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May 17, 2006

Administrative Law Judge, Kathryn Logan
550 Capitol St NE Suite 215
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Salem, OR 97308-2148

RE: AR 499 - draft administrative rules, excluding the section on properly attributed

Dear ALJ Logan,

Consistent with the schedule in this proceeding, please find attached the proposed administrative rules to implement SB 408, excluding the section on properly attributed. Staff notes that these rules may change if the Commission provides direction regarding mandatory earnings reviews, the use of actual data for the ratios in 3(13)(e), or the treatment of the tax effects of regulatory disallowances and costs not included in rates.

Please do not hesitate to contact me if you have any questions.

Sincerely,

Jason W. Jones
Assistant Attorney General
Regulated Utility & Business Section

AR 499 Service List
JWJ:jwj/GENQ1681

860-022-0041

Annual Tax Reports and Automatic Adjustment Clauses Relating to Utility Taxes

(1) This rule applies to Avista Corporation, Northwest Natural Gas Company, PacifiCorp, and Portland General Electric Company, or to any successors in interest of those utilities.

(2) As used in this rule:

(a) “Affiliated group” means the group of corporations, of which the utility is a member, which files a consolidated federal income tax return.

(b) “Deferred taxes” means the total deferred tax expense of regulated operations as reported in the FERC deferred tax expense accounts that relate to the year being reported.

(c) “Income” means taxable income.

(d) “Pre-tax income” means the utility’s net revenues before income taxes and interest expense, as determined by the Commission in a general rate proceeding.

(e) “Properly attributed” means

(f) “Regulated operations of the utility” means those activities of a utility that are subject to rate regulation by the Commission.

(g) “Results of Operations Report” means the utility’s annual results of operations report filed with the Commission.

(h) “Revenue” means retail revenues from ratepayers in Oregon, excluding miscellaneous revenues and supplemental schedules not included in the utility’s revenue requirement, and adjusted for any rate adjustment imposed under this rule.

(i) “Revenue requirement” means the total revenue the Commission authorizes a utility an opportunity to recover in a general rate proceeding or other general rate revision, including an annual automatic adjustment clause under ORS 757.210.

(j) “Subgroup” means

(k) “Tax” means a federal, state or local tax or fee that is imposed on or measured by income and that is paid to a unit of government, but does not include a franchise fee or privilege tax.

(l) “Taxes authorized to be collected in rates” means the product determined by multiplying the following three values:

(A) The revenue the utility collects, using information from the utility’s results of operations report;

(B) The ratio of the net revenues from regulated operations of the utility to gross revenues from regulated operations of the utility, calculated using the pre-tax income and revenue the Commission authorized in establishing rates and revenue requirement, with revenue weighted by months when revenue requirement is reauthorized during the year; and

(C) The effective tax rate used by the Commission in establishing rates for the time period covered by the tax report as found in the last general rate order, calculated as the ratio of total income tax expense in revenue requirement to pre-tax income.

(m) "Taxes paid" means net amounts received by units of government from the utility or from the affiliated group and properly attributed to regulated operations of the utility, adjusted as follows:

(A) Increased by the amount of tax savings realized as a result of charitable contribution deductions allowed in the tax return because of the charitable contributions made by the utility;

(B) Increased by the amount of tax credits on the tax return that are associated with investment by the utility in the regulated operations of the utility, to the extent the expenditures giving rise to the tax credits and tax savings resulting from the tax credits have not been taken into account by the Commission in the utility's last general ratemaking proceeding; and

(C) Adjusted by deferred taxes related to the regulated operations of the utility. The utility must initially use its results of operations report to establish the amount of deferred taxes. If the utility does not believe that the results of operations report sufficiently reflects the amount of the utility's deferred taxes for the applicable tax year, the utility may also use its tax returns for the tax year as a supplemental source for calculating the deferred taxes adjustment as a separate submission. Deferred taxes do not include deferred tax items related to an adjustment under section 10 of this rule.

(n) "Units of government" mean federal, state and local taxing authorities.

(3) By October 15 of each year, each utility will file a tax report with the Commission. Any person may request to be placed on a list to receive all such tax report filings at the time they are submitted to the Commission or may request a copy of individual filings. Any person wishing to participate as a party shall so notify the Commission and other parties. The tax report will contain the following information for each of the three preceding fiscal years:

(a) The amount of federal and state income taxes paid to units of government by the utility or its affiliated group;

(b) The amount of the federal and state income taxes paid that is incurred as a result of income generated by the Oregon regulated operations of the utility, calculated using a pro forma tax return and including a reconciliation with revenues and expenses in the utility's results of operations report for the year;

- (c) The amount of federal and state income taxes paid to units of government by the utility or its affiliated group that is properly attributed to the Oregon regulated operations of the utility;
- (d) The amount of federal and state taxes income taxes authorized to be collected in rates for Oregon regulated operations of the utility;
- (e) The amount of the difference between the amount in section 3(d) of this rule and the lowest of the amounts in sections 3(a), 3(b) and 3(c).
- (f) The amount of local income taxes paid to units of government by the utility or its affiliated group that is incurred as a result of income generated by the regulated Oregon operations of the utility, by county;
- (g) The amount of local income taxes collected from Oregon customers, by county;
- (h) The amount of the difference between the amounts in sections 3(f) and 3(g) of this rule; and
- (i) the proposed surcharge or surcredit rate adjustments to charge or refund customers the amount of the differences in sections 3(e) and 3(h) of this rule.

(4) In calculating the amount of taxes paid under section (3) of this rule:

(a) “Taxes paid” shall be allocated to each tax year employed by the utility for reporting its tax liability in the following manner:

(A) For each positive or negative tax liability shown on an initial or amended tax return for the immediately preceding tax year, which return is filed on or before the date the tax report is due for such tax year, to the tax year for which such return is filed.

(B) For each positive or negative tax liability or tax adjustment shown on an amended tax return or made as a result of a tax audit, that is filed, paid or received after the date the tax report is due for the applicable tax year, to the tax year in which the related tax liability or tax adjustment is recognized by the utility for accounting purposes.

(C) Taxes paid shall be inclusive of any interest paid to or interest received from units of government with respect to tax liabilities.

(b) A multi-state jurisdictional utility will determine the portion of state and federal taxes allocated to its Oregon jurisdictional operations using the allocation methodology approved for use in setting the utility’s rates. The utility will apply this methodology to the utility’s total taxes paid on a multi-state basis, including any tax settlement payments and refunds, adjusted to include the utility’s total deferred taxes on a multi-state basis.

(c) When an affiliated group/sub group changes during the year, taxes paid will be calculated . . .

(5) A utility with a fiscal year other than a calendar year will also provide the information requested in section (3) of this rule for each calendar year beginning 2006.

(6) The utility must explain the method used for calculating the amounts in this rule and provide copies of all workpapers and documents supporting the calculations.

(7) Each utility must obtain and provide any information requested by the Commission to implement and administer this rule.

(8) Within 20 days following the October 15 tax report filings, an Administrative Law Judge will conduct a conference and adopt a schedule that includes the following events for each utility:

(a) On the second Monday in January, discovery completed and Commission staff issue its initial recommendations regarding the findings in section 9 of this rule;

(b) During the second to fourth weeks in January, a settlement conference;

(c) One week following the settlement conference, Commission staff and intervenor testimony;

(d) Two weeks following Commission staff and intervenor testimony, utility rebuttal testimony;

(e) Two weeks following utility rebuttal testimony, a hearing;

(f) Two weeks following the hearing, simultaneous briefs; and

(e) Within 180 days of the tax report filings, the Commission order making the findings in section 9 of this rule.

(9) The Commission's order in section 8(e) of this rule will contain the following findings:

(a) whether the taxes authorized to be collected in rates for any of the three preceding fiscal years differs by \$100,000 or more from the amount of taxes paid to units of government that are properly attributed to the Oregon regulated operations of the utility;

(b) the amount in section 3(e) of this rule for federal and state income taxes;

(c) the amount in section 3(h) of this rule for local income taxes; and

(d) the amount of the surcharge or surcredit rate adjustments to charge or refund customers the amounts in sections 9(b) and 9(c) of this rule.

(10) Upon entry of an order finding a difference of \$100,000 or more in section (9) of this rule, the utility must file an amendment to its automatic adjustment clause tariff to be effective each June 1. The amended tariff will implement a rate adjustment applying to taxes paid to units of government and collected from ratepayers for each calendar year beginning 2006.

(a) The utility will establish a balancing account and automatic adjustment clause tariff to recover or refund the difference determined by the Commission in section 9(b) of this rule through a surcharge or surcredit rate adjustment.

(b) A utility that is assessed a local income tax shall establish a separate balancing account and automatic adjustment clause tariff for each county assessing such tax. The utility will apply a surcharge or surcredit on the bills of customers within the county assessing the tax. The amount of the surcharge or surcredit will be calculated to recover or refund the difference determined by the Commission in section 9(c) of this rule.

(c) Any rate adjustment will be calculated to amortize the difference over a one-year period, unless otherwise authorized by the Commission.

(d) Any rate adjustment will be allocated by customer class according to equal percentage of margin for natural gas utilities and equal cents per kilowatt-hour for electric utilities.

(e) Each balancing account will accrue interest at the Commission-authorized rate for deferred accounts. For purposes of calculating interest, the amount of the difference calculated in this section of the rule will be deemed to be added to the balancing account on January 1 in the year following the tax report filing.

(f) The automatic adjustment clause shall not operate in a manner that allocates to customers any portion of the benefits of deferred taxes resulting from accelerated depreciation or other tax treatment of utility investment or regulated affiliate investment required to ensure compliance with the normalization method of accounting or any other requirements of federal tax law.

(g) Prior to initial implementation of the automatic adjustment clause, each utility will seek and obtain a Private Letter Ruling from the Internal Revenue Service on whether the utility's compliance with Senate Bill 408, this rule, or any other relevant guidance or authorities would cause the utility to fail to comply with federal normalization requirements or other requirements of federal tax law.

(11) No later than 30 days following the Commission's findings in section 9 of this rule, any person may file a claim that a rate adjustment under the automatic adjustment clause will have a material adverse effect or potential violation of ORS 756.040. The Commission will hold a

hearing to make a determination within 120 days following the filing. In the event of a claim under this section, the applicable rate adjustment will not be implemented until the Commission makes its determination, but interest will accrue according to section 10(e) of this rule on the final amount of the rate adjustment. The person filing the claim will bear the burden of proof to substantiate the claim. In making a determination regarding a potential violation of ORS 756.040, the Commission will perform an earnings review using the utility's results of operations report for the applicable tax year.

(12) The Commission may disclose, or any intervenor may obtain and disclose, the amount by which the amount of taxes that units of government received from the utility or from the affiliated group differs from the amount of costs for taxes collected, directly or indirectly, as part of rates paid by customers, including whether the difference is positive or negative. An intervenor may not disclose any further information unless the Commission allows the disclosure. The Commission will not disclose or authorize disclosure of any information that is exempt from disclosure under the Records Law (ORS 192.410-192.505).

Stat. Auth.: ORS Ch. 183, 756, 757 & 759

Stats. Implemented: ORS 756.040, 756.060, 757.267 & 757.268

[Hist.: PUC 5-2005(Temp), f. & cert. ef. 9-15-05 thru 3-13-06]

1 **CERTIFICATE OF SERVICE**

2 I certify that on May 17, 2006, I served the foregoing upon the parties in this proceeding
3 hereto by electronic mail and sending a true, exact and full copy by regular mail, postage prepaid
4 or by shuttle mail/hand deliver to the parties accepting paper service.

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