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April 11, 2006

***Via Electronic and U.S. Mail***

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

Re: In the Matter of the Adoption of Permanent Rules Implementing SB 408  
Relating to Matching Utility Taxes Paid with Taxes Collected  
**Docket No. AR 499**

Dear Filing Center:

Enclosed please find an original and two (2) copies of the Straw Proposal of the Industrial Customers of Northwest Utilities and Northwest Industrial Gas Users in the above-captioned Docket.

Please return one file-stamped copy of the document in the self-addressed, stamped envelope provided. Thank you for your assistance.

Sincerely yours,

/s/ Anna E. Studenny  
Anna E. Studenny

Enclosures

cc: Service List

## **CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that I have this day served a copy of the foregoing Straw Proposal of the Industrial Customers of Northwest Utilities and the Northwest Industrial Gas Users, upon the parties, on the official service list for AR 499, by causing the same to be electronically served, to those parties with an email address, as well as mailed, postage-prepaid, through the U.S. Mail.

Dated at Portland, Oregon, this 11th day of April, 2006.

/s/ Anna E. Studenny  
Anna E. Studenny

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**BEFORE THE PUBLIC UTILITY COMMISSION  
OF OREGON**

**AR 499**

	)	
In the Matter of the Adoption of Permanent	)	STRAW PROPOSAL OF THE INDUSTRIAL
Rules Implementing SB 408 Relating to	)	CUSTOMERS OF NORTHWEST UTILITIES
Utility Taxes.	)	AND NORTHWEST INDUSTRIAL GAS
_____	)	USERS

**A. Summary of Proposal**

Industrial Customers of Northwest Utilities (“ICNU”) and Northwest Industrial Gas Users (“NWIGU”) propose that the Public Utility Commission of Oregon (“OPUC” or the “Commission”) determine the amount of “taxes paid” that is properly attributed to the regulated operations of the utility by implementing the §§ 3(12)(a) and (b) caps and by applying the “proportionate share” attribution methodology to the consolidated tax group.

**B. Detailed Explanation of Proposal**

SB 408 requires that the Commission determine the total “taxes paid” to units of government that is “properly attributed to the regulated operations of the utility.” The Commission rules implementing SB 408 should reflect both a legally correct interpretation and sound policy that effectuates the legislature’s intent. ICNU and NWIGU continue to believe that the Commission’s temporary rule applied the legally correct interpretation of “properly attributed” by allocating to the utility and each affiliate its proportionate share of “taxes paid” in a consistent manner. As a compromise, however, ICNU and NWIGU propose to apply the “proportionate share” attribution method to a sub-group of the entire corporate family. This method is described in more detail below.

The taxes paid properly attributed to the utility is the lesser of the following three amounts:

**1. Section 3(12)(b) Cap**

Section 3(12)(b) provides that the taxes paid properly attributed to the utility may not exceed the taxes actually paid by the “parent of the consolidated group” filing the tax return. If the parent of the consolidated group pays little or no tax due to losses incurred in unregulated businesses, then the taxes paid properly attributed to the utility cannot exceed this amount.

Section 3(12)(b) addresses the “Enron problem,” but also stands for the general legislative principle that losses incurred by unregulated affiliates will be considered in determining the amount of taxes paid that are properly attributed to the utility.

## **2. Section 3(12)(a) Cap**

Section 3(12)(a) provides that the taxes paid properly attributed to the utility cannot exceed “that portion of total taxes paid that is incurred as a result of income generated by the regulated operations of the utility.” This cap is the amount of taxes paid by the parent of the consolidated group that are supported by income collected by the utility. This includes the taxes on “stand-alone” regulated utility operations of the Oregon utility plus any tax liabilities or credits supported, directly or indirectly, by the utility’s regulated revenues. For example, this would include:

- a) Interest payments on debt held by an affiliate/parent when the payments are supported by utility revenues; and
- b) Income tax credits on generating resources held by an affiliate when the generation costs are supported by a power sale to the utility;

but would exclude tax credits of the utility that are not supported by the utility’s regulated revenues (e.g. Bank Tax Credit tax credits from shareholder investments).

While this debt and these utility functions have been outsourced from the utility to an affiliate, they remain supported by utility revenues and, thus, the tax benefits belong to the utility and to ratepayers. The §3(12)(a) cap will require identification of such transactions or financial arrangements between the utility and any affiliate. With regard to transactions, the Commission must determine whether the price charged by the affiliate includes the associated income tax benefits; this should be addressed case-by-case when the transaction is reviewed, but there should be a presumption that tax benefits are not included when the affiliate has a net tax loss.

In the case of a parent with multiple subsidiaries supporting the parent’s debt, the interest needs to be allocated, e.g. based on net income (the utility’s share of the parent’s interest deduction is the utility’s net income divided by the net income of all subsidiaries of the parent.)

## **3. Sections 3(6) and (7)**

Option A: Sections 3(6) and (7) require total taxes paid to be allocated among the utility and each affiliate in a manner that treats the utility and an affiliate with the same income/tax circumstances consistently. This is achieved by a proportionate share methodology applied to the entire corporate family, as set forth in the temporary rule.

Option B: As a compromise, we propose to determine taxes paid properly attributed to the utility by applying the proportionate share method to a sub-group of the corporate family. The sub-group is determined as follows:

- a) All subsidiaries of the utility are included.
- b) All “sister” affiliates of the utility (any affiliate that shares the same immediate parent with the utility) are included.

- c) All affiliates that have a nexus with the utility are included. A nexus includes:
- i. All affiliates that buy or sell services or products to the utility, directly or indirectly.
- Exceptions:
- Total annual value of the affiliated transaction is less than \$100,000.
  - The service or product sold by the affiliate is purchased by the utility at a price subject to rate regulation by FERC (not a market-based rate), the price is regulated, and the service and price is generally available (not a special contract or a tariff of limited applicability).
  - Service agreements that are subject to a cap approved by the OPUC.
- ii. The immediate parent of the utility and all affiliates that have debt supported by utility revenues, directly or indirectly.
- d) All affiliates upstream from the utility and all affiliates identified in subpart (c) up to and including the common parent of the utility and such affiliates.

The method for determining taxes paid properly attributed to the utility is as follows:

Total taxes paid is determined as if the sub-group was separated from the rest of the holding company, i.e., the last common parent is assumed to file and pay on a consolidated basis. This surrogate total taxes paid is allocated among all affiliates, including the utility, within the sub-group with positive net taxable income, as in the temporary rule, to determine taxes paid properly attributed to the utility.

An example of ICNU's and NWIGU's proposal is attached.



Dated this 11th day of April, 2006.

Respectfully submitted,

/s/ Matthew Perkins

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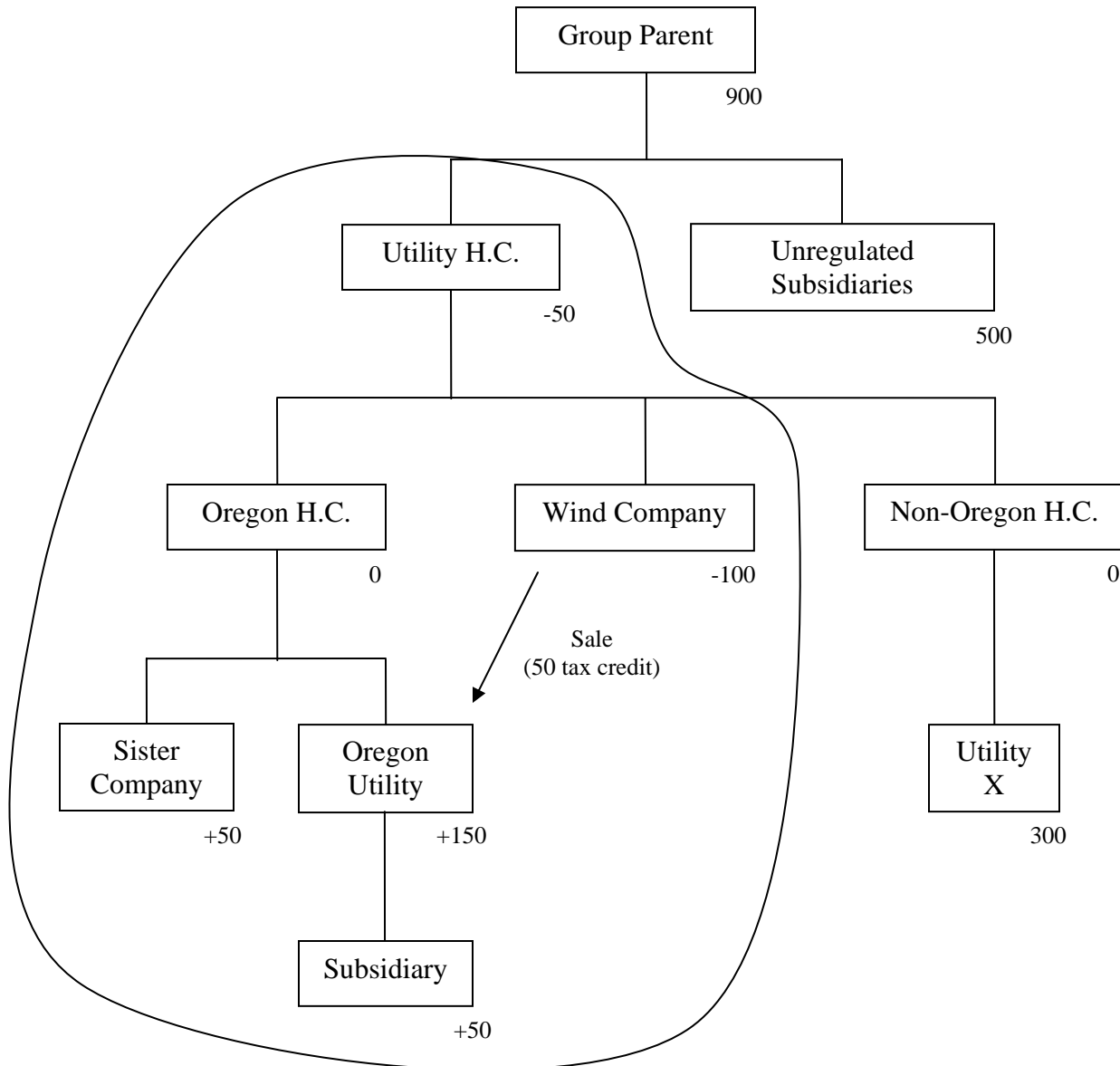
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**Example 1 – Industrial Customers of Northwest Utilities and  
Northwest Industrial Gas Users’ Straw Proposal**



The numbers represent “stand-alone” tax. The Utility Holding Company has debt supported by income from the Utility and Wind Operating Companies and this debt produces an interest deduction of \$50. The Wind Company makes a power sale to the Oregon Utility and the price does not include a \$50 tax credit associated with the resource.

**Example 1 – Industrial Customers of Northwest Utilities and  
Northwest Industrial Gas Users’ Straw Proposal**

**Calculation of the §§ 3(12)(b), 3(12)(a) and 3(6) & (7) Amounts**

- a.     3(12)(b):     The Group Parent pays taxes of \$900.
- b.     3(12)(a):      $\$150 - \$50 + [-50 \times \frac{150}{(300 + 250 - 100)}] = \$83$

The Oregon Utility “stand-alone” is \$150. This is reduced by the tax credit on the wind power sale and the \$50 interest deduction by Utility H.C. times the ratio of the Oregon Utility stand-alone to the sum of (a) Oregon Utility, Subsidiary, Sister Company, (b) Utility X, and (c) Wind Company stand-alone amounts. This determines the Oregon Utility’s share of the \$50 interest tax deduction. (Uses stand-alone tax ratio as a surrogate for net income ratio.)

- c.     3(6) & (7):      $\$150 + 50 + 50 + 0 - 50 - 100 \times [\frac{150}{(150 + 50 + 50)}] = \$60$

Total taxes paid by the Utility H.C. for the sub-group is the sum of the stand-alone tax liabilities of the Oregon Utility, Subsidiary, Sister Company, Oregon H.C., Utility H.C., and Wind Company. This is multiplied by the ratio of the stand-alone taxes of the Oregon Utility to the sum of the stand-alone taxes of all affiliates within the sub-group with positive tax liability.

The taxes paid properly attributed to the Utility is the lesser of these three amounts, which is \$60.