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Inara K. Scott
Assistant General Counsel

April 11, 2006

Via Electronic Filing and U.S. Mail

Oregon Public Utility Commission
Attention: Filing Center
PO Box 2148
Salem OR 97308-2148

Re: In the Matter of the Adoption of Permanent Rules to Implement SB 408, Relating to Matching Utility Taxes Paid with Taxes Collected
OPUC Docket No. AR 499
Letter to ALJ Logan of Portland General Electric Company

Attention Filing Center:

Enclosed for filing in the above-captioned docket is Portland General Electric's Letter to ALJ Logan. This document is being filed by electronic mail with the Filing Center.

An extra copy of this cover letter is enclosed. Please date stamp the extra copy and return it to me in the envelope provided.

Thank you in advance for your assistance.

Sincerely,

/s/ INARA K. SCOTT
Inara K. Scott

cc: AR 499 Service List

Enclosure

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the foregoing LETTER TO ALJ LOGAN AND STRAW PROPOSALS OF PORTLAND GENERAL ELECTRIC COMPANY to be served by First Class US Mail, postage prepaid and properly addressed, and by electronic mail, upon each party on the attached service list.

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

/s/ INARA K. SCOTT
Inara K. Scott

AR 499
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Inara K. Scott
Assistant General Counsel

April 11, 2006

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Kathryn A. Logan
Administrative Law Judge
Oregon Public Utility Commission
PO Box 2148
Salem OR 97308-2148

Re: In the Matter of the Adoption of Permanent Rules to Implement SB 408, Relating to Matching Utility Taxes Paid with Taxes Collected
OPUC Docket No. AR 499
Straw Proposals of Portland General Electric Company

Dear Judge Logan:

Enclosed are several "straw proposals" PGE is filing to further the development of the rules for the implementation of Senate Bill 408 (SB 408). These straw proposals are not centered around the term "properly attributed." However, because so many portions of the bill interrelate, and because PGE believes it is crucial for the Oregon Public Utility Commission (Commission) to understand that significant issues related to stand-alone utilities remain to be addressed in the implementation of SB 408, regardless of the interpretation of "properly attributed," we are filing these proposals now.

PGE has not offered a specific proposal for the definition of the term "properly attributed" because PGE understands that other proposals will be offered to Commission. PGE looks forward to working with the other parties in docket AR 499 to develop fair and reasonable rules for the interpretation of this key aspect of SB 408.

These proposals represent suggestions for the development of reasonable rules for the implementation of Senate Bill 408. However, PGE does not hereby represent that the enactment of any one or even all of these proposals would ensure that the rules established in AR 499 will be just, reasonable, fair, or constitutionally permissible, either on their face or as applied.

Sincerely,

/s/ INARA K. SCOTT
Inara K. Scott

IKS:am

cc: AR 499 Service List

PUBLIC UTILITY COMMISSION OF OREGON

Docket No. AR 499

STRAW PROPOSALS OF PORTLAND GENERAL ELECTRIC
April 11, 2006

1. **Calculating the amount of taxes charged to customers by actual net to gross ratios**.

   a. **Proposed rule language**:

   Taxes Charged for a given period is the product of multiplying the following three factors:

   1. The revenues the utility collects from customers in Oregon, excluding any revenues from supplemental adjustments or other revenue amounts the Commission finds inappropriate for the calculation of Taxes Charged.

   2. The utility's actual ratio of the net revenues from regulated operation of the utility to gross revenues from regulated operations of the utility, calculated by reference to the Company's FERC Form 1 data for that period.

   3. The utility's actual effective tax rate, calculated by reference to the utility's FERC Form 1 data for that period.

   b. **Related sections of bill**: 3(6) (automatic adjustment clause)

   c. **Brief description**: This proposal would calculate an amount for "taxes charged" to customers that incorporates both the amount of "taxes authorized to be collected" per Commission rate setting and variances from that amount caused by tax effect of utility's actual financial results.

   d. **Brief rationale**: Under the plain language of the statute, the automatic adjustment clause "shall account for all taxes paid to units of government…and all taxes that are authorized to be collected through rates, so that *ratepayers are not charged* for more tax than…the utility pays to units of government." 3(6) (emphasis added). The bill does not define the calculation of taxes charged to ratepayers. This proposal works within the language of the bill to reach a fair result that calculates the amount of *taxes charged* by the utility by reference to actual utility results. This proposal would not have an effect on the calculation of "taxes paid and properly attributed" – it simply acknowledges that amounts calculated solely by reference to the utility's test year are not representative of the utility's actual results.

   e. **Consequences**: This proposal would eliminate surcharges and collections from customers that result solely from variances from the utility's actual net to gross ratio and forecasted net to gross ratio. This proposal does not alter the impact of the "properly attributed" calculation. The primary impact of the proposal would be to mitigate the wide variances in rates that would otherwise result from the interpretation of "taxes authorized to be collected," which appear to be an unintended consequence of SB 408's definition of "taxes authorized to be collected."

2. Calculate net to gross ratios by reference to the utility's most recent rate decisions.

a. **Proposed Rule Language**:

In calculating the utility's ratio of the net revenues from regulated operation of the utility to gross revenues from regulated operations of the utility, the utility shall use data from the utility's general rate case that set rates for the period adjusted by any changes in gross revenues resulting from subsequent commission-approved changes in rates effective during the period.

b. **Related section of bill**: 3(13)(e)(B): "The ratio of the net revenues from regulated operations of the utility to gross revenues from regulated operations of the utility, as determined by the commission in establishing rates."

c. **Brief description**: This proposal includes all of the commission's rate proceedings affecting the utility's net to gross ratio in the calculation of the utility's net to gross ratio for purposes of calculating "taxes authorized to be collected" or "taxes charged" (per PGE Proposal #1).

d. **Brief rationale**: From time to time the Commission resets certain portions of the utility's rates outside of a general rate case. These proceedings do establish rates and they alter the amount of the utility's authorized revenue requirement, which in turn affects the utility's authorized net to gross ratio. If the net to gross ratio does not reflect these adjustments, it will not accurately reflect the utility's authorized rate structure.

e. **Consequences**: If this proposal is not implemented, and the net to gross ratio is calculated solely by reference to the utility's last general rate case, revenues authorized by the Commission for collection that are not intended to have a tax component will be imputed a tax component in the calculation of "taxes authorized to be collected" or "taxes charged."

For example, where the utility is authorized in a rate proceeding like PGE's RVM to collect $50 million in additional revenue solely to cover power costs, use of a fixed ratio from the previous general rate case would impute a portion of that revenue to taxes, allowing the utility to collect less than the full amount for power costs. Such a rate adjustment would be *per se* unreasonable, where the Commission has already designated recovery of $50 million as necessary for the recovery of just and reasonable rates. Alternatively, if a fixed ratio from the previous rate case is used in calculating "taxes authorized to be collected," it would be necessary to "gross-up" adjustments such as the RVM in order to provide net recovery of authorized expenses.

3. Exclusion of revenues from supplemental schedules

a. Proposed rule language:

Revenues: For purposes of 3(13)(e)(A) revenues means revenues from those rate schedules (or successor rate schedules) that were used to produce the utility's revenue requirement in its general rate case that set rates for the period.

b. **Related section of bill**: 3(13)(e)(A) ("revenues the utility collects from ratepayers in Oregon…")

c. **Brief description of proposal**: The proposal eliminates from the definition of revenue those from supplemental schedules that have no income tax component.

d. **Brief rationale**: Supplemental schedules for which the Commission has specifically authorized recovery in a rate proceeding, such as BPA credits or a PCA, do not have an income tax component. In these cases, the Commission has authorized a level of recovery for the utility that simply allows the utility to recover the cost incurred; i.e., there is no margin (and therefore no tax expense) imputed in the calculation of the authorized amount of recovery.

The same type of revenues should be considered in the calculation of the utility's revenue under 3(13)(e)(A) and net revenues and gross revenues under 3(13)(e)(B). Revenues that are not included in the net to gross calculation do not have a tax component and for the same reason noted in Proposal 2 it would be unreasonable to impute a tax component to those revenues for purposes of calculating the amount of "taxes authorized to be collected." Moreover, it is simply logical that the legislature only intended to include in the definition of revenues those revenues that have a margin and an income tax component.

e. **Consequences and Example**: If this proposal is not enacted, the utility will not be able to recover its costs at the level authorized by the Commission.

For example, presently, under the supplemental BPA credit schedule, if the utility receives $20 million in credits from BPA, it passes through $20 million of credits to customers. The $20 million from BPA would not be recognized in the utility revenues, but the $20 million credited to customers would reduce the utility's retail revenues. Thus if this proposal is not enacted, the utility revenues used to calculate "taxes authorized to be collected" would be reduced by $20 million. This would result in a charge to customers based on a nonexistent tax difference.

4. **Use of deferred accounting to capture tax effects of disallowed expenses:**

    a. **Proposed rule language:** A deferral account would be set up each year and would account for tax benefits related to disallowed expenses and investments, or investments that have not been included in rates. If an adjustment under SB 408 credits utility customers for these tax benefits, the deferral would operate in the opposite manner to return that credit to the utility.

    b. **Related sections of the bill:** 3(6); 3(13)(e), (f).

    c. **Brief description:** This proposal would return to the utility the tax effect of certain cost variances that should not trigger a rate action under the bill because the costs were not included in rates. These cost variances can be divided into three categories: 1) disallowed utility investments; 2) disallowed expenditures; and 3) investments not included in rates.

    d. **Brief rationale:** When a cost item is disallowed or never included in rates, customers do not pay the cost of the item. It would be inappropriate to then give customers a benefit related to the disallowed item or item not in rates. This proposal addresses a significant unintended consequence of the bill – utility customers receive a benefit from costs that they do not bear and that are not included in rates, and utilities are required to credit amounts to customers related to an item for which the utility has received no cost recovery.

    e. **Consequences and Example:** Imagine a utility purchases an asset for $10,000,000. The investment is not included in rates. Sometime after purchase the asset is deemed worthless or inoperable, and the utility is required to write off its value on its books. Because the asset has not been sold, a tax deduction may not be claimed on its tax return, but the book-tax difference causes the utility to establish a deferred tax asset of (assuming 40% tax rate) $4,000,000. In a subsequent year the utility disposes of the asset. The utility's tax payments to governmental units are reduced by $4,000,000 at date of disposal. If this asset had been related to the regulated operations of the utility, the deferred tax adjustment under 3(13)(f)(C) would offset the reduction in "taxes paid" by a corresponding increase in "taxes authorized to be collected," and there would be no net adjustment to customers under SB 408. However, because the deferred tax adjustment was not included in rates and therefore appears unrelated to the utility's regulated operations, it would not offset the $4,000,000 reduction in "taxes paid." Therefore, utility customers would receive a refund of this amount despite the fact that they have borne none the cost of the investment and that neither the cost of the item or the tax benefit was included in the utility's last general rate case.

        This situation can be remedied simply by using a deferral to track deferred tax adjustments related to non-regulated subsidiaries and return those tax adjustment to the utility if credited to customers through the operation of an automatic adjustment clause under SB 408.

5. **Eliminating the iterative effect**

   a. **Proposed rule language:**

      For purposes of section 3(13)(f)(C), deferred taxes related to the regulated operations of the utility does not include deferred tax items related to adjustments under section 3(6).

   b. **Related sections of the bill:** 3(13)(f)

   c. **Brief description:** This proposal would eliminate from the calculation of "taxes paid" deferred tax items related to an adjustment under SB 408.

   d. **Brief rationale:** The definition of "taxes authorized to be collected" (Section 3(13)(e)(A)) eliminates from revenues rate adjustments imposed under Section 3(6). However, the definition of "taxes paid" does not explicitly address the tax effects of adjustments made under Section 3(6). As a result, when the utility books an adjustment, it will have to recognize a tax effect as a basis of that adjustment. That tax effect will flow through the calculation of "taxes paid," necessitating another adjustment, which will create another tax effect, and so on. This iterative cycle will repeat until the adjustment is small enough not to lead to another tax effect (which may take many iterations). This appears to have been an unintended consequence of the bill. It is simply illogical to make rate adjustments based on previous rate adjustments.

   e. **Consequences:** If left in place, the iterative effect will substantially increase the amount of the adjustment. Allowing the iterative effect to take place is similar to "grossing up" the amount of the adjustment (see Proposal 6, below). This unintended consequence results in customers paying an amount that varies substantially from the amount of taxes the utility actually paid.

6. **Grossing up adjustments under SB 408**

   a. **Proposed rule language:** None is necessary. Follows plain language of the bill.

   b. **Related sections of the bill:** 3(6)

   c. **Brief description:** This proposal requires no action – it simply notes that adjustments calculated under Section 3(6) as the difference between "taxes authorized to be collected" and "taxes paid" should not be grossed up for their tax effect.

   d. **Brief rationale:** In a prospective ratemaking setting, adjustments to the utility's revenue requirement are grossed up to account for their tax effect. This prompted many to wonder if adjustments under SB 408 should be grossed up as well. This proposal recognizes that adjustments under SB 408 are very different from a prospective rate setting process. SB 408 adjustments represent a flat amount that is intended to "true up" the difference between amounts charged to ratepayers and amounts collected. There is simply no indication in the language of the bill or in the nature of the adjustment that would justify increasing the size of the adjustment.

   e. **Consequences and Example:** Imagine the utility is "properly attributed" a tax loss from an affiliated entity in the amount of $10M. If grossed up, the utility would be responsible for refunding $14M to customers, even though only $10M was actually properly attributable.

      In a year in which the adjustment is a charge to customers, grossing up the adjustment appears to violate the language in Section 3(6), which states that ratepayers should not be charged for "more tax than…the utility pays." Consider the following example:

Taxes paid	**12**
Taxes authorized to be collected:	**10**
Adjustment (charge to customers)	**2**
Adjustment grossed up	**3.6**
Total charged to customers (10 + 3.6) = 13.6	

7. Earnings Test

a. Proposed Rule Language: In applying the automatic adjustment clause, the Commission will administer an earnings test to determine if any resulting surcharge or refund is reasonable. The earnings test will generally conform to standards required of utilities for filing their Results of Operations reports with the Commission. However, actual stand-alone utility financial results for the regulated operations of Oregon will be adjusted by replacing the utility's stand-alone Oregon regulated income tax expense with "taxes paid that are properly attributable to the regulated Oregon operations of the utility." Surcharges or refunds will be limited by the earnings test as follows:

1. Surcharges are limited to those amounts that result in the utility earning no greater than its authorized return on equity as determined by the Commission in the last general rate case proceeding.
2. Refunds are limited to those amounts that result in the utility earning no less than its authorized return on equity as determined by the Commission in the last general rate case proceeding.

b. Related sections of bill: 3(6) (automatic adjustment clause)

c. **Brief description:** An earnings test would be used to evaluate the reasonableness of adjustments calculated under the automatic adjustment clause. The earnings test would replace the utility's actual stand-alone Oregon income tax expense with the amount of "taxes paid that are properly attributable to the regulated Oregon operations of the utility" calculated as part of the automatic adjustment clause. All other aspects of the earnings test would generally conform to the approach used by utilities to develop their Results of Operations reports, including the application of previous rate making decisions from the last applicable general rate case Order of the Commission.

Surcharges resulting from the application of SB 408 will be limited to those collections that result in the utility earning no more than its authorized return on equity from the last applicable general rate case Order of the Commission.

Refunds resulting from the application of SB 408 will be limited to those refunds that result in the utility earning no less than its authorized return on equity from the last applicable general rate case Order of the Commission.

d. Brief Rationale: While an earnings test is not explicitly prescribed by SB 408, the Commission has a responsibility to produce rates that are fair, just and reasonable (ORS 756.040; 757.210). In fact, amendments to ORS 757.210 included in Senate Bill 408 prohibit the Commission from setting a rate that is not just and reasonable. An earnings test would ensure that the operation of the automatic adjustment clause neither unreasonably harms the utility nor

unreasonably harms customers. An earnings test is also a common element used in the application of other automatic adjustment clauses administered by the Commission. By requiring that the utility replace its stand-alone Oregon regulated income tax expense with the "taxes paid" amount, the application of the earnings test is consistent with the intent of SB 408 to only credit the utility when actual tax payments are made to the appropriate entities.

e. Consequences: The Commission must consider the impact of surcharges or refunds calculated under an SB 408 automatic adjustment clause on the utility prior to allowing rates to go into effect. The earnings test would provide a simple, verifiable, and easy to administer test for making this calculation. The earnings test would ensure that rates remain fair, just, and reasonable.