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VIA ELECTRONIC FILING

PUC Filing Center
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Re: Docket AR 499

Enclosed for filing in the above-referenced matter are PacifiCorp's Straw Proposals. A copy of this filing has been served on all parties to this proceeding as indicated on the attached certificate of service.

Very truly yours,



Katherine A. McDowell

KAM:knp
Enclosure
cc: Service List

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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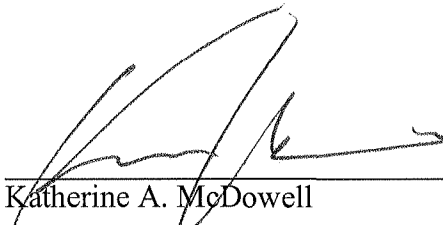
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AR 499 Straw Proposal on Properly Attributed *“With and Without”*

Concept Summary

The Commission should define “taxes paid that are properly attributed to the regulated operations of the public utility” as the portion of the affiliated group’s actual tax payments that “but for” the existence of the utility in the affiliated group, the affiliated group would not have incurred. The “With and Without” test identifies the actual tax payments of the affiliated group incurred solely *as a result of* the utility’s membership in the group. It does this by simply comparing the tax liability of the affiliated group, computed with the utility and without the utility, then capping this amount by the lesser of the taxes paid by the standalone utility and its affiliated group. By properly attributing to the utility no more taxes than the government receives, this “With and Without” measurement approach resolves the legislature’s concerns about the “Enron problem.” It also goes a step further by allocating to utility customers all verifiable tax benefits associated with the utility’s presence in the affiliated group.

Proposal Explanation

The “With and Without” approach is a fair, comprehensive and easy to administer method for determining the impact that an Oregon utility has on the tax liability of its affiliated group.

The “With and Without” approach is grounded in sound policy rationale. The fairest approach to determining the taxes paid that are properly attributable to the utility is to conduct a “but for” analysis to determine exactly what the utility contributes to the affiliated group’s tax assets and liabilities. By precisely quantifying and attributing this contribution, utility customers can be assured that they will receive a credit for all tax benefits that the utility provides to the affiliated group.

The “With and Without” approach is as inclusive as possible both in terms of tax benefits and affiliated companies considered. The attribution approach captures all tax benefits associated with filing a consolidated tax return, including asset gain and loss, percentage depletion, charitable contribution limitations, net operating losses, business tax credits, and AMT-related items such as accelerated depreciation. Additionally, the approach looks to the entire affiliated group, rather than a smaller sub-group, to avoid the potential for artificial increases or reductions in the attribution calculation.

While comprehensive, the approach is nevertheless simple to implement and audit because it relies upon the consolidated tax returns actually filed by the affiliated group for virtually all the data needed to conduct the attribution analysis. The “With and Without” approach can be applied by running a single set of calculations to remove the utility from the affiliated group’s consolidated return, a type of pro forma analysis commonly conducted among tax professionals and accountants.

Determining the “With and Without” Amount

The “With and Without” amount is measured by determining the arithmetic difference between: (1) the affiliated group’s tax liability computed with the utility included in the group and (2) the affiliated group’s tax liability computed without the utility included in the group. This tax difference is the “‘With and Without’ amount.” The “With and Without” amount is then compared to the section 3(12) “lesser of” amount—*i.e.*, the lesser of the utility’s standalone liability and the taxes paid by the affiliated group of which the utility is a part. Whichever is the lower amount (*i.e.*, the “With and Without” or the “lesser of” amount) constitutes “the amount of taxes that are properly attributed to the utility.”

Applied in this way, the “With and Without” test can only reduce the amount of taxes that are taken as taxes properly attributed to the utility and cannot ever result in rates being adjusted to a higher level than they would have been if the “With and Without” test had not been applied.

Application to SB 408 Automatic Adjustment Clause

The “With and Without” test is applied to determine the amount of the rate adjustment through the following steps:

- 1) Calculate the affiliated group tax liability. Assume this is \$500 million.
- 2) Calculate what the affiliated group tax liability would be if it did not have the utility as part of the group. Assume in this example that the affiliated group tax liability would be \$420 million without the utility.
- 3) Subtract the affiliated group tax liability without the utility (\$420 million) from the affiliated group tax liability with the utility (\$500 million) to get the “With and Without” tax difference (*i.e.*, $\$500 - \$420 = \$80$ million).¹
- 4) Calculate the utility standalone tax liability. Assume this is \$110 million.
- 5) Calculate the § 3(12) “lesser of” amount by determining the lesser of standalone tax liability (\$110 million) and affiliated group tax (\$500 million). The lesser of amount is therefore \$110 million.
- 6) Compare the “With and Without” tax difference (\$80 million) from Step (3) with the lesser of amount (\$110 million) from Step (5), and take the lower amount (\$80 million) as taxes paid that are *properly attributed to the regulated operations of the utility*.
- 7) Compute the amount of the rate adjustment as follows:
 - a) Adjust the taxes paid that are properly attributed to the regulated operations of the utility as required by SB 408 § 3(13) (d) and (f).²
 - b) Calculate taxes collected in rates. Assume this is \$100 million.
 - c) Determine the amount of the potential rate adjustment by subtracting the taxes paid that are properly attributed amount from taxes collected in rates (*i.e.*, $\$80 - \$100 = (\$20 \text{ million})$).
 - d) Apply the earnings test contained in PacifiCorp’s SB 408 automatic adjustment clause tariff. Based on the utility’s most recent semi-annual report, determine whether the potential sur-charge or sur-credit (in this case a \$20 million sur-charge) would cause the Company’s earned return on equity to exceed or fall below authorized levels. Reduce the amount of the sur-charge or sur-credit to the extent necessary to avoid over- or under-earning.

¹ There are various reasons why this figure would be different from the utility standalone tax liability—*e.g.*, affiliated tax losses that could only be offset by the utility’s taxable income, impact of alternative minimum taxes, general business tax credits, etc.

² SB 408 § 3(13)(d) requires taxes paid to be net of tax settlement payments and refunds plus interest. SB 408 § 3(13)(f) requires taxes paid to be increased by the amount of charitable contributions, tax credits and deferred taxes. For simplicity, the determinations herein assume no adjustments under SB 408 § 3(13)(d) or (f).

Further Examples

The two scenarios developed by the participants of the March 17 workshop do not contain sufficient data to determine the “With and Without” amount. PacifiCorp therefore provides the following 4 hypothetical examples (Scenarios A-D) to illustrate the “With and Without” test.

Determining the With and Without Amount of Taxes	A	B	C	D
Affiliated group tax liability \$ million	500	120	500	500
Group tax without utility \$ million	400	30	395	395
“With and Without” tax difference \$ million (1)	100	90	105	105

Determining Section 3(12) Lesser of Amount	A	B	C	D
Utility standalone tax liability \$ million	110	130	120	100
Affiliated group tax liability \$ million	500	120	500	500
Lesser of Amount \$ million (2)	110	120	120	100

Determining Rate Adjustment	A	B	C	D
Properly Attributed taxes \$ million = lower of (1) and (2)	100	90	105	100
Taxes collected in rates \$ million	100	100	100	100
Earning above/(below) authorized ROE	(15)	3	(4)	(15)
Rate reduction required	No	Yes	No	No
Rate increase required	No	No	Yes	No
“With and Without” benefit to customers	Yes	Yes	Yes	Neutral
Rate adjustment	0	(3)	4	0

- Scenario A** – The § 3(12) “lesser of” amount of taxes was \$110 million, indicating a \$10 million rate increase is required. However, the difference between the affiliated group tax “With and Without” the utility is only \$100 million (*i.e.*, \$500 million – \$400 million). Thus, the properly attributed taxes paid are \$100 million. Because this is the same as the taxes collected in rates, there would be no rate increase or reduction. Because no rate adjustment is contemplated, the fact that the utility is under-earning does not change the outcome that no sur-charge or sur-credit is required.
- Scenario B** – The § 3(12) “lesser of” amount of taxes was \$120 million, indicating a \$20 million rate increase is required. However, the “With and Without” amount is only \$90 million (*i.e.*, \$120 million- 30 million). Thus, even though the § 3(12) “lesser of” amount suggests an increase in rates, the “With and Without” computation amount results in a potential rate reduction of \$10 million. Under the earnings test contained in PacifiCorp’s SB 408 automatic adjustment clause tariff, the SB 408 sur-credit is then adjusted to \$3 million to avoid causing the utility to earn below its authorized rate of return.
- Scenario C** – The § 3(12) “lesser of” amount of taxes was \$120 million, indicating a \$20 million rate increase is required. However, the “With and Without” amount is only \$105 million (*i.e.*, \$500 million– \$395 million). Thus, the potential rate increase is only \$5 million and the “With and Without” method saves customers \$15 million. Under the earnings test contained in PacifiCorp’s SB 408 automatic adjustment clause tariff, the SB 408 sur-charge is then adjusted to \$4 million to avoid causing the utility to earn above its authorized rate of return.
- Scenario D** – The § 3(12) “lesser of” amount of taxes was \$100 million, indicating that no rate adjustment is required. However, the “With and Without” amount is \$105 million (*i.e.*, \$500 million- \$395 million). Although the “With and Without” test produced a higher figure, the taxes that are properly attributed to the utility are capped by the “lesser of” amount (*i.e.*, \$100 million), and no rate increase is required. Because no rate adjustment is contemplated, the fact that the utility is under-earning does change the outcome that no sur-charge or sur-credit is required.

AR 499 Straw Proposal on Properly Attributed “Lesser-Of Attribution”

Concept Summary

In applying SB 408, the Commission should define “taxes paid that are properly attributed to the regulated operations of the public utility” as the lesser of the standalone tax liability resulting from Oregon regulated operations and the amount of taxes paid to the government by the utility or its affiliated group. This straightforward approach departs from past regulatory practice and clearly responds to the legislative intent in SB 408 to solve the “Enron problem.”

Proposal Explanation

The Lesser-Of Attribution approach ensures that tax costs collected in rates are paid to units of government, comports with the “properly attributed” definition in section (3)(12), and avoids cross-subsidization between regulated and unregulated activities when the affiliated group’s tax expense is equal to or greater than the standalone tax liability resulting from Oregon regulated operations. The Lesser-Of Attribution approach achieves these goals by:

- 1) Attributing to the Oregon-regulated utility operations the tax liability that the utility would have if it were not affiliated with any other entities or unregulated utility operations—in other words, the tax liability that is solely caused by and arises from the utility’s regulated activities; and,
- 2) Looking to the amount of taxes paid to governments by the utility or its affiliated group as the upper limit of the properly attributed amounts measured in step (1).

Thus, the Lesser-Of approach provides an opportunity for Oregon customers to benefit from a rate reduction when the affiliated tax payment is less than the standalone tax liability of the Oregon utility’s regulated operations.

Application to SB 408 Automatic Adjustment Clause

The methodology proposed here is easily illustrated with the following examples from Staff’s August 12, 2005 letter to Oregon utilities.

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

The Lesser-Of Attribution approach is applied through the following steps:

- 1) Calculate the utility standalone tax liability. For Utilities A, B, and C, that amount is \$130.
- 2) Calculate the affiliated group tax liability. For Utility A, that amount is \$200; for Utility B, it is \$100; and for Utility C, it is \$50.
- 3) Taxes paid that are properly attributed are the lesser of standalone tax liability and affiliated group tax liability. For Utility A, that amount is \$130; for Utility B, it is \$100; and for Utility C, it is \$50.
- 4) Compute the amount of the rate adjustment as follows:
 - a) Adjust the taxes paid that are properly attributed amount as required by SB 408 § 3(13)(d) and (f).¹

¹ SB 408 § 3(13)(d) requires taxes paid to be net of tax settlement payments and refunds plus interest. SB 408 § 3(13)(f) requires taxes paid to be increased by the amount of charitable contributions, tax credits and deferred taxes. For simplicity, the determinations herein assume no adjustments under SB 408 § 3(13)(d) or (f).

- b) Determine the amount of the potential rate adjustment by subtracting the taxes paid that are properly attributed amount from taxes collected in rates.
- c) Apply the earnings test contained in PacifiCorp's SB 408 automatic adjustment clause tariff. Based on the utility's most recent semi-annual report, determine whether the potential sur-charge or sur-credit would cause the Company's earned return on equity to exceed or fall below authorized levels. Reduce the amount of the sur-charge or sur-credit to the extent necessary to avoid over- or under-earning.

Further Examples – The two scenarios developed by the participants of the March 17 workshop are relatively complex, but the Lesser-Of Attribution approach proposed here can easily be applied to them. The scenarios are presented in the table below.

	Lesser-Of Tax Liability \$ million	
	Scenario A	Scenario B
Parent of Affiliated Group	0	0
Various Parent Affiliates	0	0
Intermediate Parent	0	0
Oregon Utility Acquisition Parent	80	(80)
Oregon Utility Regulated Activity	100	100
Unregulated Activity	-	-
Sub 1	50	50
Sub 2	50	(50)
Sub 3	(50)	(50)
<i>Oregon Utility subtotal</i>	<i>230</i>	<i>(30)</i>
Non-regulated Affiliates	-	-
Affiliate A	(60)	(60)
Affiliate B	60	(60)
Sub 1	(30)	(30)
Sub 2	30	30
Affiliate C	60	60
<i>Non-reg. Affiliates subtotal</i>	<i>60</i>	<i>(60)</i>
Non-Oregon Utilities	-	-
Utility D Acquisition Parent	20	(20)
Utility D	70	70
Utility E	(70)	(70)
<i>Non-Oregon Utilities subtotal</i>	<i>20</i>	<i>(20)</i>
Total of all entities	310	(110)

To compute taxes *properly attributed to the regulated operations of the utility*, the table can be collapsed to the two bold lines—which show the standalone tax liability of the Oregon utility and the sum of the standalone tax liabilities of all members of the affiliated group. Assuming the sum of the standalone tax liabilities of all members of the affiliated group equals the tax payment of the affiliated group, the Lesser-Of Attribution approach would simply attribute \$100 to the regulated operations of the Oregon utility in Scenario A and \$0 in Scenario B.

Using the Lesser-Of Attribution approach to determine taxes *properly attributed to the regulated operations of the utility* in Scenarios A-D presented in PacifiCorp’s “With and Without” Straw Proposal produces the following results:

Example	A	B	C	D
Taxes collected in rates \$ million	100	100	100	100
Utility standalone tax liability \$ million	110	130	120	100
Affiliated group tax liability \$million	500	120	500	500
Properly attributed taxes \$ million	110	120	120	100
Earning above/(below) authorized ROE	(15)	3	(4)	(15)
Rate reduction required	No	No	No	No
Rate increase required	Yes	No	Yes	No
Rate adjustment	10	0	4	0

- **Scenario A** – The properly attributed amount is \$110 million, indicating a \$10 million rate increase is required. As the utility is under-earning its authorized rate of return by greater than \$10 million, the adjustment would not cause the utility to over- or under-earn. Thus, under the Lesser-Of Attribution approach, the adjustment would be a \$10 million rate increase.
- **Scenario B** – The properly attributed amount is \$120 million, indicating a \$20 million rate increase is required. However, the utility is already earning above its authorized rate of return. Thus, under the Lesser-Of Attribution approach applied with the earnings test contained in PacifiCorp’s SB 408 automatic adjustment clause tariff, there would be no adjustment.
- **Scenario C** – The properly attributed amount is \$120 million, indicating a \$20 million rate increase is required. However, a \$20 million rate increase would cause the utility to earn \$16 million above its authorized rate of return. Thus, under the Lesser-Of Attribution approach applied with the earnings test contained in PacifiCorp’s SB 408 automatic adjustment clause tariff, the adjustment would be only a \$4 million rate increase.
- **Scenario D** – The properly attributed amount is \$100 million. This is the same as the taxes collected. Thus, no rate adjustment is required. Because no rate adjustment is contemplated, the fact that the utility is under-earning does not change the outcome that no sur-charge or sur-credit is required.