of taxes paid to the utility at the stand-alone amount. ORS 757.268(12)(a). In other words, when the Apportionment Method allocates more of the taxes paid to the regulated utility, the Commission replaces the three-factor test with the stand-alone amount. When the Apportionment Method allocates less taxes paid to the utility, the Commission uses the Apportionment Method. The multi-state tax system has no corollary.

Fifth, the Apportionment Method bears little resemblance to the allocation formula that the Oregon Department of Revenue ("ODR") uses. The ODR uses the apportionment technique to allocate the taxable income among states. The Commission's approach allocates taxes paid, not taxable income. Moreover, the ODR makes no allocations of state and local taxes, which already reflect allocations of taxable income by the state and local taxing authorities. In addition, the Apportionment Method does not match state and local taxes apportionment, which is often based solely on one factor: sales.

Last, the Apportionment Method fails the criteria we have identified throughout this docket. We can't tell whether it satisfies statutory or constitutional standards. We don't know whether it will violate normalization rules. We don't know whether it will produce just and reasonable or confiscatory rates. Nor can we tell if it reflects good regulatory policy. We don't know the intended consequences of the Apportionment Method, much less the unintended consequences.

The parties have been working together since October 2005 analyzing the impact of various straw proposals, carefully reviewing the policy and legal implications of each. The Interim Order adopted an approach no state public utility commission has adopted and no party suggested, let alone analyzed. The four weeks allotted between the Interim Order and the close of the written comment period is simply not enough time to consider carefully all of the potential impacts of this approach.

Below we identify proposed changes to the rules to address some of our initial concerns. We have organized our comments as follows: (1) federal taxes; (2) state and local taxes; and (3) other issues.

## III. FEDERAL TAXES

The object of the apportionment rules is to properly attribute taxes paid to the regulated operations of the utility. The ratio used to attribute taxes paid, therefore, should reflect the relationship between the regulated operations of the utility and the taxpayer. The numerator for the three-factor ratios should reflect all utility property, payroll and sales associated with providing regulated service to Oregon customers. It appears that this was the intent of the Interim Order, which concluded that "[a]pplying the Apportionment method to a utility, we must determine the property, payroll, and sales of the regulated operations of the utility, as well as those factors of the total affiliated group." Interim Order at 7.

Nevertheless, the draft rules suggest an Oregon "situs" requirement for the numerator of the ratios. In calculating the numerator for federal taxes, the draft rules limit the utility's property, payroll and sales to "regulated operations of the utility in Oregon." Draft Rule 3(a)(B). This arguably would exclude from the numerator utility property, payroll and sales outside of Oregon even if the utility uses the property or employees to serve Oregon customers.

Such an Oregon situs requirement makes no sense. It creates a fundamental and unnecessary mismatch between how rates are set and the attribution of taxes paid. For example, the Commission sets PGE's rates based upon utility property used to provide service. Some of that utility property—PGE's interest in the Colstrip generating plaint—is located in Montana.

But PGE has no Montana customers. An Oregon "situs" requirement would effectively allocate some portion of PGE's federal and Oregon state taxes to Montana when PGE has no ability to charge Montana customers for these costs.

Most tellingly, it would violate the entire goal of SB 408, which is to match the amount of taxes collected in rates with the amount of taxes paid. Exhibit 1 illustrates the fundamental problem. In this example, we assume the utility is a stand-alone regulated utility with no non-regulated operations. The service territory is 100% Oregon. Taxes collected from customers, as calculated under SB 408, are $100 and taxes paid are $100. The utility's power plants are located 50% in Oregon and 50% in other states. Using the Apportionment Method with an Oregon situs requirement reaches the wrong result. It would allocate only 83% of the taxes paid to Oregon, resulting in a $17 SB 408 adjustment. But in this example, the taxes collected exactly matched the taxes paid so there should be no SB 408 adjustment. Removing the Oregon situs requirement would fix this problem.

To remove the Oregon situs requirement, we propose amending Draft Rule 3(a)(B) as follows:

> "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 the taxpayer in the denominator."

## IV. STATE AND LOCAL TAXES

### A. STATE TAXES SHOULD REFLECT OUT-OF-STATE TAXES PAID USED TO SET OREGON UTILITY RATES

The "taxes paid" side of the SB 408 equation must reflect all taxes paid by the utility's regulated operations that are included in Oregon utility rates. Otherwise, the SB 408 calculation of taxes collected and taxes paid uses fundamentally different variables on both sides of the equation. In calculating the state income taxes paid to units of government, the draft rules should include all applicable state taxes. The draft rules limit the state taxes available for apportionment to "Oregon income taxes" paid. Draft Rule 3(b)(A).

Failing to include other state income taxes that are included in Oregon utility rates contradicts the fundamental purpose of SB 408—to match taxes collected in rates with taxes paid. SB 408 defines taxes as "a federal, state, or local tax or fee that is imposed on or measured by income and that is paid to units of government;" (ORS 757.268(13)(d)); there is no limitation to Oregon state income taxes. Consider the example of a stand-alone utility with no non-regulated operations and which serves only Oregon customers. In this example, assume the utility collects from customers $100 in taxes, $10 of which is for Montana state taxes based on power plants located in Montana and used to provide utility service in Oregon. Assume that the utility pays $100 in taxes, $10 of which is paid to the state of Montana. The current draft rules would automatically exclude the $10 of Montana state taxes. This would result in a $10 SB 408 adjustment even though taxes paid and taxes collected were equal in this example.

We propose below our proposed method for attributing state and local taxes and a draft rule attached as Exhibit 2. Including out-of-state taxes paid is necessary to balance taxes collected and taxes paid, whether the Commission adopts PGE's recommended approach for state and local taxes—the "with or without" test—or the Apportionment Method.

## B. STATE AND LOCAL TAXES—WITH OR WITHOUT APPROACH

There is no precedent or rationale for applying the Apportionment Method to state and local taxes. For that reason, we favor application of the "with or without" test for attributing state and local taxes. The "with" calculation should include the utility within its unitary tax group, and the "without" calculation should reflect the state and local taxes paid for the unitary tax group "without" the utility. The three-factor approach, when applied to state and local taxes, is redundant and often at odds with the underlying tax allocation method. It is redundant because state and local taxes already reflect the application of the apportionment method. It is inconsistent because the state and local taxing authorities do not use the same three factors. Multnomah County, for example, uses a singe factor—sales—to allocate taxable income. Overlaying a three-factor test will lead to inconsistent and arbitrary results.

## C. STATE TAXES AND LOCAL TAXES USING THE APPORTIONMENT METHOD

In the event the Commission elects to use the Apportionment Method for allocating state and local taxes paid, we make the following suggestions. The Apportionment Method can be applied in many alternative ways for state and local taxes. It is impossible to know at this time all the implications of choosing from among the many alternative ways the Commission could possibly apply the Apportionment Method to state and local taxes. Further complicating the selection of an appropriate approach is the lack of any clear standard or criteria for judging among the alternatives. The Interim Order offers no standard and we are unaware of any agreed method or standard. With these reservations, we offer the following recommendations regarding how the Commission should implementation the Apportionment Method to state and local taxes should it elect to do so:

### 1. STATE TAXES

As noted above, the Commission should consider all state taxes that are included in rates. A separate attribution calculation should be done for each such state. For simplicity's sake, and to reduce unnecessary administrative burden, the taxpayer for this purpose (the denominator) should be the unitary group that includes the utility. The ratios for each state should reflect the appropriate factors for that state.

### 2. LOCAL TAXES

The taxpayer (the denominator) for local taxes should be the state unitary group that includes the utility. We propose apportionment based upon sales in the applicable locality as the only apportionment factor. This approach has several advantages. Sales information is already readily available given that local taxing authorities normally apportion state taxable income using this factor. A three-factor approach requires, for each member of the unitary group, property and payroll information by location. This information is often difficult to obtain; it is not part of the local tax filing or workpapers. Finally, a single factor sales approach matches the apportionment method local taxing authorities apply. This serves to decrease the chances of

arbitrary or inconsistent outcomes. Exhibit 3 shows how PGE's proposal works with respect to local taxes.[2]

We have attached as Exhibit 2 a proposed rule that implements our recommendations. As mentioned above, we propose the use of the "with or without" method for apportioning state and local taxes, but our proposed draft rule includes both a "with or without" and an Apportionment Method alternative. Because of the tentative nature of our conclusions, our draft rule permits the addition of affiliated unitary groups as part of the taxpayer for this calculation whenever required.

## V. OTHER DRAFT RULE ISSUES

### A. NORMALIZATION

We have had less than two weeks to review the potential impacts of the Apportionment Method. Based on our initial review, it appears that the proposed Apportionment Method may pass through to customers the benefits of deferred taxes resulting from accelerated depreciation. This would violate the normalization method of accounting, putting in jeopardy the substantial benefits customers receive through accelerated depreciation. The draft rules prohibit violations of the normalization rules and the statute expressly authorizing the Commission to include in rates deferred taxes notwithstanding the operation of the SB 408 adjustment. Draft Rule 9(f); ORS 757.268(8)(a). Nevertheless, the rules provide no specific mechanism to cure these likely violations of the normalization rules.

Given that the parties have had little time to analyze the potential impacts of the Apportionment Method, it is impossible to predict all the ways in which the approach may

[2] At the July 21, 2006 workshop, ALJ Smith asked the parties to address Section 13's definition of "affiliated group" in connection with the "properly attributed" test. The definition of "affiliated group" does not impose a material limitation on the Commission's discretion to fashion an appropriate "properly attributed" test. The Commission has considerable discretion to implement and define the specific mechanics for calculating the amount of taxes properly attributed. Section 13(a) does not limit that discretion. Moreover, the unitary group that includes the utility—which PGE recommends for use as the "taxpayer" for state and local taxes—is a member of the "Affiliated Group" and, therefore, falls within the Section 13(a) definition.

violate normalization rules. We propose permitting the utility to make any and all adjustments necessary in the tax report to avoid violating the normalization method of accounting or any other requirements of federal tax law.

> Insert as new Rule 2(o)(D):
>
> Any other adjustment necessary to avoid violating the normalization method of accounting or any other requirements of federal tax law.

We propose adding similar language to permit the Commission to make similar adjustments in its order implementing the automatic adjustment clause.

> Insert at the end of draft rule 8(d)
>
> Any other finding or determination necessary to implement the automatic adjustment clause: <u>including, but not limited to, any adjustments necessary to avoid violating the normalization method of accounting or any other requirements of federal tax law</u>.

**B. SUBSECTION 12(A) CAP**

The draft rules eliminate the stand-alone utility as one of the caps for "taxes paid" properly attributed to the utility. Former Draft Rule 4(b). In its place, the draft rules use the "with or without" test as a surrogate for the stand-alone cap set forth in ORS 757.268(12)(A). The "with or without" test is an inappropriate replacement for the stand-alone cap for at least two reasons. First, the "with or without" test is an <u>attribution rule</u> to determine taxes paid that are properly attributed to the utility. It captures the interactive effects of the utility and other members of the tax group. The cap in subsection 12(a) is not an attribution rule but rather a hard cap for "taxes paid" incurred "as a result of income generated by the regulated operations of the utility." The point of this cap is to remove the effect of other tax group members to focus on what would have been the taxes paid by the stand-alone utility. The "with or without" test fails to accomplish that purpose because its express purpose is to calculate the interactive effects of the utility and other tax group members.

Second, there is no evidence that the Legislature intended such an interpretation of the 12(a) cap. The intent of the Legislature is fairly clear on this point. It gave the Commission discretion to fashion an appropriate method for determining taxes paid "properly attributed" to the utility. It capped that amount based on a figure that was well known and understood at the time. The stand-alone regulated utility taxes (12(a)) reflect the Commission's traditional approach to taxes—a stand-alone approach. The "with or without" test had not been developed when the Legislature passed SB 408. The Legislature could not possibly have intended for the then-undeveloped test to apply through subsection 12(a). There is ample legislative history directly on point, which conclusively proves that the Legislature intended subsection 12(a) to serve as a stand-alone tax liability cap. *See* PGE Opening Comments at 17 (Oct. 28, 2005).

### C. WHEN INTEREST BEGINS TO ACCRUE

The draft rules provide that interest begins to accrue on the difference calculated under the proposed rules effective January 1 following the tax year. Draft Rule 9(e). We propose that interest begin accruing effective January 1 following the tax report. The Commission has considerable discretion in this area. SB 408 is silent, and delegates such administrative and implementation issues to the Commission. As discussed above, the volatility SB 408 imposes will harm utilities and customers alike. Postponing the effective date on which interest accrues for one year, as PGE proposes, will have the salutary effect of dampening such fluctuations. Moreover, the delay in imposing interest will work both ways. Interest will be deferred on surcharge and refund balances alike. Finally, the balances SB 408 creates cannot possibly be known or quantified as of January 1 following the tax year. Utilities and the Commission can do nothing to reduce or amortize the balance since it is unknowable at that time. The rules provide that the SB 408 adjustment to amortize such balances will not take effect until six months following the filing of the Tax Report. Draft Rule 7(b). Under these circumstances, we submit that interest should not accrue until January 1 following the Tax Report, which coincides with the year in which amortization begins.

### D. GROSS UP

The intent of the current draft rules is for the Commission to implement the SB 408 adjustment without a tax gross up. In other words, if the SB 408 adjustment reflects a $10 million surcharge, then the Commission will charge customers $10 million and will not include a gross up for the tax impact of the surcharge. Similarly, the Commission will not add a gross up for a SB 408 refund. Parties have pointed to Draft Rule 2(n)(C) as reflecting this understanding.

We agree with the other parties about the intent of the rules. The SB 408 adjustment should not include a gross up factor for taxes. The statute provides for no gross up and there is no principled argument for applying one. We suggest adding the following subsection to clarify the intent of the permanent rules on this topic:

> Insert as new Rule 4(l): The proposed surcharge or surcredit rate adjustment shall not include a tax gross up factor.
>
> Insert as new Rule 9(h): Any rate adjustment determined by the Commission pursuant to Section 8 of this rule shall not include a tax gross up factor.

## VI. CONCLUSION

The Commission has proposed a completely new method for allocating taxes paid that are "properly attributed" to the utility. Throughout this docket, the parties have thoroughly vetted a number of alternative techniques for calculating taxes paid that are properly attributed to the utility. At this late stage in the docket, there is not enough time to subject the Apportionment Method to the same kind of careful and thorough testing. Nevertheless, our initial review shows that certain changes must be made to the Apportionment Method to align "taxes paid" with "taxes collected" and avoid several unintended consequences. As described above, (a) including all utility property, sales and payroll to the ratios used to apportion federal taxes paid and (b) capturing out-of-state taxes paid that the Commission includes in Oregon utility rates would address the two most important mismatches we have discovered based on just two weeks of

review. The properly attributed test for state and local taxes paid should be substantially simplified, as suggested above.

DATED this 31st day of July, 2006.

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**AR 499: Properly Attributed**
**Three-factor allocation method**

**EXAMPLE- Federal taxes paid, per Rule (3)(a)(B)**

Rule (3)(a)(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 the taxpayer in the denominator. (emphasis added)

Assumptions-

1. The Company is a stand-alone, regulated utility, with no nonregulated operations.
2. Service territory is 100% Oregon.
3. All sales are to Oregon customers; Payroll is all in Oregon; Power plants are located 50% in Oregon and 50% in other states.
4. Taxes collected from customers and paid to IRS are the same amount- $100.

| | | | | | | |
|---|---|---|---|---|---|---|
| Taxes Collected from Customers, per AR 499 | | | | | $ | 100 |
| Taxes paid to IRS for applicable year | | | | $ 100 | | |
| Apportionment Factors: | Property | 50% | | | | |
| | Payroll | 100% | | | | |
| | Sales | 100% | | | | |
| | | 250% | / 3 | 83.3% | | |
| Apportioned Federal Taxes Paid | | | | $ 83 | $ | 83 |
| | | | | | **$** | **17** |

Exhibit 1 - Page 1 of 1
PGE's Opening Comments on the Interim Order and Draft Rules

July 21, 2006 Workshop
PGE Example

## PGE'S DRAFT RULE FOR ATTRIBUTING STATE AND LOCAL TAXES PAID

(a) The amount of state income taxes paid to units of government that is properly attributed to the regulated operations of a utility is the sum of each state income taxes paid to units of government that is properly attributed to the regulated operation of the utility. A separate calculation will be performed for each state income tax to which the regulated utility is subject and which state income tax is included in the rates for regulated service offered to Oregon customers by the regulated utility. For purposes of the calculations in these subsections, the taxpayer shall be the unitary tax group that includes the regulated utility. For local taxes paid, the taxpayer may include other affiliated tax groups if necessary.

With or Without Alternative

(b) For each applicable state income tax to be attributed, the amount of state income taxes paid to units of government that is properly attributed to the regulated operations of the utility is equal to the difference between the taxpayer's tax liability computed with and without the regulated operations of the utility.

(c) The amount of local income taxes paid to units of government that is properly attributed to the regulated operations of the utility is equal to the difference between the taxpayer's local tax liability computed with and without the regulated operations of the utility.

Apportionment Alternative

(b) For each applicable state income tax paid to be attributed, the amount of state income taxes paid to units of government that is properly attributed to the regulated operations of the utility is the product of the following two figures:

(A) The total amount of state income taxes for the applicable state that is paid by taxpayer; and

(B) The average of the ratios calculated for the utility's property, payroll and sales, as defined in applicable state tax allocation statutes, using the amounts for regulated operations of the utility in the applicable state in the numerator and the amounts for the taxpayer in the applicable state 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:

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

(B) The ratio calculated for utility sales, as defined by the local taxing authority, using the amounts for regulated operations of the utility in the local taxing authority's jurisdiction in the numerator and amounts for the taxpayer in the local taxing authority's jurisdiction in the denominator.

**PGE & SUBSIDIARIES**

**MULTNOMAH COUNTY INCOME TAX**

# *With-Without Method*

| Ln | | PGE | | | PGE SUBSIDIARIES | | | | PGE & SUBS Combined Tax Return |
|---|---|---|---|---|---|---|---|---|---|
| | | Utility | Non-Utility | Total | Port Gen'l Res. Develop | Salmon Springs Hospitality, Inc. | 121 SW Salmon Street. Corp | WTC Northwest | |
| 1 | Net Income or (Loss) per Oregon tax return | 100,000,000 | 5,000,000 | 105,000,000 | 1,000,000 | 500,000 | (3,000,000) | 2,000,000 | 105,500,000 |
| 2 | Multnomah County Business Income Tax addback | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 3 | Compensation of controlling shareholders | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 4 | Other additions and subtractions | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 5 | Adjusted Net Income (total lines 1,2,3 and 4) | 100,000,000 | 5,000,000 | 105,000,000 | 1,000,000 | 500,000 | (3,000,000) | 2,000,000 | 105,500,000 |
| 6 | Compensation allowance deduction | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 7 | Subject Net Income (line 5 minus line 6) | 100,000,000 | 5,000,000 | 105,000,000 | 1,000,000 | 500,000 | (3,000,000) | 2,000,000 | 105,500,000 |
| | Apportionment Calculation | | | | | | | | |
| 8 | County Gross Income | 900,000,000 | 10,000,000 | 910,000,000 | 0 | 1,500,000 | 5,000,000 | 0 | 916,500,000 |
| 8 | Total Gross Income | 2,000,000,000 | 12,000,000 | 2,012,000,000 | 0 | 1,500,000 | 5,000,000 | 0 | 2,018,500,000 |
| 8 | | 45.0000% | 83.3333% | 45.2286% | 0.0000% | 100.0000% | 100.0000% | 0.0000% | 45.4050% |
| 9 | County Apportioned Net Income (line 7 x line 8) | 45,000,000 | 4,166,665 | 47,490,030 | 0 | 500,000 | (3,000,000) | 0 | 47,902,275 |
| 10 | Net Operating Loss Deduction (max 75% of line 9) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 11 | Income subject to tax (line 9 minus line 10) | 45,000,000 | 4,166,665 | 47,490,030 | 0 | 500,000 | (3,000,000) | 0 | 47,902,275 |
| 12 | Tax (line 11 x tax rate of 1.45%) | 652,500 | 60,417 | 688,605 | 0 | 7,250 | (43,500) | 0 | 694,583 |

| SB 408 "WITH/WITHOUT COMPUTATION" | |
|---|---|
| MCBIT tax *with* PGE reg. ops | 694,583 |
| MCBIT tax *without* PGE reg. ops | 71,128 |
| | 623,455 |
| Lesser of: | |
| PGE Standalone tax | 652,500 |
| "Properly Attributable" MCBIT | 623,455 |
| SB 408 "Taxes Paid" | 623,455 |

Exhibit 3 - Page 1 of 3
PGE's Opening Comments on the
Interim Order and Draft Rules

**PGE & SUBSIDIARIES**

**MULTNOMAH COUNTY INCOME TAX**

# *With-Without Method*

| Ln | | PGE | | | PGE SUBSIDIARIES | | | | PGE & SUBS Combined Tax Return |
|---|---|---|---|---|---|---|---|---|---|
| | | Utility | Non-Utility | Total | Port Gen'l Res. Develop | Salmon Springs Hospitality, Inc. | 121 SW Salmon Street. Corp | WTC Northwest | |
| 1 | Net Income or (Loss) per Oregon tax return | 0 | 5,000,000 | 5,000,000 | 1,000,000 | 500,000 | (3,000,000) | 2,000,000 | 5,500,000 |
| 2 | Multnomah County Business Income Tax addback | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 3 | Compensation of controlling shareholders | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 4 | Other additions and subtractions | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 5 | Adjusted Net Income (total lines 1,2,3 and 4) | 0 | 5,000,000 | 5,000,000 | 1,000,000 | 500,000 | (3,000,000) | 2,000,000 | 5,500,000 |
| 6 | Compensation allowance deduction | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 7 | Subject Net Income (line 5 minus line 6) | 0 | 5,000,000 | 5,000,000 | 1,000,000 | 500,000 | (3,000,000) | 2,000,000 | 5,500,000 |
| | Apportionment Calculation | | | | | | | | |
| 8 | County Gross Income | 0 | 10,000,000 | 10,000,000 | 0 | 1,500,000 | 5,000,000 | 0 | 16,500,000 |
| 8 | Total Gross Income | 0 | 12,000,000 | 12,000,000 | 0 | 1,500,000 | 5,000,000 | 0 | 18,500,000 |
| 8 | | 0.0000% | 83.3333% | 83.3333% | 0.0000% | 100.0000% | 100.0000% | 0.0000% | 89.1892% |
| 9 | County Apportioned Net Income (line 7 x line 8) | 0 | 4,166,665 | 4,166,665 | 0 | 500,000 | (3,000,000) | 0 | 4,905,406 |
| 10 | Net Operating Loss Deduction (max 75% of line 9) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 11 | Income subject to tax (line 9 minus line 10) | 0 | 4,166,665 | 4,166,665 | 0 | 500,000 | (3,000,000) | 0 | 4,905,406 |
| 12 | Tax (line 11 x tax rate of 1.45%) | 0 | 60,417 | 60,417 | 0 | 7,250 | (43,500) | 0 | 71,128 |
| | | | | | | | | Assume "Without" Computation can not be less than zero | **71,128** |

Exhibit 3 - Page 2 of 3
PGE's Opening Comments on the
Interim Order and Draft Rules

**PGE & SUBSIDIARIES**

**MULTNOMAH COUNTY INCOME TAX**

# *Single Sales Factor Apportionment*

*( Amounts not actuals. Used for illustrative purposes only.)*

| Mult County Line # | | PGE | | | PGE SUBSIDIARIES | | | | PGE & SUBS Combined Tax Return |
|---|---|---|---|---|---|---|---|---|---|
| | | Utility | Non-Utility | Total | Port Gen'l Res. Develop | Salmon Springs Hospitality, Inc. | 121 SW Salmon Street. Corp | WTC Northwest | |
| 1 | Net Income or (Loss) per Oregon tax return | 150,000,000 | 5,000,000 | 155,000,000 | 1,000,000 | 500,000 | (3,000,000) | 2,000,000 | 155,500,000 |
| 2 | Multnomah County Business Income Tax addl | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 3 | Compensation of controlling shareholders | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 4 | Other additions and subtractions | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 5 | Adjusted Net Income (total lines 1,2,3 and 4) | 150,000,000 | 5,000,000 | 155,000,000 | 1,000,000 | 500,000 | (3,000,000) | 2,000,000 | 155,500,000 |
| 6 | Compensation allowance deduction | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 7 | Subject Net Income (line 5 minus line 6) | 150,000,000 | 5,000,000 | 155,000,000 | 1,000,000 | 500,000 | (3,000,000) | 2,000,000 | 155,500,000 |
| | Apportionment Calculation | | | | | | | | |
| 8 | County Gross Income | **900,000,000** | **10,000,000** | **910,000,000** | **100,000,000** | **1,500,000** | **5,000,000** | **0** | **1,016,500,000** |
| 8 | Total Gross Income | 2,000,000,000 | 12,000,000 | 2,012,000,000 | 100,000,000 | 1,500,000 | 5,000,000 | 0 | 2,118,500,000 |
| 8 | | 45.0000% | 83.3333% | 45.2286% | 100.0000% | 100.0000% | 100.0000% | 0.0000% | 47.9821% |
| 9 | County Apportioned Net Income (line 7 x line 8 | 67,500,000 | 4,166,665 | 70,104,330 | 1,000,000 | 500,000 | (3,000,000) | 0 | 74,612,166 |
| 10 | Net Operating Loss Deduction (max 75% of lir | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 11 | Income subject to tax (line 9 minus line 10) | 67,500,000 | 4,166,665 | 70,104,330 | 1,000,000 | 500,000 | (3,000,000) | 0 | 74,612,166 |
| 12 | Tax (line 11 x tax rate of 1.45%) | 978,750 | 60,417 | 1,016,513 | 14,500 | 7,250 | (43,500) | 0 | **1,081,876** |

Single Factor Apportionment Calculation for SB 408 Purposes

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| A | Numerator: Mult County Gross Income | 900,000,000 | 10,000,000 | | 100,000,000 | 1,500,000 | 5,000,000 | 0 | 1,016,500,000 |
| B | Denominator: Total Mult County Gross Inc. | 1,016,500,000 | 1,016,500,000 | | 1,016,500,000 | 1,016,500,000 | 1,016,500,000 | 1,016,500,000 | 1,016,500,000 |
| C= A/B | Multnomah County Gross Income % | 88.5% | 1.0% | | 9.8% | 0.1% | 0.5% | 0.0% | 100.0% |
| D | Consolidated Mult County Tax | 1,081,876 | 1,081,876 | | 1,081,876 | 1,081,876 | 1,081,876 | 1,081,876 | |
| C X D | **Apportioned Mult County Tax** | **957,884** | **10,643** | | **106,432** | **1,596** | **5,322** | **0** | **1,081,876** |

Green = Regulated Utility Stand-alone results.

Blue = Multnomah County Tax Return results.

Exhibit 3 - Page 3 of 3
PGE's Opening Comments on the
Interim Order and Draft Rules

## CERTIFICATE OF SERVICE

I hereby certify that on this day I served the foregoing **PORTLAND GENERAL ELECTRIC COMPANY'S OPENING COMMENTS ON THE INTERIM ORDER AND DRAFT RULES** by mailing a copy thereof in a sealed envelope, first-class postage prepaid, addressed to each party listed below, deposited in the U.S. Mail at Portland, Oregon.

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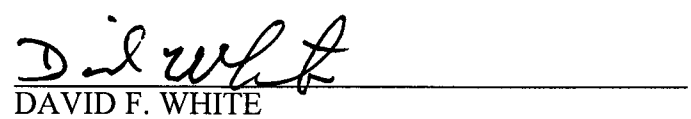

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