**Portland General Electric Company**
*Legal Department*
*121 SW Salmon Street • Portland, Oregon 97204*
*(503) 464-8926 • Facsimile (503) 464-2200*

**Douglas C. Tingey**
*Assistant General Counsel*

February 25, 2009

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

Oregon Public Utility Commission
Attention: Filing Center
550 Capitol Street NE, #215
PO Box 2148
Salem OR 97308-2148

**Re: UE 178 – SB 408 Automatic Adjustment Clause**

Attention Filing Center:

Enclosed for filing in UE 178 are an original and five copies of:

- **Rebuttal Testimony of Bob Tamlyn and Jay Tinker, PGE 2008 Tax Report for Calendar Year 2007 (PGE/100-108/Tamlyn-Tinker/2008 Tax Report).**

These documents are being filed electronically. Hard copies will be sent via postal mail.

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,

DOUGLAS C. TINGEY

DCT: cbm
Enclosures
cc: UE 178 Service List

# BEFORE THE PUBLIC UTILITY COMMISSION

# OF THE STATE OF OREGON

# UE 178

## 2008 Tax Report for Calendar Year 2007

# PORTLAND GENERAL ELECTRIC COMPANY

## Rebuttal Testimony and Exhibits

**February 25, 2009**

UE 178 / PGE / 100
TAMLYN - TINKER

BEFORE THE PUBLIC UTILITY COMMISSION

OF THE STATE OF OREGON

# 2008 Tax Report for Calendar Year 2007

PORTLAND GENERAL ELECTRIC COMPANY

Rebuttal Testimony and Exhibits of

*Bob Tamlyn – Jay Tinker*

February 25, 2009

## Table of Contents

## I. Introduction

**Q. Please state your names and positions with PGE.**

A. My name is Bob Tamlyn. I am the Tax Director for PGE.

My name is Jay Tinker. I am a Project Manager for PGE. My areas of responsibility include revenue requirement analyses and other regulatory analyses.

Our qualifications appear at the end of this testimony.

**Q. What is the purpose of your testimony?**

A. Our testimony responds to the testimony of Ms. Blumenthal on behalf of the Industrial Customers of Northwest Utilities (ICNU) filed January 28, 2009.

**Q. How is your testimony organized?**

A. First, we respond to ICNU's contention that they could not participate meaningfully in the tax report proceeding due to the protective order in this docket and current safe room requirements under the protective order (ICNU/100, pgs. 6-7). Second, we respond to ICNU's contention that the administrative rules approved by the Commission to implement SB 408 run counter to the goals of the law (ICNU/100, pgs. 3-5). Finally, we also address ICNU's contention that the Commission's rules for determining the stand-alone tax liability do not meet the requirements of SB 408 (ICNU/100, pg. 5).

## II. Rebuttal to ICNU

### A. ICNU's Expert Witness Could Conduct a Meaningful Review

**Q. Did PGE have an arrangement with ICNU and Ms. Blumenthal to provide copies of the tax report and work papers?**

A. Yes. Beginning with last year's tax report docket (2006 calendar year tax report filed October 15, 2007), PGE and ICNU entered into an agreement whereby PGE would provide ICNU's expert witness with a copy of the tax report and associated work papers and data request responses, including material marked as "highly confidential" under the protective order. In return for providing the requested material, ICNU agreed to treat the material in a manner consistent with Commission Order No. 06-033 (the Protective Order) and to return or destroy the material after the end of the proceeding. A copy of the letter setting out this understanding is provided as Exhibit 101. Exhibit 102 provides a letter in which PGE provided Ms. Blumenthal follow-up information in the same proceeding. Based on this understanding, Ms. Blumenthal participated in last year's tax report, reviewed highly confidential information in her Corpus Christi office, and was able to refer to the tax report and other highly confidential information in her office.

**Q. Do you believe this arrangement allowed ICNU to meaningfully participate in the tax report proceeding concerning calendar year 2006?**

A. Yes, we believe the approach of providing Ms. Blumenthal with copies of the relevant material afforded ICNU an opportunity to review PGE's tax report and associated work papers. We note that ICNU was a signing party to a stipulation in that proceeding.

**Q. Did PGE provide the 2007 calendar year tax report and work papers to Ms. Blumenthal on the same basis as the information provided the prior year?**

A. Yes. At the outset of this docket, counsel for ICNU informed us that it would like to use the same process as we followed in last year's tax report docket. Exhibit 103 is an email correspondence from ICNU. ICNU requested access to the report and work papers on the same terms as was agreed upon the prior year. PGE was prepared to operate on the same basis as it had last year. For this reason, PGE sent a copy of the 2007 calendar year tax report and work papers to Ms. Blumenthal. Exhibit 104 is a copy of the cover letter, dated November 17, 2008 providing the requested material.

**Q. Did Ms. Blumenthal receive the material?**

A. Yes. Exhibit 105 is a copy of ICNU's data response indicating that the material was received "in the November timeframe", Ms. Blumenthal elected to not open the package, and that the material was then shredded.

**Q. Did PGE ask that ICNU destroy the tax report and supporting work papers?**

A. No. Based on our prior discussions with ICNU, we assumed that we would continue to work with ICNU as we had in the past and make available to Ms. Blumenthal highly confidential material for review in her Corpus Christi office. We do not know why ICNU chose to shred the tax report that we provided to Ms. Blumenthal.

**Q. Was ICNU's out of town witness afforded an opportunity to conduct a meaningful review of PGE's tax report in this docket?**

A. Yes. Ms. Blumenthal's claims that she must travel to view documents, write testimony in the presence of a company employee, or is not trusted to protect highly confidential information are simply not true. She had the material in her possession. Ms. Blumenthal could have worked with the tax report and work papers in private, unencumbered by the

requirements of the safe room. It was ICNU's choice to not review the tax report which PGE provided to its expert.

**Q. Other than the initial tax report, has ICNU requested access to any of the highly confidential material in this matter?**

A. No. ICNU has not requested access to any highly confidential information other than the initial tax report which it elected to destroy. ICNU's expert has not asked to review the revised tax report which forms the basis of the stipulation between Staff and PGE in this matter and, to our knowledge, Ms. Blumenthal has not visited the safe room in Portland to review highly confidential information.

## B. OAR 860-022-0041 fairly implements SB 408, including the Stand-Alone method of determining Taxes Paid

**Q. Ms. Blumenthal claims that OAR 860-022-0041 is inconsistent with the goals of SB 408. Do you agree?**

A. No. Much of this issue as discussed by Ms. Blumenthal is a legal issue and will be discussed in PGE's brief. However, we note a couple of factual items for which we are in disagreement with Ms. Blumenthal. Ms. Blumenthal points out that there are three methods of determining Taxes Paid (Consolidated, Apportioned, and Stand-Alone). She claims that "none of these methods produces the actual taxes paid attributable to the regulated operations of the utility." (ICNU/100, pg.4). Her only claim for this statement seems to be the use of a pro-forma tax return and the interest synchronization method of determining taxes paid under the Stand-Alone method.

**Q. Does PGE, in fact, use its actual tax return to determine Taxes Paid under the Consolidated and Apportionment methods?**

A. Yes. PGE's Federal Form 1120 and Oregon Form 20 are the beginning points for analysis of Taxes Paid under both the Consolidated and Apportionment methods of determining Taxes Paid.

**Q. Do these returns reflect PGE's actual interest deductions?**

A. Yes. As a result, to the extent that consolidated tax savings due to interest deductions actually occur, Taxes Paid under the Consolidated and Apportionment methods will reflect these savings and since, as Ms. Blumenthal points out, the lower of the three methods is used as the final determination of Taxes Paid, consolidated tax savings (whether from interest deductions or other deductions) will, in fact, flow through to customers under the current rules implementing SB 408.

**Q. Does it make sense to perform the Stand-Alone calculation using a proforma return and using the interest synchronization adjustment as prescribed in OAR 860-022-0041?**

A. Yes. The Stand-Alone calculation is meant to provide an indication of what Taxes Paid would be if a utility were a Stand-Alone utility with no greater interest deduction than that allowed through the Commission's standard rate making formula. Since the Commission authorizes rate recovery of interest based on rate base and cost of debt, the interest synchronization adjustment to Taxes Paid under the Stand-Alone method provides for an "apples to apples" comparison between Taxes Collected (which is inherently based on the interest synchronization method) and Taxes Paid. Also, the Results of Operations Report, filed by utilities to provide an indication of regulated earnings, contains the interest synchronization adjustment in determining Regulated Earned Return on Equity. As previously stated, the existence of the other methods of determining Taxes Paid

(Consolidated and Apportioned), along with the requirement that the lower of the three methods be used, ensures that consolidated tax savings are reflected in the final determination of amounts owed to/by the utility.

**Q. Which of the three methods resulted in the lowest Taxes Paid and therefore was used to determine the final adjustment amount?**

A. The consolidated method resulted in the lowest Taxes Paid and therefore was the method used.

**Q. Did the parties conduct exhaustive rule making sessions to develop OAR 860-022-0041?**

A. Yes. All of the major parties, including ICNU, engaged in multiple rulemaking sessions to develop OAR 860-022-0041. For reference, we include the Commissions Orders approving and modifying OAR 860-022-0041 as Exhibits 106, 107, and 108.

**Q. Does this conclude your testimony?**

A. Yes.

## III. Qualifications

**Q. Mr. Tamlyn, please describe your qualifications.**

A. I am a graduate of Portland State University receiving a Bachelor's degree in Political Science in 1974. I also have a Masters of Taxation degree from Portland State University, received in 1996 and have been a certified public accountant since 1979. I am a member of the American Institute of CPAs as well as the Oregon Society of CPAs, a director of the Portland chapter of Tax Executives Institute, and a member of the Edison Electric Institute tax committee.

I worked for the Portland Oregon based CPA firm of Fellner & Kuhn, PC from 1976 to 1987, advising clients on various accounting and tax matters. Subsequent to that I worked in various tax capacities at PacifiCorp, NERCO, PacifiCorp Financial Services and Standard Insurance Company.

I have been the tax director at PGE from March 2005 until the present time.

**Q. Mr. Tinker, please describe your qualifications.**

A. I received a Bachelor of Science degree in Finance and Economics from Portland State University in 1993 and a Master of Science degree in Economics from Portland State University in 1995. In 1999, I obtained the Chartered Financial Analyst (CFA) designation. I have worked in the Rates and Regulatory Affairs department since joining PGE in 1996.

**Q. Does this conclude your testimony?**

A. Yes.

# List of Exhibits

| PGE Exhibit | Description |
|---|---|
| 101 | December 11, 2007 cover letter indicating Agreement between ICNU and PGE to provide 2006 calendar year tax report and work papers. |
| 102 | January 15, 2008 cover letter providing additional follow-up information to ICNU related to 2006 calendar year tax report and work papers. |
| 103 | Email correspondence from ICNU regarding 2007 tax report information. |
| 104 | November 17, 2008 cover letter providing 2007 calendar year tax report and work papers. |
| 105 | ICNU Response to PGE Data Request No. 001 |
| 106 | OPUC Order No. 06-400 |
| 107 | OPUC Order No. 06-532 |
| 108 | OPUC Order No. 07-401 |

**Portland General Electric Company**
*121 SW Salmon Street • Portland, Oregon 97204*
*PortlandGeneral.com*

December 11, 2007

Mr. Allen Chan
Davison Van Cleve PC
333 SW Taylor, Suite 400
Portland, OR 97204

Ms. Ellen Blumenthal
GDS Associates, Inc.
13517 Queen Johanna Court
Corpus Christi, TX 78418

Re: UE 178

Dear Ms. Blumenthal and Mr. Chan:

We are enclosing for delivery to Ms. Blumenthal, the following documents (Bates Nos. PGE TAX REPORT 10/07 0000115-000202) that Portland General Electric Company ("PGE") has identified as highly confidential pursuant to the terms of the protective order in UE 178, Order No. 06-033 (the "Protective Order"). We are providing copies of these documents conditioned on our mutual understanding reflected in this letter. Our counsel has provided you with a draft of this letter and you have indicated your agreement with the understandings set forth below.

PGE is amenable to providing the requested highly confidential documents as a limited exception to the terms of the Protective Order, which otherwise require viewing of highly confidential material in the Portland or Salem safe rooms. Ms. Blumenthal is an out-of-town consultant, and the Commission order adopting the Protective Order urged the utilities to work with out-of-town experts to determine whether special arrangements could be made. Given the specific circumstances of your request for a limited set of highly confidential documents, we have agreed to make such a special arrangement in this case. By providing copies of the requested documents PGE does not waive any of the terms of the Protective Order or waive its classification of these documents as highly confidential.

Ms. Blumenthal agrees to treat the requested highly confidential documents in a manner consistent with the terms of the Protective Order. PGE's decision to make a special arrangement in this instance should not be viewed as a precedent for how it will respond to future similar requests in this proceeding or in future tax report proceedings. PGE and Industrial Customers of Northwest Utilities ("ICNU") agree and acknowledge that PGE's production of the requested highly confidential documents shall not be used by ICNU in this proceeding or any other proceeding for any purpose, including, but not limited to, as a basis for seeking (1) reclassification of the requested documents or (2) amendment, modification, elimination or an exception to, of the terms of a protective order approved by the Commission.

Pursuant to the terms of the Protective Order, Ms. Blumenthal is required to either destroy or return confidential material within 90 days after final resolution of this proceeding. If Ms. Blumenthal elects to destroy the requested highly confidential material, she will provide PGE with written confirmation of her election. Because the documents are being sent directly to Ms. Blumenthal, we ask that she sign below to reflect her agreement to treat the documents in accordance with this letter.

Very truly yours,

Randy Dahlgren
Director, Regulatory Policy & Affairs

By signing below, I agree to abide by the terms of this letter.

_____

Ellen Blumenthal

DFW/ldh
001991\00252\799907 V002

**Portland General Electric Company**
*121 SW Salmon Street • Portland, Oregon 97204*
*PortlandGeneral.com*

January 15, 2008

Mr. Allen Chan
Davison Van Cleve PC
333 SW Taylor, Suite 400
Portland, OR 97204

Ms. Ellen Blumenthal
GDS Associates, Inc.
13517 Queen Johanna Court
Corpus Christi, TX 78418

**Re: UE 178**

Dear Ms. Blumenthal and Mr. Chan:

We are enclosing for delivery to Ms. Blumenthal, the following documents (Bates Nos. REVISED TAX REPORT REFLECTING STAFF ADJUSTMENTS 000220-000235) that Portland General Electric Company ("PGE") has identified as highly confidential pursuant to the terms of the protective order in UE 178, Order No. 06-033 (the "Protective Order"). We are providing copies of these documents conditioned on our mutual understanding reflected in our previous correspondence dated December 11, 2007, which is summarized below.

PGE is amenable to providing the highly confidential documents as a limited exception to the terms of the Protective Order, which otherwise require viewing of highly confidential material in the Portland or Salem safe rooms. Ms. Blumenthal is an out-of-town consultant, and the Commission order adopting the Protective Order urged the utilities to work with out-of-town experts to determine whether special arrangements could be made. We have agreed to make such a special arrangement in this case. By providing copies of the highly confidential documents PGE does not waive any of the terms of the Protective Order or waive its classification of these documents as highly confidential.

Ms. Blumenthal agrees to treat the highly confidential documents in a manner consistent with the terms of the Protective Order. PGE's decision to make a special arrangement in this instance should not be viewed as a precedent for how it will respond to future similar requests in this proceeding or in future tax report proceedings. PGE and Industrial Customers of Northwest Utilities ("ICNU") agree and acknowledge that PGE's production of the highly confidential documents shall not be used by ICNU in this proceeding or any other proceeding for any purpose, including, but not limited to, as a basis for seeking (1) reclassification of the documents or (2) amendment, modification, elimination or an exception to, of the terms of a protective order approved by the Commission.

Pursuant to the terms of the Protective Order, Ms. Blumenthal is required to either destroy or return confidential material within 90 days after final resolution of this

proceeding. If Ms. Blumenthal elects to destroy the highly confidential material, she will provide PGE with written confirmation of her election.

Very truly yours,

Randy Dahlgren
Director, Regulatory Policy & Affairs

**From:** Irion A. Sanger [mailto:IAS@dvclaw.com]
**Sent:** Friday, October 17, 2008 5:22 PM
**To:** David White
**Cc:** Ellen Blumenthal
**Subject:** SB 408 Tax Reports

David

This email is in regards to PGE's 2007 tax report. We are planning to use Ellen Blumenthal again to review PGE's tax filing and would like to use the same procedures as before. Should we work with you to set this up?

**Irion A. Sanger**
Attorney
Davison Van Cleve, PC
333 SW Taylor St., Suite 400
Portland, OR 97204
Tel: 503.241.7242
Fax: 503.241.8160
ias@dvclaw.com

**Portland General Electric Company**
*121 SW Salmon Street • Portland, Oregon 97204*
*PortlandGeneral.com*

November 17, 2008

Ms. Ellen Blumenthal
GDS Associates, Inc.
13517 Queen Johanna Court
Corpus Christi, TX 78418

Mr. Irion Sanger
Davison Van Cleve PC
333 SW Taylor, Suite 400
Portland, OR 97204

Re: UE 178

Dear Ms. Blumenthal and Mr. Sanger:

We are enclosing for delivery to Ms. Blumenthal, the 2007 template and associated work papers as filed in the tax report on October 15, 2008. These are the same documents Ms. Blumenthal received last year, except that PGE also included responses to Staff discovery requests last year. PGE has not yet responded to Staff data requests this year, hence their omission. Portland General Electric Company ("PGE") has identified relevant documents as highly confidential pursuant to the terms of the protective order in UE 178, Order No. 06-033 (the "Protective Order"). These documents are printed on green paper. We are providing copies of these documents conditioned on our mutual understanding reflected in this letter, which reflects the same terms under which the highly confidential material was provided last year. The terms are set forth below.

PGE is amenable to providing the requested highly confidential documents as a limited exception to the terms of the Protective Order, which otherwise require viewing of highly confidential material in the Portland or Salem safe rooms. Ms. Blumenthal is an out-of-town consultant, and the Commission order adopting the Protective Order urged the utilities to work with out-of-town experts to determine whether special arrangements could be made. Given the specific circumstances of your request for a limited set of highly confidential documents, we have agreed to make such a special arrangement in this case. By providing copies of the requested documents, PGE does not waive any of the terms of the Protective Order or waive its classification of these documents as highly confidential.

Ms. Blumenthal agrees to treat the requested highly confidential documents in a manner consistent with the terms of the Protective Order. PGE's decision to make a special arrangement in this instance should not be viewed as a precedent for how it will respond to future similar requests in this proceeding or in future tax report proceedings. PGE and Industrial Customers of Northwest Utilities ("ICNU") agree and acknowledge that PGE's production of the requested highly confidential documents shall not be used by ICNU in this proceeding or any other proceeding for any purpose, including, but not limited to, as a basis for seeking

(1) reclassification of the requested documents or (2) amendment, modification, elimination or an exception to, of the terms of a protective order approved by the Commission.

Pursuant to the terms of the Protective Order, Ms. Blumenthal is required to either destroy or return confidential material within 90 days after final resolution of this proceeding. If Ms. Blumenthal elects to destroy the requested highly confidential material, she will provide PGE with written confirmation of her election. Because the documents are being sent directly to Ms. Blumenthal, we ask that she sign below to reflect her agreement to treat the documents in accordance with this letter.

Very truly yours,

Jay Tinker
Project Manager, Regulatory Affairs

By signing below, I agree to abide by the terms of this letter.

_____
Ellen Blumenthal

JT/sg

**BEFORE THE**

**PUBLIC UTILITY COMMISSION OF OREGON**

**DOCKET NO. UE 178**

**ICNU'S RESPONSE TO PGE'S DATA REQUEST NO. 1**

**Data Request No. 1:**

Attachment 1 is a cover letter from PGE to ICNU and Ms. Blumenthal, dated November 17, 2008. The letter indicates PGE's intent to deliver to Ms. Blumenthal a copy of the 2007 tax report template and associated work papers. Did Ms. Blumenthal receive the indicated material? If "yes", when did Ms. Blumenthal receive the material? Does Ms. Blumenthal still have the material? Does Ms. Blumenthal intend to return the material to PGE or destroy the material?

**Response to Data Request No. 1:**

Ms. Blumenthal received a package from PGE, in the November 2008 timeframe. Ms. Blumenthal never opened the package. Ms. Blumenthal shredded the package, including all of its contents. Thus, Ms. Blumenthal no longer has the material sent by PGE.

ORDER NO. 06-400

ENTERED 07/14/06

# BEFORE THE PUBLIC UTILITY COMMISSION

# OF OREGON

AR 499

| | | |
|---|---|---|
| In the Matter of | ) | |
| | ) | INTERIM ORDER |
| Adoption of Permanent Rules to Implement | ) | |
| SB 408 Relating to Utility Taxes. | ) | |

DISPOSITION: PROPOSED RULES ON PROPERLY ATTRIBUTED ISSUED; PRELIMINARY DECISIONS ON RELATED ISSUES

On September 2, 2005, Governor Theodore Kulongoski signed into law Senate Bill 408 (SB 408), passed during the 2005 Legislative Assembly and generally codified at ORS 757.268.[1] SB 408 requires certain public utilities to file annual tax reports and other tax information with the Public Utility Commission of Oregon (Commission). In this annual filing, the affected utilities must identify the amount of taxes paid, either by the public utility itself or its consolidated group, and the amount of taxes authorized to be collected in rates during specified time periods. If amounts collected and amounts paid differ by more than $100,000, SB 408 requires this Commission to direct the public utility to implement a rate schedule with an automatic adjustment clause accounting for the difference.

This process of "truing up" a utility's cost for taxes constitutes a departure from ratemaking methods traditionally employed by the Commission. Instead of calculating taxes on a stand-alone basis, SB 408 requires this Commission to track the amount of taxes actually paid and determine what portion of those amounts are properly attributed to the regulated operations of the utility. Where taxes are paid on a consolidated basis by a utility parent, this task necessarily involves an apportionment of the paid taxes to all affiliates within a taxpaying entity, to ensure that ratepayers only pay the utility's share of the taxes paid.

Establishing a method to determine what amounts are "properly attributed" to the regulated operations of a utility has been difficult and controversial. In this interim decision, we state our intention to adopt a widely established methodology used by Oregon and other states to apportion income for multistate corporations' state tax liability. *See Fisher Broadcasting, Inc. v. Dept. of Rev.*, 321 Or 341, 351 (1995). We

[1] The discussion in this interim order generally refers to the part of the statute codified at ORS 757.268, in Section 3 of SB 408. References in this order to sections of the law refer to citations of ORS 757.268.

refer to this approach as the "Apportionment method." For reasons further explained in this interim decision, the Apportionment method provides a sound basis for calculating taxes "properly attributed" to the utility. This methodology fairly balances the interests of the utility and its ratepayers and, by utilizing readily available information, is easy to administer. Moreover, the process is legislatively sanctioned, well established, and has been widely utilized to apportion income for the purpose of state taxation for over fifty years. Finally, we believe that the Apportionment method is consistent with the letter and spirit of SB 408.

This interim order sets forth preliminary decisions regarding the determination of "properly attributable" and other aspects necessary to implement SB 408. The purpose of issuing this order is to indicate the intention of the Commission, so that participants can further develop proposed rules for the implementation of SB 408. Public comment may still be made on any issue in this order, until August 21, 2006, the date of the rulemaking hearing. After that date, the Commission will not take any further comment and will issue final rules.

**Background**

Temporary rules were adopted in Order No. 05-991, on September 15, 2005. Subsequently, several workshops and rounds of public comments were held to assess legal issues associated with SB 408, and a letter of advice regarding several questions was issued by the Department of Justice on December 27, 2005. Further workshops were held to develop and evaluate straw proposals put forth by participants in the rulemaking process on application of various interpretations of "properly attributed" in SB 408. After the straw proposals were revised, two rounds of comments were submitted and a workshop with Commissioners was held to discuss the merits of various interpretations of "properly attributed." The comments also addressed whether an earnings test should be adopted, whether actual figures should be used for certain components of the "taxes authorized to be collected" calculation, whether deferred accounting and offsets from other deferred accounts should be used, and how Section (12)(a) should be interpreted.

**"Properly Attributed"**

Section (6) states:

> The automatic adjustment clause shall account for all taxes paid to units of government * * * by the affiliated group[2] that are properly attributed to the regulated operations of the utility, and all taxes that are authorized to be collected

[2] The statute also contains similar provisions for just a utility, but since the four relevant utilities, as defined in ORS 757.268(13)(b), are part of larger affiliated groups with non-utility operations, we address only the provisions related to affiliated groups.

> through rates, so that ratepayers are not charged for more tax than * * * the affiliated group pays to units of government and that is properly attributed to the regulated operations of the utility.

Under Section (12), the amount of "properly attributed" taxes that are paid may not exceed the lesser of (a) the portion of the total taxes paid that is incurred as a result of income generated by the regulated operations of the utility or (b) the total amount of taxes paid to units of government by the affiliated group.

On December 27, 2005, the Department of Justice issued a letter of advice stating that "properly attributed" is a delegative term, which requires the Commission "to make a judgment as to what constitutes a 'proper' allocation of income taxes." Letter from Hardy Meyers, Or Atty Gen, to Lee Beyer, Commn Chair, at 8 (Dec 27, 2005) (available at http://www.puc.state.or.us/PUC/leg/sb408/index.shtml) (hereinafter "Letter from Atty Gen"). The letter states that the Commission may craft a "properly attributed" method that is equal to or lesser than the cap as determined by the calculation set forth in Section 12. *See* Letter from Atty Gen,13-14. Whichever method the Commission chooses, rates must be "fair and reasonable" under ORS 756.040. *See* Letter from Atty Gen, 16.

***Straw Proposals***

In discussing straw proposals for implementation of the "properly attributed" language, participants identified what have been referred to as the two "book ends" that represent the opposite ends of participants' positions. The first book end, which was put in the temporary rule and supported by customer groups, allocates taxes paid within the affiliated group, on the basis of taxable income, to every affiliate with taxable income within that company. *See* OAR 860-022-0039 (adopted in AR 498, Order No. 05-991). Opponents criticize this approach, however, because it gives utility customers the tax benefit of losses in other businesses even though they do not bear any portion of those losses. Further, it may require auditing the tax liability of every affiliate in the group in order to determine the utility's ratio, which could be impractical to implement.

The opposite book end, generally supported by the utilities and the Commission Staff (Staff), seeks to match the costs borne by ratepayers with the corresponding tax benefits. Represented by the "with and without" method, this approach requires determining the consolidated tax payment with the regulated operations of the utility factored in, and then the consolidated payment without the regulated operations of the utility. *See* PacifiCorp straw proposal. The difference between the two amounts would be considered the tax that is properly attributed to the utility. A perceived flaw with this approach is that it mirrors one of the caps set forth in the bill, Section (12)(a), which states that taxes paid may not exceed that "portion of the total taxes paid that is incurred as a result of income generated by the regulated

operations of the utility."[3] While we have the discretion to craft a "properly attributed" method equal to the lesser of the two caps set out in Section (12), *see* Letter from Atty Gen, 17, critics of the "with and without methodology" question whether a "properly attributed" calculation equal to the Section (12) cap is the most appropriate method of implementing the statute.

There were other variations presented by the rulemaking participants. Several proposals required numerous adjustments to a utility's hypothetical stand-alone tax liability. *See* CUB straw proposal; Avista straw proposal. Such a starting point appears contrary to the policy underlying the statute, which begins with taxes paid and "attributes" them to various affiliates, including the utility. *See* ORS 757.268(6). Other proposals require identification of a subgroup of affiliates with a defined transactional nexus. *See* ICNU/ NWIGU straw proposal. Again, the proposed adjustments would be to the hypothetical utility's stand-alone liability, not to taxes paid by the parent. Further, the Commission would be required to identify the subgroup each year, taking the "automatic" out of "automatic adjustment clause." *See* ORS 757.210(1)(a)("no hearing need be held if the particular rate change is the result of an automatic adjustment clause").

***Proposed Resolution***

The task before us is to determine what amounts of taxes paid to units of government by an affiliated group are "properly attributed" to the regulated operations of a utility. On its face, the concept of "attributing" a utility's share from a consolidated tax bill appears straightforward. We need only establish a formula to divide the amount of taxes paid among entities in the taxpaying group. The difficulty is determining what factors should be used to develop a formula suited for properly isolating the taxes of a regulated utility from other corporations in a consolidated tax return.

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[3] Participants appear to have interpreted Section (12)(a) as the stand-alone calculation. We note that this is not entirely accurate. There are two parts to the section: (1) the portion of taxes paid, which is defined in SB 408 as "amounts received by units of government" from the taxpaying entity that contains the utility, and subject to certain adjustments, and (2) that is incurred as a result of regulated operations of the utility. This implies a certain amount of attribution; that is, a determination of the portion of taxes actually paid that result from regulated operations. Where a utility stands alone, or its tax-paying owner does not have a negative tax liability that is counteracted by the utility's taxes, the calculation *may* be the equivalent of a stand-alone computation. However, a tax-paying parent may have a negative tax liability that is offset by the utility's taxes, resulting in an amount less than stand-alone. In keeping with this logic, the Attorney General explained that "paragraph 3(12(a) addresses those taxes that would not have been received by units of government 'but for' the existence of the regulated operations." Letter from Atty Gen,15.

For these reasons, we believe that PacifiCorp's with and without proposal best reflects the application of the language in Section (12)(a). To determine the effect of a utility's income on the consolidated parent's tax liability, the utility should first calculate the parent's tax liability without the regulated operations of the utility, and then calculate liability with the regulated operations factored in. The difference will reflect the portion of taxes paid that is incurred as a result of the income from the regulated operations of the utility.

To perform this task, we believe the methodology used to determine amounts "properly attributed" should seek to balance the interests of the utility and ratepayers. To be consistent with the spirit and letter of SB 408, the methodology should also begin with the amount of taxes actually paid to governmental units. Such a method, moreover, should be easy to administer, use readily available information, and be "automatically" applied without a hearing, *see* ORS 757.210. Finally, the adopted methodology should be flexible enough to apply to any corporate structure currently in place or in place in the future.

After extensive consideration of this matter, we find that we need not create a new apportionment process to meet these parameters. The task of determining the amounts of taxes "properly attributed" to the regulated operations of a utility is similar to the task facing state taxing authorities in determining the state tax liability for multistate corporations. To accomplish this, our Legislative Assembly and other states have adopted a methodology, which we will call the Apportionment method, to fairly determine a multistate corporation's portion of income so that, when summed up, the corporation pays state taxes on no more than one hundred percent of its net income. This three-factor Apportionment method, first proposed by a committee of the National Tax Association in 1939, has enjoyed widespread acceptance. *See* Jerome Hellerstein, Walter Hellerstein, *State Taxation: Constitutional Limitations and Corporate Income and Franchise Taxes*, ¶ 8.06 n 174 (3rd ed). The Apportionment method was adopted by Oregon in 1965, *see* Or Laws 1965, c 152, § 10, and is utilized, with some variation, by nearly every state. *See* Hellerstein, ¶ 9.02, table 9-3.

As used by state taxing authorities to determine a corporation's state tax liability, this Apportionment method apportions a multistate corporation's federal taxable income based on the amounts of property, payroll, and sales in each state.[4] As the Oregon Supreme Court has described it,

> The three-factor formula works in the following way: Dollar values are assessed to each of three aspects of taxpayer's business: property, sales and payroll. Each of these factors is a fraction. The numerator of each fraction is the Oregon portion of the value and the denominator is the total value everywhere. Each fraction is rendered a percentage. The three percentages are added together and divided by three. The resultant percentage represents the extent of taxpayer's business in Oregon. It is multiplied by taxpayer's income during the tax year to determine the

[4] We acknowledge that the State of Oregon has weighted the factors unequally for economic development purposes. At this time, we have no reason to weight one factor more heavily than another, and propose to use an average of the ratios based on the three equally-weighted factors. This three factor system has wide support, as noted by the United States Supreme Court, but we remain open to comments from the participants on this point. *See Container Corp. v. Franchise Tax Bd.*, 463 US 159, 170, 183 (1983); *Gen. Motors v. District of Columbia*, 380 US 553, 561 (1965).

> Oregon taxable income. The resultant dollar figure, after modifications not relevant to this case, is multiplied by the applicable excise tax rate to determine the amount taxpayer must pay.

*Twentieth Century-Fox Film v. Dept. of Rev.*, 299 Or 220, 224 (1985). The Court later provided an example of how the Apportionment method is applied in *Crocker Equipment Leasing, Inc. v. Dept. of Rev.*, 314 Or 122 (1992). In that case affirming the Department of Revenue's interpretation of "property," the Court upheld the Department's findings for the tax years 1978-1980, a payroll ratio of zero percent for each year, property ratios of .931 percent, .748 percent, and .502 percent; and sales ratios of .123 percent, .093 percent, and .061 percent. *See id.* at 127. The Court then averaged the ratios and found apportionment factors of .351 percent, .046 percent, and .031 percent for 1978-1980, respectively. After multiplying those ratios by the company's total federal taxable income, the Court came up with the amount of income apportioned to Oregon and the resulting Oregon income tax.

The principles underlying the Apportionment method may also be used to determine taxes paid "that are properly attributed to the regulated operations of the utility." To start, we must determine the amount of taxes paid by the utility or its affiliated group. Under Section 13(a), the "affiliated group" includes all entities comprising the tax-paying group of which the utility is a member and that files a consolidated federal income tax return.

We must make this determination for federal, state, and local income taxes. For federal taxes, the determination is simple: the amount of taxes paid is reported on the consolidated return of the affiliate group that includes the utility. On a state basis, it is more complicated. In Oregon, taxes are filed by unitary groups, which may not be the same as the affiliated group that files a consolidated federal income tax. *See* ORS 317.715(2). For a large conglomerate involved in several different industries, there may in fact be several unitary groups that file taxes in Oregon. To comply with the language of SB 408, particularly the definitions set forth in the law,[5] the various unitary groups that include entities in the consolidated federal return must be aggregated to determine the amount of taxes paid by the affiliated group in Oregon.[6]

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[5] ORS 757.268(6) states, "The automatic adjustment clause shall account for all taxes paid to units of government by the * * * *affiliated group* that are properly attributed to the regulated operations of the utility * * *." Taxes paid is defined as "amounts received by units of government * * * from the *affiliated group* of which the utility is a member," with certain adjustments. ORS 757.268(13)(f). An affiliated group is defined as "an affiliated group of corporations of which the public utility is a member and that files a consolidated federal income tax return." ORS 757.268(13)(a).

[6] We recognize that not every entity in the federal consolidated return necessarily pays state income taxes. Those entities that are in the federal consolidated return and that also pay state income taxes, regardless of the state tax structure, are considered part of the affiliated group. ORS 757.268(13)(a).

After the amount of taxes paid has been determined on a federal, state, and local level, the amount attributable to the regulated operations of the utility must be found. To determine that amount, we may apply the Apportionment method to isolate the amount of taxes related to a utility's regulated operations from other entities and activities in an affiliated group.

Applying 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 for the total affiliated group. Ratios must be calculated for each amount and averaged on the federal, state and local levels. Once a ratio has been determined, it is then multiplied by the taxes paid in that jurisdiction to establish the amount of taxes paid in that jurisdiction which are attributable to the regulated operations of the utility. Then the attributed amount is adjusted by the items listed in ORS 757.268(13)(f).

The amount of taxes paid, properly attributed to the regulated operations of the utility as set out above, will then be measured against taxes collected in rates to determine whether an adjustment is required to account for the difference. We acknowledge that this system varies from generally accepted ratemaking principles, but we note that we are not implementing a typical ratemaking law. SB 408 was enacted to address the discrepancy between taxes collected and taxes paid by utilities, regardless of the regulatory principles behind the long-standing practice of calculating taxes on a stand-alone basis. In adopting the Apportionment method, we implement SB 408 using a method based on tax principles, developed by a national panel, and adopted to determine taxes by the Legislative Assembly. *See* ORS 314.605-314.675. The wide acceptance of the Apportionment method, albeit with some variations, and the resulting thorough consideration of the definitions and problems of application, weighs in favor of its adoption. *See, e.g.,* Hellerstein, §§ 8-9.

Furthermore, the Apportionment method may be adapted for SB 408 purposes using information that is either already reported by the corporation to determine its multistate taxes or can be readily determined from work papers or calculated using well established definitions. In addition, the methodology starts with taxes paid, the starting point for the legislation, and provides for an automatic adjustment clause that is actually automatic and, contrary to some proposals, does not require refiguring a relevant subgroup for adjustments each year. This will provide some degree of certainty to the utilities that the process will be consistent from year to year. Because it is simple and used for other purposes, there is also less potential for gaming by any one group seeking a particular result. Finally, this method has been sanctioned by the Legislative Assembly, which repudiated the stand-alone calculation, but did not endorse any particular approach to "properly attributed." For all of the reasons cited above, we state our intention to choose the Apportionment method to calculate taxes "properly attributed" to a utility, as reflected in the draft rule language attached at Appendix A.

**Earnings Test and the "Double Whammy"**

The so-called "double whammy" situation arises because taxes vary with a utility's earnings. When lower than expected earnings reduce the amount of taxes that will be paid, provision of service is more expensive than was predicted in the rate case, and consumers pay less than the utility's actual costs. At the same time, customers will receive a SB 408 refund because income taxes are less than expected. Utilities argue that this result is unreasonable because it exacerbates their under-recovery and customers do not bear the higher cost of service. Conversely, when a utility's earnings are higher than expected as a result of higher revenues or lower costs, income taxes will also rise, and SB 408 requires a surcharge on ratepayers to compensate for those higher taxes. This would result in further increases in the utility's earnings.

To mitigate the effect of the "double whammy" problem, PGE and NW Natural propose using an earnings test to modify the effect of the automatic adjustment clause. Under this proposal, SB 408 refunds would not be implemented if they result in the utility earning below its authorized rate of return, and surcharges would not be made if they cause the utility to earn above its authorized return. NW Natural states that "the earnings test is an adjustment for excess or deficient earnings, made to the extent needed to avoid an arbitrary and capricious surcharge or refund order that would undermine the Commission's determination of what constitutes a fair, just, and reasonable return." NW Natural Opening Comments, 2 (May 3, 2006). NW Natural goes on to say that an earnings test would prevent double recovery or double-penalization by the utility. *See id.* at n 1. PGE also argues that, by failing to take into account actual earnings, the Commission could adjust rates below the "fair, just, and reasonable" standard, in contravention of the Commission's duty under ORS 757.210. *See* PGE Opening Comments, 17 (May 3, 2006).

ICNU and NWIGU argue that adoption of an earnings test would conflict with the intent of the law. Further, they assert that such a test would "turn[] each SB 408 tax filing into a mini rate case and eliminat[e] the incentives to control costs." Opening Comments of ICNU and NWIGU, 20 (May 3, 2006). This test, which would balance a downward tax adjustment against upward costs, or vice versa, would provide inappropriate insulation for the utility and "enhanc[e the utility's] ability to earn its authorized return each year." *Id.* Staff also opposes an earnings test, arguing that an adjustment for taxes below a utility's approved rate of return is not necessarily confiscatory. *See* Staff's Opening Comments, 6 (May 3, 2006).

While we can see the predicament of the utilities, we find existing protections in law eliminate the need for the utilities' proposed earnings test. First, ORS 756.040 requires that rates ultimately allowed must be "fair and reasonable" to avoid confiscation. As the Attorney General made clear, ORS 756.040 provides a limitation to the effect on utilities of rate reductions flowing from the automatic adjustment clause. Letter from Atty Gen, 16. Moreover, the law provides ample opportunities to adjust rates if there is over- or under-earnings. Utilities may file a rate

case under ORS 757.210 if it is under-earning, and Commission Staff or another party may initiate a rate case if it has reason to believe that a utility is significantly over-earning.

That said, we do acknowledge the general concerns raised by the utilities. In response, we will consider the tax effects when evaluating issues in other dockets, such as power cost adjustment mechanisms.

We believe that it would be contrary to the intent of the legislature to effectively offset the automatic adjustment clause so that it did not "adjust" rates, as it was designed to do. That is, the earnings test offset could net out the automatic adjustment clause. Because this would strike at the heart of the intent behind SB 408 to adjust rates for the difference between taxes collected and taxes paid, we decline to adopt the earnings test proposed by the utilities.

**Actual Amounts**

As discussed above, SB 408 requires this Commission to track amounts of taxes paid by the utility and compare these amounts against taxes authorized to be collected in rates. *See* ORS 757.268(6). "Taxes authorized to be collected in rates" is defined in the bill according to a specific formula: revenues collected from ratepayers, multiplied by the ratio of net to gross revenues from regulated operations, multiplied by the effective tax rate used by the commission in setting rates. *See* ORS 757.268(13)(e)(A)-(C).

PGE attempts to modify the definition of "taxes authorized to be collected in rates" by replacing it with a new definition for "taxes charged." Under this new definition, the automatic adjustment clause would use, to determine taxes paid, the revenues actually collected from Oregon customers, excluding certain revenues as selected by the Commission, multiplied by the utility's actual ratio of net to gross revenues from regulated operations, as derived from PGE's FERC Form 1 data, multiplied by the utility's actual effective tax rate, also derived from PGE's FERC Form 1 data from that period. PGE argues that 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. This proposal, PGE believes, would address the potential mismatch of comparing actual amounts of taxes paid with rate case estimates for taxes paid.

Staff opposes PGE's proposed interpretation of "taxes charged," because the term does not actually appear in the statute. *See* Staff's Opening Comments, 7 (May 6, 2006). In addition, Staff reads the definition of "taxes charged for" as the difference between taxes authorized to be collected in rates and taxes properly attributed to the utility. *See id.* at 7-8.

We decline to adopt PGE's interpretation of "taxes charged" under Section (6). First, the structure of Section (6) refers to calculation of taxes paid and "taxes that are authorized to be collected through rates," so that the amount of taxes charged is not inequitable. The "taxes that are authorized to be collected" is a directive to the Commission to consider a certain calculation; "so that ratepayers are not charged for more tax than" taxes paid refers to a consequence to be avoided. Second, the tax reports filed with the Commission are to include information on taxes paid and properly attributed to the utility, and "the amount of taxes authorized to be collected in rates for the three preceding years." ORS 757.268(1)(b). PGE's argument that this amount should not be used to compute the difference in taxes collected and taxes paid would render the information useless, an illogical interpretation of the legislation which is to be avoided. *See FOPPO v. Washington County*, 142 Or App 252, 259, *rev den* 324 Or 394 (1996). We are not persuaded by PGE's arguments and conclude that Section (6) requires use of the statute's formula to calculate "taxes authorized to be collected in rates," for purposes of the automatic adjustment clause.[7]

**Deferred Accounting and Related Offsets**

PGE also proposes a deferral mechanism to ensure "the proper treatment of disallowed expenses, non-utility expenses, and expenses that have not been included in rates." PGE Straw Proposal, 1. That is, PGE is concerned that the tax impact of these expenses cannot fairly be considered in the forecast of taxes authorized to be collected from ratepayers, and therefore should not be credited to ratepayers in the adjustment for taxes paid. PGE uses the example of a turbine not included in rates, and which was sold at a loss. This sale would result in a tax deduction, which PGE argues should not flow to ratepayers because they did not pay for the turbine. *See* PGE Opening Comments, 19 (May 3, 2006).

ICNU and NWIGU counter that a deferral mechanism is contrary to the intent of SB 408. Further, they assert that the statute governing deferrals, ORS 757.259, was not meant to serve as an ongoing mechanism to recover for this type of event or for an event of this scale. *See* Opening Comments of ICNU and NWIGU, 18 (May 3, 2006).

Staff argues that we should not permit a deferred account to make adjustments for items not included in rates. The only items for which adjustments should be made are set forth in Section (13)(f)(A)-(C), which provide for adjustments to "taxes paid" for charitable contribution deductions, tax credits associated with investment in the regulated operations of the utility not considered in the last rate case, and deferred taxes related to the regulated operations of the utility.

[7] The Attorney General's letter weighed in on whether rate case data or actual data should be used to calculate the ratio of net revenues to gross revenues and the effective tax rate under ORS 757.268(13)(e)(B) and (C), respectively. *See* Letter from Atty Gen, 26-28. The letter stated that the bill appeared to intend that data be taken from the last rate case, and not updated for purposes of the tax adjustment. *See id.*

In a recent order setting forth guidelines for future and pending deferral applications, we clarified our intent to balance the foreseeability of a cost against the magnitude of its impact on the utility in determining whether to grant the deferral application:

> Initially, the proper approach in analyzing an event is to examine the nature of the event, its impact on the utility, the treatment in ratemaking, and other factors used to evaluate whether a deferred account is appropriate. The next step is to examine the magnitude of the underlying event in terms of the potential harm. The type of event—modeled in rates or not, foreseeable or not—will affect the amount of harm that must be shown by the utility. If the event was modeled or foreseen, without extenuating circumstances, the magnitude of harm must be substantial to warrant the Commission's exercise of discretion in opening a deferred account. If the event was neither modeled nor foreseen, or if extenuating circumstances were not foreseen, then the magnitude of harm that would justify deferral likely would be lower.

UM 1147, Order No. 05-1070, 7.

The automatic adjustment clause for taxes is certainly foreseeable; it is set in statute. As to variances as a result of items not included in rates, those too are foreseeable. In keeping with our prior decisions to consider deferral applications on a case by case basis, we will consider applications for deferral with a skeptical eye in light of the principles set forth in this order and other orders related directly to deferred accounting.

Finally, we believe that adoption of a deferral mechanism would be in opposition to the intent of the legislature, because it would effectively offset the automatic adjustment clause so that it did not "adjust" rates, as it was designed to do. Just as with the utilities' proposed earnings test, this deferral mechanism could net out the automatic adjustment clause. Because this would be contrary to the intent behind SB 408 to adjust rates for the difference between taxes collected and taxes paid, we decline to adopt a deferral mechanism as proposed by PGE.

Made, entered, and effective JUL 14 2006.

**Lee Beyer**
Chairman

**John Savage**
Commissioner

**Ray Baum**
Commissioner

PUBLIC UTILITY COMMISSION OF OREGON

"Properly attributed" means the share of taxes paid that is apportioned to the Oregon regulated operations as calculated in [the rule with the Apportionment method calculation].

"Taxpayer" means the utility or the affiliated group, whichever files income tax returns with units of government.

**Properly Attributed**

(1) The amount of federal 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 federal income taxes paid by the taxpayer; and

(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.

(2) The amount of state 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 Oregon income taxes that is paid by the taxpayer; and

(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.

(3) 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 for each local taxing authority in Oregon:

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

(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 the local taxing authority in the numerator and amounts for the taxpayer in the local taxing authority in the denominator.

ORDER NO. 06-532

ENTERED 09/14/06

# BEFORE THE PUBLIC UTILITY COMMISSION

# OF OREGON

AR 499

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| In the Matter of | ) | |
| | ) | |
| Adoption of Permanent Rules to Implement SB 408 Relating to Utility Taxes. | ) | ORDER |

DISPOSITION: PERMANENT RULES ADOPTED

In this order, we adopt administrative rules, attached as Appendix A, necessary to implement Senate Bill 408 (SB 408). This bill, passed by the 2005 Legislative Assembly and generally codified at ORS 757.268,[1] requires certain public utilities to file annual tax reports and other information with the Public Utility Commission of Oregon (Commission). In this annual filing, the affected utilities[2] must identify the amount of income taxes paid, either by the public utility itself or its consolidated group and properly attributed to the utility, and the amount of taxes authorized to be collected in rates during specified time periods. If amounts collected and amounts paid differ by more than $100,000 for any utility, SB 408 requires this Commission to direct the public utility to implement a rate schedule with an automatic adjustment clause accounting for the difference.

This process of "truing up" a utility's cost for taxes constitutes a departure from ratemaking methods traditionally employed by the Commission. Instead of calculating taxes on a stand-alone basis, SB 408 requires this Commission to track the amount of taxes actually paid and determine what portion of those amounts are properly attributed to the regulated operations of the utility. Where taxes are paid on a consolidated basis by a utility parent, this task necessarily involves an apportionment of the paid taxes to all affiliates within a taxpaying entity, to ensure that ratepayers only pay the utility's share of the taxes paid.

**Background**

On April 10, 2006, the Commission filed a Notice of Proposed Rulemaking Hearing and Statement of Need and Fiscal Impact with the Secretary of

[1] This order generally refers to the part of the statute codified at ORS 757.268, in Section 3 of SB 408. References refer to citations of ORS 757.268.
[2] The affected utilities are Avista Utilities (Avista), Northwest Natural Gas Company (NW Natural), Portland General Electric Company (PGE), and Pacific Power & Light (PacifiCorp).

State. On April 21, 2006, notice was provided to certain legislators specified in ORS 183.335(1)(d) and to all interested persons on the service lists maintained pursuant to OAR 860-011-0001. Notice of the rulemaking was published in the *Oregon Bulletin* on May 1, 2006.

A number of participants contributed regularly in this docket, including the affected utilities, the Citizens' Utility Board (CUB), Industrial Customers of Northwest Utilities (ICNU), Northwest Industrial Gas Users (NWIGU), Utility Reform Project (URP), and the City of Portland. On September 15, 2005, we adopted temporary rules in Order No. 05-991. Subsequently, Administrative Law Judges and Commission staff (Staff) conducted several workshops and received public comments to assess legal issues associated with SB 408. At our request, the Oregon Attorney General issued a letter of advice addressing specified legal questions on December 27, 2005.

Rulemaking participants developed straw proposals on the definition of "properly attributed." After revision and comment, we held a workshop to discuss the merits of various interpretations of the law, whether an earnings test should be adopted, whether actual figures should be used for certain components of the "taxes authorized to be collected" calculation, whether deferred accounting and offsets from other deferred accounts should be used, and how Section (12)(a) should be interpreted.

On July 14, 2006, we entered an interim order proposing the adoption of the "Apportionment Method" to calculate taxes "properly attributed" to the utility. *See* Order No. 06-400. Rulemaking participants filed two additional rounds of comments in response to that interim order, and also participated in two workshops and a final rulemaking hearing on August 21, 2006.

## COMMENTS AND DISCUSSION

Comments from rulemaking participants primarily focused on our proposed interpretation of "properly attributed." Other comments addressed the so-called "double whammy," the interpretation of Section (12)(a), and the date of accrual of interest for the automatic adjustment clause. We address these four issues separately.

### I. "Properly Attributed"

In Order No. 06-400, we identified a method to determine taxes that are "properly attributed" to the utility. Specifically, we proposed the use of an adaptation of the three-factor method used by states to apportion the income of multi-state corporations for the purposes of assessing state income tax. Dubbed the "Apportionment Method," our adaptation apportions taxes paid by calculating the utility's amounts of payroll, property, and sales compared to the consolidated group's amounts for the same items. A combination of the three ratios would then be multiplied by the amount of taxes paid to units of government, yielding the utility's attributed portion.

In this order, we formally adopt the "Apportionment Method" to determine the amount of taxes paid that are properly attributed to the utility, specifically, the Oregon portion of the utility. In response to certain concerns raised by the rulemaking participants, however, we make certain modifications to this method for use in attributing taxes paid to the utility.

Normalization requirements

ORS 757.268(8) provides that, notwithstanding other sections of SB 408, "the commission may authorize a public utility to include in rates: (a) Deferred taxes resulting from accelerated depreciation or other tax treatment of utility investment; and (b) Tax requirements and benefits that are required to be included in order to ensure compliance with the normalization requirements of federal tax law." Rulemaking participants propose several modifications to the Apportionment Method to ensure that the normalization requirements are not violated, "even though the parties may have had differing understandings of what those requirements were." NW Natural Comments, 12 (July 31, 2006).

To ensure that normalization issues are simply eliminated from the calculation, PacifiCorp proposes that all regulated entities within the affiliated group, other than Oregon regulated operations, be excluded from the taxes paid calculation. *See* PacifiCorp comments, 8-9 (July 31, 2006). Avista suggests apportioning losses from non-regulated affiliates to regulated operations, rather than apportioning total taxes paid or, alternatively, adjusting "taxes paid" for deferred taxes before apportioning the taxes paid to the various affiliates. *See* Avista comments, 3-4 (July 31, 2006).

Staff, Avista, NW Natural, PacifiCorp, and PGE (Joint Parties), assert that "taxes paid" should be adjusted prior to apportionment for deferred taxes related to non-Oregon regulated operations. *See* Joint Comments, 4 (Aug 14, 2006). PacifiCorp also states that another "possible way to minimize normalization issues" is to add back the imputed tax benefit of tax depreciation on Oregon disallowed capital costs. *See* PacifiCorp comments, 3 (Aug 14, 2006).

PGE also notes the problem of passing along the accelerated depreciation amounts to customers, thereby violating normalization requirements, and putting the benefits of accelerated depreciation at risk. To address this concern, PGE proposes that utilities be allowed to make changes to their tax report filings to avoid normalization problems. *See* PGE comments, 11-12 (July 31, 2006). PacifiCorp also endorses the idea of allowing utilities to adjust their compliance filings as necessary "to address normalization risk." *See* PacifiCorp comments, 9 (July 31, 2006). ICNU proposes allowing utilities to identify tax normalization issues and possible solutions in their tax filings, for Commission review and approval. *See* ICNU comments, 7-8 (July 31, 2006). ICNU emphasizes, however, that any normalization adjustment "should be construed

narrowly to focus on compliance with normalization requirements as applied to regulated utilities and deferred taxes," and cautions against "attempts to expand [the authority to adjust for normalization issues] to address other issues." ICNU comments, 7 (Aug 14, 2006).

CUB requests an opportunity to review any letters submitted by utilities seeking Private Letter Rulings from the Internal Revenue Service (IRS) regarding normalization issues. *See* CUB comments, 9-10 (July 31, 2006). The Joint Parties also request that the deadline by which utilities must seek a Private Letter Ruling should be pushed back from October 15, 2006, to December 31, 2006. *See* Joint Comments, 9 (Aug 14, 2006).

*Commission Resolution*

ORS 757.268(8) provides that this Commission may allow a utility to recover all tax requirements and benefits necessary to ensure compliance with the normalization requirements of federal tax law. We agree that the Apportionment Method for determining properly attributed amounts could result in a violation of federal tax normalization requirements unless certain adjustments are made. Accordingly, we will modify the definition of "taxes paid" to remove all tax effects resulting from accelerated depreciation on public utility property. To accomplish this, the utility, in reporting taxes paid, will first remove the tax benefits of depreciation and federal investment tax credits by adding back the related tax effects to the amount of taxes paid to each taxing authority. *See* Appendix A, OAR 860-022-0041(2)(r) (adjustments for all taxes after apportionment); OAR 860-022-0041(3)(a)(A)(i) through (iii) (adjustments prior to apportionment for federal taxes), OAR 860-022-0041(3)(c)(A)(i) (adjustments prior to apportionment for state taxes), OAR 860-022-0041(3)(e)(A)(i) (adjustments prior to apportionment for local taxes), OAR 860-022-0041(4)(a) and (g) (amount of taxes paid to federal, state and local taxing authorities), OAR 860-022-0041(2)(n) and OAR 860-022-0041(4)(b) (calculation of stand-alone tax liability). When the final taxes paid amounts are calculated, an adjustment will be made to reflect the proper amount of current and deferred taxes related to Oregon regulated operations. *See* Appendix A, OAR 860-022-0041(4)(d) (adjustments to federal and state taxes paid), OAR 860-022-0041(4)(j) (adjustments to local taxes paid). These steps should ensure that no tax benefits flow to Oregon customers that would cause a violation of normalization requirements.

Further, we agree that utilities should have the flexibility to separately identify additional normalization issues as they arise, and propose solutions to those issues. We will then review possible normalization violations, decide whether to consider them and, if necessary, resolve them in an order establishing the amount of the automatic adjustment clause for that period. *See* Appendix A, OAR 860-022-0041(4)(o).

To facilitate review of utility letters seeking Private Letter Rulings from the IRS, we establish a deadline for draft letters to be submitted by the utilities to the

Commission and all participants in this docket on or before November 15, 2006. *See* Appendix A, OAR 860-022-0041(8)(g). Participants may review the letters and submit proposed edits and comments to all participants and the Commission on or before December 4, 2006. The Commission will review the proposed edits and work with the utilities on a final draft, to be submitted to the IRS on or before December 31, 2006. *See id.*

Other add-backs

ORS 757.268 provides for "add-backs" for certain items in determining "taxes paid." In addition to add-backs for deferred taxes, which must be added back to prevent a normalization violation, *see infra* 2-4, the statute allows for adding back of tax savings realized as a result of charitable contributions made by the Oregon utility and tax savings associated with investment by the utility in the regulated operations of the utility which have not yet been taken into account by the Commission in the utility's last general rate case. *See* ORS 757.268(13)(f)(A) and (B). The Commission has the discretion to add-back other items to "taxes paid" as part of the properly attributed calculation as a matter of policy.

NW Natural proposes additional add-backs be allowed, such as tax credits associated with renewable electricity production and business energy tax credits. *See* NW Natural Comments, 3 (July 31, 2006). PacifiCorp also suggests further add-backs, including all deferred taxes, tax credits, and charitable contributions incurred by non-regulated affiliates. *See* PacifiCorp comments, 9-10 (July 31, 2006). CUB agrees that certain add-backs should be made, including the Business Energy Tax Credit (BETC). *See* CUB straw proposal (April 11, 2006). ICNU opposes further modifications. It argues that, because add-backs were carefully selected by the Legislative Assembly, no additional add-backs should be considered. *See* ICNU comments, 7 (Aug 14, 2006).

*Commission Resolution*

In determining what amounts of taxes paid are properly attributed to the utility, we have broad discretion to include add-backs in addition to those identified by the legislature. We exercise this discretion to avoid unintended consequences that would be contrary to the public interest. Accordingly, we conclude that charitable contributions for all affiliates should be added-back prior to apportionment in order to not discourage worthy contributions. Further, we agree that certain tax credits should be added to taxes paid for purposes of determining amounts properly attributed to the utility. On the state level, we agree BETCs related to conservation and renewable resources for all affiliates should be added back so that these kinds of investments are encouraged. This will allow the benefits of these credits go to shareholders as intended under law and not be flowed through to ratepayers except when they bear the associated cost. On the federal level, Internal Revenue Code section 45 renewable electricity production tax credits for all affiliates should be added back prior to apportionment so that these credits do not go to

ratepayers. These credits are tied to tax policy to promote renewable energy sources, and, as a matter of policy, we exercise our discretion in adding them to "taxes paid" to determine the proper attribution of taxes paid by the utility.

Situs and Alternatives

In the interim order, we stated that the numerators for the ratios to determine the utility's portion of taxes paid should account for the utility's property, payroll, and sales in the state of Oregon. This was derived from the origination of the Apportionment Method, which was developed to determine a state's share of income from a multi-state corporation in order to apply that state's income tax.

Several rulemaking participants argue that the numerator should reflect all utility property, payroll, and sales used to provide regulated service for Oregon customers, including those amounts located or incurred outside the state of Oregon. *See, e.g.,* PGE comments, 8-9 (July 31, 2006), CUB comments, 4-7 (July 31, 2006), URP comments, 1 (Aug 14, 2006). Otherwise, CUB contends, to calculate the numerator according to the utility assets located solely in Oregon would result in "perverse incentives." CUB comments, public comment hearing (Aug 21, 2006).[3] For example, CUB explains that the resulting tax consequences may cause a utility to make a decision on the siting of a particular resource based on issues other than which location provides the least risk and cost for customers. ICNU opposes any deviation from our interim decision. It argues that, while the situs figures for the numerator are not precise, they approximate the taxes for which the utility's Oregon ratepayers are liable and should be used. *See* ICNU comments, 2-4 (Aug 14, 2006).

*Commission Resolution*

We agree with the majority of rulemaking participants that Oregon ratepayers should be responsible for the tax effects of all assets in rate base, whether located in Oregon or not. Regardless of their respective locations, all these assets have been approved by this Commission as necessary and useful in providing service to Oregon ratepayers. This requires an adjustment to the Apportionment Method. In the numerator, utilities should use the utility's gross plant, wages and salaries, and sales, as set forth in the utility's "results of operations" report to determine the amount of those ratios in relation to the entire consolidated entity's amount of payroll, property, and sales. That ratio will then be multiplied against the total taxes paid by the consolidated taxpayer, yielding the amount of taxes properly attributed to the utility. If necessary, this amount will be further adjusted to determine the amount of taxes attributed to the Oregon portion of a multi-state utility.

[3] The audio files for the August 21, 2006, public comment hearing can be found, as of the date of this order, at http://apps.puc.state.or.us/agenda/audio/2006/082106/default.htm.

Multi-State Tax Rate

The interim order also determined state taxes paid for the state of Oregon only. This is also a hold-over from the Apportionment Method's initial purpose of attributing taxes to Oregon alone. As noted above, however, utility resources used to serve Oregon customers are not necessarily located in Oregon. As several participants note, the interim order does not give proper consideration to taxes paid in other states on resources used to provide energy service to Oregon customers. For instance, PGE operates the Colstrip plant in Montana, which is used to provide electricity to Oregon customers. Therefore, the argument goes, Montana taxes, incurred at least in part by the Colstrip plant, should be properly attributed to the utility's regulated operations.

Participants put forth several solutions. One proposal requires the utility to calculate its proper attribution of taxes paid in each state where it has property, payroll, or sales used to provide service to Oregon customers. Another proposal allows the utility to calculate its proper attribution of taxes paid only in Oregon, but using an "effective tax rate" used to determine taxes collected in the rate case. Utilities have proposed allowing them to make the choice between the two options. *See* Joint Comments, 5-7 (Aug 14, 2006). Customer groups, however, are wary of allowing utilities to run both sets of numbers and then unilaterally choose which method to report, and note that utilities may not make the choice that is in the best interests of customers. *See* ICNU comments, public comment hearing (Aug 21, 2006).

*Commission Resolution*

We adopt the participants' proposal that we should consider state taxes paid on a wider basis than just those paid in Oregon, either by examining taxes paid in all states in which the utility pays state income taxes, or by an "effective tax rate" approach to taxes paid in Oregon. To resolve the concern of the customer groups, we require the utilities to make a one-time election and decide which methodology they will use to calculate their state taxes paid. *See* Appendix A, OAR 860-022-0041(3)(c)(C).

Apportionment of Local Taxes Paid

In the interim order, we decided that taxes paid should be apportioned at each level according to property, payroll, and sales, with the understanding that the multi-state companies would have those figures readily available on a statewide basis to calculate the portion of their income subject to each state's income taxes. Since then, we have learned that those factors are not necessarily calculated on a local basis. Instead, local taxes are determined by other measures.

NW Natural appears to argue that local taxes need not be apportioned, because they are essentially paid on a stand-alone basis and are collected only from impacted ratepayers in a separate surcharge. *See* NW Natural, 12 (July 31, 2006). PGE

also argues that local taxes should not be apportioned. *See* PGE comments, 9 (July 31, 2006). URP and ICNU oppose calculating local taxes paid on a stand-alone basis, and assert that local taxes should be apportioned. *See* URP comments, 2 (Aug 14, 2006); ICNU comments, 4-5 (Aug 14, 2006). Staff and the Joint Parties argue that local taxes should be apportioned, but not necessarily based on the same three factors used to apportion federal and state taxes. *See* Joint Comments, 7 (Aug 14, 2006).

*Commission Resolution*

The Apportionment Method was selected in part because the amounts for property, payroll, and sales would be readily available for other purposes, and could easily be used to calculate the utility's portion of taxes paid. Following that reasoning, we agree that it makes sense to apportion local taxes based on the factor used to assess those taxes. For example, the taxable income used to calculate the Multnomah County Business Income Tax (MCBIT) is apportioned based on gross income; therefore, determination of taxes properly attributed to the utility on the local level should be based on an apportionment by gross income for the MCBIT. *See* Appendix A, OAR 860-022-0041(3)(e)(B). If other local taxes arise, they too will be apportioned based on the factor used to assess those taxes, and will be dealt with on a case by case basis.

Lower Limit on Properly Attributed

The Joint Parties express concern that the Apportionment Method could yield a result in which customers receive more than 100 percent of the tax benefits from losses within the taxpaying group. *See* Joint Comments, 8 (Aug 14, 2006). To illustrate, the Joint Parties assume a utility has a stand-alone tax liability of $50 and a sole affiliate with a loss of $5. In this example, the utility's affiliated group's consolidated tax liability is $45. Application of the Apportionment Method, however, would produce a "properly attributed" amount lower than this $45 figure, because a portion of that consolidated tax liability would be attributed to the affiliate. To avoid this result, the Joint Parties recommend the Commission include a "floor" for the three-factor attributed amount. The proposed floor: the utility's stand-along tax liability minus the total amount of negative tax liabilities of affiliates in the applicable federal or state tax filing. *See id.*

Customer groups express concern about the inclusion of a floor. ICNU contends that any floor should be "narrowly tailored," beginning with the amount in ORS 757.268(12)(a) and attributing losses from all entities in the consolidated federal tax group. *See* ICNU comments, 8-9 (Aug 14, 2006). CUB opposes the proposed floor as an inappropriate limit on the method for properly attributing taxes that had been adopted by the Commission. CUB comments, public comment hearing (Aug 21, 2006).

*Commission Resolution*

The Apportionment Method allocates any taxes paid to all affiliates in the taxpaying group, including entities with no tax liability. As a result, we agree with the Joint Parties that this could produce a result in which customers receive more than 100 percent of the benefit from the tax losses of the utility's taypaying group. We agree with the Joint Parties that the Apportionment Method should be revised to preclude such an unjust result.

To provide a safety net against this result, we will include a "floor" beneath which the taxes paid that are properly attributed to the utility cannot fall. The floor will be calculated at the federal and state level by first determining the federal and state stand-alone tax liability for the utility. On the federal level, and at the state level for a utility with a multi-state tax rate, these amounts will then be reduced by the sum of the tax effects of all income tax losses of entities within the taxpaying group, as allocated to the Oregon operations of the utility using the ratios derived from the utility's gross plant, wages and salaries, and sales. On the state level for a utility for which Oregon state income taxes are the only state income taxes included in rates, the amounts equal to the stand-alone tax liability will be reduced by the sum of the tax benefits of all income tax losses of entities within the unitary group. These amounts will establish the lowest amounts of "taxes paid," determined under the Apportionment Method, that are properly attributed to the regulated operations of the utility. *See* Appendix A, OAR 860-022-0041(3)(b) (floor for federal taxes), OAR 860-022-0041(3)(d) (floor for state taxes).

Unitary Group

ORS 757.268 refers to the utility's "affiliated group," which includes every entity that is part of the consolidated federal tax return. *See* ORS 757.268(13)(a). The interim order stated that, to determine the "affiliated group" on the state level, "the various unitary groups that include entities in the consolidated federal return must be aggregated to determine the amount of taxes paid by the affiliated group in Oregon." Order No. 06-400, 6.

The participants agree that, rather than using all the state unitary groups as the taxpaying entity, the Commission should instead focus solely on the unitary group containing the utility. *See, e.g.*, CUB comments, 8 (July 31, 2006); PacifiCorp comments, 7 (July 31, 2006); Joint Parties, 7 (Aug 14, 2006). Staff adds that the Commission had discretion to use this single unitary group to calculate the properly attributed amount, and agrees that it would be "appropriate" because the unitary group is the taxpaying entity. *See* Staff comments, 2-3 (July 31, 2006).

*Commission Resolution*

We agree that taxes paid should be determined by the amount paid by the entity that includes the utility. On the state level, that means that state taxes should be gauged only by the amount paid by the unitary group that includes the utility.

**II. "Double Whammy"**

In Order No. 06-400, 8, we described the oft-discussed "double whammy" problem:

> The so-called "double whammy" situation arises because taxes vary with a utility's earnings. When lower than expected earnings reduce the amount of taxes that will be paid, provision of service is more expensive than was predicted in the rate case, and consumers pay less than the utility's actual costs. At the same time, customers will receive a SB 408 refund because income taxes are less than expected. Utilities argue that this result is unreasonable because it exacerbates their under-recovery and customers do not bear the higher cost of service. Conversely, when a utility's earnings are higher than expected as a result of higher revenues or lower costs, income taxes will also rise, and SB 408 requires a surcharge on ratepayers to compensate for those higher taxes. This would result in further increases in the utility's earnings.

We concluded that, while this is a difficult problem posed by SB 408, we believed, "that it would be contrary to the intent of the legislature to effectively offset the automatic adjustment clause so that it did not "adjust" rates, as it was designed to do. That is, the earnings test offset could net out the automatic adjustment clause." Order No. 06-400, 9.

After the interim order, utilities continue to express concern about the effect of the "double whammy." PacifiCorp suggests that the Commission allow utilities to add in the tax effect of expenses between rate cases to the extent there is a difference between the properly attributed amount and the stand-alone amount of taxes paid. *See* PacifiCorp comments, 8 (Aug 14, 2006). NW Natural urges the Commission to exercise its discretion to allow deferrals to mitigate the "double whammy" problem, or recommend a statutory solution to the next Legislative Assembly. *See* NW Natural comments, 13-14 (July 31, 2006). At the public comment hearing, ICNU questioned the utilities' characterization of the "double whammy" problem and disagreed that any remedies should be implemented in this rulemaking. *See* ICNU comments, public comment hearing (Aug 21, 2006).

*Commission Resolution*

We continue to believe that, as the agency charged with implementing SB 408, the proposed solutions to the "double whammy" problem may run contrary to the intent of the Legislative Assembly. However, as we stated earlier, we will be responsive to concerns related to the consequences of the "double whammy" problem, and may address those in ORS 756.040 proceedings, general rate cases, and power cost adjustment mechanism dockets. *See* Order No. 06-400, 9.

## III. Section 12(a) Cap

ORS 757.268(12)(a) states that the amount of taxes properly attributed to a utility shall not exceed "[t]hat portion of the total taxes paid that is incurred as a result of income generated by the regulated operations of the utility." The Attorney General's letter of advice examined Section 12(a), and interpreted it as addressing "those taxes that would not have been received by units of government "but for" the existence of the regulated operations." Letter from Hardy Meyers, Or Atty Gen, to Lee Beyer, Commn Chair, at 15 (Dec 27, 2005) (available at http://www.puc.state.or.us/PUC/leg/sb408/index.shtml). In the interim order, we interpreted the Section 12(a) cap as best calculated by using the "With and Without" methodology proposed by PacifiCorp to determine what portion of taxes is directly tied to the utility. *See* Order No. 06-400, 4 n 3.

The utilities argue that we incorrectly interpreted Section 12(a). PGE asserted that the Section 12(a) cap was designed "to remove the effect of other tax group members to focus on what would have been the taxes paid by the stand-alone utility." PGE comments, 12 (July 31, 2006). Other utilities agree that Section 12(a) should be calculated based on the utility as a stand-alone entity. *See* PacifiCorp comments, 11-12 (July 31, 2006); NW Natural comments, 3 (Aug 14, 2006). Staff also agrees with that interpretation, asserting that the Commission has discretion in interpreting the cap in Section 12(a). *See* Joint Comments, 8 (Aug 14, 2006). ICNU argues that the Section 12(a) cap should include "all tax liabilities and credit that are supported, directly or indirectly, by the utility's regulated revenues." ICNU comments, 8 (July 31, 2006).

*Commission Resolution*

We agree with Staff that this Commission has discretion in interpreting the meaning of Section 12(a). In exercising that discretion, we may interpret the 12(a) cap as either a utility's stand-alone tax liability or as the amount produced under the "With and Without" methodology. There is little practical effect in choosing one interpretation over the other, however. The two interpretations will produce different amounts when all other members of the affiliated group together have a tax loss. In that case, however, the Section 12(b) cap will be no higher than either result produced under the competing interpretations of the Section 12(a) cap and, consequently, will establish the cap under

Section 12.[4] Due to this interaction between the Section 12(a) and 12(b) caps, and to simplify the Section 12(a) calculation, we will require the utilities to report the amount of stand-alone tax liability for purposes of the Section 12(a) cap. *See* Appendix A, OAR 860-022-0041(4)(b) (for federal and state taxes), OAR 860-022-0041(4)(h) (for local taxes).

## IV. Date of Accrual of Interest

In the interim order, we stated that interest on the amount of the adjustment should begin to accrue on January 1 after the tax year for the difference for which the adjustment must be applied. For instance, a utility will track and report taxes collected and taxes paid for the year 2006 in a filing to be submitted on or before October 15, 2007. The Commission will then have 180 days to determine the amount of the automatic adjustment clause, which would take effect on June 1, 2008. Under the draft rule, interest would begin to accrue January 1, 2007. *See* Order No. 06-400, Draft Rule 9(e). PGE argues that interest should begin to accrue one year later, on January 1, 2008, to "dampen" volatile fluctuations that could have a harmful impact as a result of SB 408. *See* PGE comments, 13 (July 31, 2006).

*Commission Resolution*

SB 408's primary feature is a backward-looking true-up mechanism designed to align taxes paid with those collected from ratepayers. As explained above, this mechanism takes time to implement. Taxes collected in rates beginning in January 2006 will not be trued-up until June 2008. To ensure that neither utilities nor ratepayers are harmed by this delay, we find that interest should accrue as of the start date for the adjustment period. Thus, rather than the January 1, 2007 date proposed in Staff's proposed rules, circulated on July 25, 2006, we conclude that interest should begin to accrue for differences beginning January 1, 2006. The timing of the interest accrual is consistent with policies governing the accrual of interest on deferred accounts. *See* ORS 757.259. For purposes of calculating interest, we will assume that the mismatch of taxes paid with those collected accrues and accumulates evenly over the course of the entire tax year. Using this mid-year convention, interest will accrue on the amount of the annual difference as of July 1 of the tax year.

[4] In the example discussed above on page 8, the utility's stand-alone tax liability is $50 and the other affiliate(s) have a tax loss of $5. The "With and Without" approach to the Section 12(a) cap yields $45, since the group's tax liability is $45 with the utility and $0 without it. The "With and Without" cap is lower than a stand-alone approach to the Section 12(a) cap, but it is the same as the Section 12(b) cap, which is the affiliated group's tax payment.

ORDER NO. 06-532

## ORDER

IT IS ORDERED that:

1. OAR 860-022-0041, as set forth in Appendix A, is adopted.

2. The rule shall become effective upon filing with the Secretary of State.

3. Avista Utilities, Northwest Natural Gas Company, Pacific Power & Light, and Portland General Electric Company shall file their tax reports on or before October 15, 2006, in compliance with the rule in Appendix A and this order.

4. Avista Utilities, Northwest Natural Gas Company, Pacific Power & Light, and Portland General Electric Company shall submit their draft requests for a Private Letter Ruling from the Internal Revenue Service to the Public Utility Commission of Oregon and all participants in this docket on or before November 15, 2006.

Made, entered, and effective SEP 1 4 2006.

**Lee Beyer**
Chairman

**John Savage**
Commissioner

**Ray Baum**
Commissioner

A person may petition the Commission for the amendment or repeal of a rule pursuant to ORS 183.390. A person may petition the Court of Appeals to determine the validity of a rule pursuant to ORS 183.400.

860-022-0041
Annual Tax Reports and Automatic Adjustment Clauses Relating to Utility Taxes

(1) This rule applies to regulated investor-owned utilities that provided electric or natural gas service to an average of 50,000 or more customers in Oregon in 2003, or to any successors in interest of those utilities that continue to be regulated investor-owned utilities.

(2) As used in this rule:

(a) "Affiliated group" has the meaning given to "affiliated group" in ORS 757.268(13)(a);

(b) "Deferred taxes" for purposes of the utility means the total deferred tax expense of regulated operations, as reported in the deferred tax expense accounts as defined by the Federal Energy Regulatory Commission, that relate to the year being reported in the utility's results of operations report or tax returns;

(c) "Income" means taxable income as determined by the applicable taxing authority, except that income means regulatory taxable income when reporting or computing the stand-alone tax liability resulting from a utility's regulated operations;

(d) "IRC" means Internal Revenue Code;

(e) "Investment" means capital outlays for utility property necessary or useful in providing regulated service to customers;

(f) "Local taxes collected" means the total amount collected by the utility from customers under the local tax line-item of customers' bills calculated on a separate city or county basis;

(g) "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;

(h) "Properly attributed" means the share of taxes paid that is apportioned to the regulated operations of the utility as calculated in section (3), subject to subsections (4)(a), (4)(b), (4)(g) and (4)(h), of this rule;

(i) "Public utility property" means property as defined by the Code of Federal Regulations, Title 26, Section 168(i)(10);

(j) "Regulated operations of the utility" has the meaning given to "regulated operations of the utility" in ORS 757.268(13)(c);

(k) "Results of operations report" means the utility's annual results of operations report filed with the Commission;

(l) "Revenue" means utility retail revenues received from ratepayers in Oregon, excluding supplemental schedules or other revenues not included in the utility's revenue requirement and adjusted for any rate adjustment imposed under this rule;

(m) "Revenue requirement" means the total revenue the Commission authorizes a utility an opportunity to recover in rates pursuant to a general rate proceeding or other general rate revision, including an annual automatic adjustment clause under ORS 757.210;

(n) "Stand-alone tax liability" means the amount of income tax liability calculated using a pro forma tax return and revenues and expenses in the utility's results of operations report for the year, except using zero depreciation expense for public utility property, excluding any tax effects from investment tax credits, and calculating interest expense in the manner used by the Commission in establishing rates;

(o) "System regulated operations" means those activities of the utility, in Oregon and other jurisdictions, that are subject to rate regulation by any state commission;

(p) "Tax" has the meaning given to "tax" in ORS 757.268(13)(d);

(q) "Taxes authorized to be collected in rates" means:

(A) The following for federal and state income taxes calculated by multiplying the following three values:

(i) The revenue the utility collects, as reported in the utility's results of operations report;

(ii) 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; and

(iii) The effective tax rate used by the Commission in establishing rates for the time period covered by the tax report as set forth in the most recent general rate order or other order that establishes an effective tax rate, calculated as the ratio of total income tax expense in revenue requirement to pre-tax income;

(B) For purposes of paragraph (2)(q)(A) of this rule, when the Commission has authorized a change during the tax year for gross revenues, net revenues or effective tax rate, the amount of taxes authorized to be collected in rates will be calculated using a weighted average of months in effect;

(r) "Taxes paid" has the meaning given to "taxes paid" in ORS 757.268(13)(f);

(s) "Taxpayer" means the utility, the affiliated group or the unitary group that files income tax returns with units of government;

(t) "Tax report" means the tax filing each utility must file with the Commission annually, on or before October 15 following the year for which the filing is being made, pursuant to ORS 757.268;

(u) "Unitary group" means the utility or the group of corporations of which the utility is a member that files a consolidated state income tax return; and

(v) "Units of government" means federal, state, and local taxing authorities.

(3) The amount of income taxes paid that is properly attributed to regulated operations of the utility is calculated as follows:

(a) The amount of federal income taxes paid to units of government that is properly attributed to the regulated operations of the utility is the product of the values in paragraphs (3)(a)(A) and (B), subject to subsection (3)(b) of this rule:

(A) The total amount of federal income taxes paid by the federal taxpayer, to which is added:

(i) The current tax benefit, at the statutory federal income tax rate, of tax depreciation on public utility property;

(ii) The tax benefits associated with federal investment tax credits related to public utility property; and

(iii) Imputed tax benefits on charitable contributions and IRC section 45 renewable electricity production tax credits of the affiliated group, except those tax benefits or credits associated with regulated operations of the utility; and

(B) The average of the ratios calculated for the utility's gross plant, wages and salaries and sales, using amounts allocated to regulated operations of the utility as set forth in the utility's results of operations report in the numerator and amounts for the federal taxpayer in the denominator;

(b) The amount of federal income taxes paid that is properly attributed to the regulated operations of the utility under subsection (3)(a) of this rule shall not be less than

the amount of the federal stand-alone tax liability calculated for the regulated operations of the utility, reduced by the product of:

(A) The imputed negative tax associated with all federal income tax losses of entities in the utility's federal taxpayer group, after making the adjustments in subparagraphs (3)(a)(A)(i) and (ii) of this rule; and

(B) The average of the ratios for the utility's gross plant, wages and salaries and sales, using amounts allocated to the regulated operations of the utility as set forth in the utility's results of operations report in the numerator and amounts for the system regulated operations in the denominator;

(c) The total 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 values in paragraphs (3)(c)(A) and (B), subject to paragraphs (3)(c)(C) and (D) and subsection (3)(d) of this rule:

(A) The total amount of Oregon income taxes paid by the Oregon unitary group taxpayer, to which is added:

(i) The current tax benefit, at the state statutory rate, of tax depreciation on public utility property; and

(ii) Imputed Oregon tax benefits on charitable contributions and state business energy tax credits related to conservation and renewable energy production of the unitary group, except those tax benefits or credits associated with regulated operations of the utility; and

(B) The average of the ratios calculated for the utility's gross plant, wages and salaries and sales using amounts allocated to regulated operations of the utility as set forth in the utility's results of operations report in the numerator and amounts for the unitary group taxpayer in Oregon, adjusted to reflect amounts allocated to regulated operations of the utility, in the denominator;

(C) If a utility's taxes collected in rates reflect non-Oregon state income taxes, the utility must make a one-time permanent election in its October 15, 2006, tax report filing to either:

(i) Multiply the total amount of Oregon income taxes paid in paragraph (3)(c)(A) of this rule before adjustments by the ratio calculated as the state income tax rate used by the Commission in establishing rates divided by the Oregon statutory tax rate set forth in ORS 317.061; or

(ii) Calculate the total state taxes paid using the formula set forth in paragraphs (3)(c)(A) and (B) of this rule on a state by state basis, apportioned to Oregon by multiplying the total state taxes paid by the average of the ratios calculated for gross plant, wages and salaries and sales using amounts allocated to the regulated operations of the utility in the numerator and amounts for the system regulated operations in the denominator;

(D) When Oregon income tax attributable to system regulated operations is 100 percent allocated to Oregon in setting rates, 100 percent of the Oregon income tax of system regulated operations must be attributed to the regulated operations of the utility;

(d) The amount of state income taxes paid that is properly attributed to the regulated utility operations of the utility under subsection (3)(c) of this rule must not be less than:

(A) For a utility for which Oregon state income taxes are the only state income taxes included in rates, the amount of the Oregon state stand-alone tax liability calculated for the regulated operations of the utility, minus the imputed negative tax associated with all

Oregon state income tax losses of entities in the utility's unitary group after making the adjustment in subparagraph (3)(c)(A)(i) of this rule; or

(B) For a utility for which non-Oregon state income taxes are included in rates, the product of:

(i) The sum of the state stand-alone tax liability calculated for the applicable system regulated operations in each state in which the utility is a member of a unitary group, minus the sum of the imputed negative tax associated with all state income tax losses of entities in the utility's unitary group in each state, after making the adjustment in subparagraph (3)(c)(A)(i) of this rule for each state; and

(ii) The average of the ratios calculated for gross plant, wages and salaries and sales using amounts allocated to the regulated operations of the utility in the numerator and amounts for the system regulated operations in the denominator;

(e) The amount of local income taxes paid to units of government that is properly attributed to the regulated operations of a utility is the product of the values in paragraphs (3)(e)(A) and (B) of this rule for each local taxing authority in Oregon:

(A) The total amount of income taxes paid by the taxpayer to the local taxing authority, as adjusted to include the imputed effect on local income taxes of:

(i) The current tax benefit of tax depreciation on public utility property; and

(ii) Imputed tax benefits on charitable contributions of the taxpayer except those associated with regulated operations of the utility; and

(B) The ratio calculated using the method for apportioning taxable income used by the local taxing authority, with the amount for the regulated operations of the utility in the local taxing authority in the numerator and the amount for the taxpayer in the local taxing authority in the denominator.

(4) On or before October 15 of each year, each utility must file a tax report with the Commission. The tax report must contain the following applicable 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 taxpayer, as adjusted pursuant to subparagraphs (3)(a)(A)(i) and (ii) of this rule;

(b) The amount of the utility's federal and state income taxes paid that is incurred as a result of income generated by the regulated operations of the utility, where:

(A) The amount of federal income taxes paid is equal to the federal stand-alone tax liability calculated for the regulated operations of the utility;

(B) For a utility for which Oregon state income taxes are the only state income taxes included in rates, the utility's state income taxes paid is the Oregon state stand-alone tax liability calculated for the regulated operations of the utility; and

(C) For a utility for which non-Oregon state income taxes are included in rates, the amount of state income taxes paid is the product of:

(i) The sum of the state stand-alone tax liability calculated for the applicable system regulated operations in each state in which the utility is a member of a unitary group; and

(ii) The ratio calculated as the income of the regulated operations of the utility divided by the income of the system regulated operations;

(c) The amount of federal and state income taxes paid to units of government by the taxpayer that is properly attributed to the regulated operations of the utility, as calculated in section (3) of this rule;

(d) The lowest of the amounts in subsections (4)(a), (4)(b) and (4)(c) of this rule, after making adjustments for:

(A) The items defined in subsection (2)(r) of this rule;

(B) A reduction equal to the current tax benefit related to tax depreciation of public utility property for regulated operations of the utility; and

(C) A reduction equal to the tax benefit related to federal investment tax credits recognized by the Commission in establishing rates;

(e) The amount of federal and state income taxes authorized to be collected in rates;

(f) The amount of the difference between the amounts in subsections (4)(d) and (4)(e) of this rule;

(g) The amount of local income taxes paid to units of government by the taxpayer, calculated for each local taxing authority, and to which is added the imputed effect on local income taxes of the amount in subparagraph (3)(e)(A)(i) of this rule;

(h) The amount of local income taxes paid to units of government by the taxpayer that is incurred as a result of income generated by the regulated operations of the utility, calculated as the stand-alone tax liability in each local taxing authority;

(i) The amount of local income taxes paid to units of government by the taxpayer that is properly attributed to the regulated operations of the utility, as calculated in section (3) of this rule for each local taxing authority;

(j) The lowest of the amounts in subsections (4)(g), (4)(h) and (4)(i) of this rule, calculated for each local taxing authority, after making adjustments for:

(A) The items defined in subsection (2)(r) of this rule; and

(B) A reduction equal to the local tax effect of the current tax benefit related to tax depreciation of public utility property for regulated operations of the utility;

(k) The amount of local income taxes collected from Oregon customers, calculated for each local taxing authority;

(l) The amount of the difference between the amounts in subsection (4)(j) and (4)(k) of this rule, calculated for each local taxing authority;

(m) The proposed surcharge or surcredit rate adjustments for each customer rate schedule to charge or refund customers the amount of the differences in subsections (4)(f) and (4)(l) of this rule;

(n) If the utility claims the minimum taxes paid amount set by subsections (3)(b) and (3)(d) of this rule, the total federal and state income tax losses in the utility's affiliated and unitary groups associated with the imputed negative tax claimed; and

(o) Any adjustments, in addition to the adjustments required in section (3) and subsections (4)(a) through (4)(n) of this rule, that the utility proposes to avoid probable violations of federal tax normalization requirements.

(5) In calculating the amount of taxes paid under sections (3) and (4) of this rule:

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

(A) For any tax return prepared for the preceding tax year and filed on or before the date the tax report is due for such tax year, the utility must allocate each reported tax liability to the tax year for which such return is filed;

(B) For each 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, the utility must allocate the tax liability or tax adjustment to the tax year that is recognized by the utility for accounting purposes;

(C) Taxes paid must include any interest paid to or interest received from units of government with respect to tax liabilities;

(b) When a utility's fiscal year or parent changes, and a partial year consolidated federal income tax return is filed during the year, taxes paid must be calculated in the manner defined by ORS 314.355 and OAR 150-314.355. For purposes of this rule, the amount of taxes paid must reflect a weighted average of the months in effect related to each tax return filing.

(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) The Commission will establish an ongoing docket for each of the October 15 tax report filings. Upon signing a protective order prepared by the Commission, any intervenor may have access to all such tax report filings, subject to the terms of the protective order;

(a) Within 20 days following the tax report filings, an Administrative Law Judge will conduct a conference and adopt a schedule;

(b) Within 180 days of the tax report filings, the Commission will issue an order that contains 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 is properly attributed to the regulated operations of the utility;

(B) For the preceding fiscal year, the difference between the amount of federal and state income taxes paid to units of government by the taxpayer that is properly attributed to the regulated operations of the utility and the amount of taxes authorized to be collected in rates;

(C) For the preceding fiscal year, the difference between the amount of local income taxes paid to units of government by the taxpayer that is properly attributed to the regulated operations of the utility and the amount of local taxes collected in rates; and

(c) Any other finding or determination necessary to implement the automatic adjustment clause.

(8) Upon entry of an order finding a difference of $100,000 or more in section (7) of this rule, the utility must file an amended tariff, to be effective each June 1 unless otherwise authorized by the Commission, to implement a rate adjustment applying to taxes paid to units of government and collected from ratepayers for each fiscal year beginning on or after January 1, 2006;

(a) The utility must establish a balancing account and automatic adjustment clause tariff to recover or refund the difference determined by the Commission in paragraph (7)(b)(B) of this rule through a surcharge or surcredit rate adjustment;

(b) A utility that is assessed a local income tax must establish a separate balancing account and automatic adjustment clause tariff for each local taxing authority assessing such tax. The utility must apply a surcharge or surcredit on the bills of customers within the local taxing authority assessing the tax. The amount of the surcharge or surcredit must be calculated to recover or refund the difference determined by the Commission in paragraph (7)(b)(C) of this rule;

(c) Any rate adjustment must be calculated to amortize the difference determined by the Commission in paragraphs (7)(b)(B) and (7)(b)(C) of this rule over a period authorized by the Commission;

(d) Any rate adjustment must be allocated by customer rate schedule according to equal percentage of margin for natural gas utilities and equal cents per kilowatt-hour for electric utilities, unless otherwise authorized by the Commission;

(e) Each balancing account must 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 July 1 of the tax year;

(f) The automatic adjustment clause must 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) On or before December 31, 2006, each utility must seek a Private Letter Ruling from the Internal Revenue Service on whether the utility's compliance with ORS 757.268 or this rule would cause the utility to fail to comply with any provision of federal tax law, including normalization requirements. Each utility must file a draft of its Private Letter Ruling Request with the Commission on or before November 15, 2006. While a utility's request for a Private Letter Ruling is pending, or a related Revenue Ruling is pending, no rate adjustment will be implemented, but interest will accrue according to subsection (8)(e) of this rule on the amount of any rate adjustment determined by the Commission pursuant to paragraphs (7)(b)(B) and (7)(b)(C) of this rule.

(9) No later than 30 days following the Commission's findings in section (7) of this rule, any person may petition to terminate the automatic adjustment clause on the basis that it would result in a material adverse effect on customers. In the event of a filing under this section, the applicable rate adjustment will not be implemented until the Commission makes its determination. If the Commission denies the request to terminate the rate adjustment, interest will accrue according to subsection (8)(e) of this rule on the final amount of the rate adjustment.

(10) At any time, a utility may file a claim that a rate adjustment under the automatic adjustment clause violates ORS 756.040 or other applicable law. 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.

Stat. Auth.: ORS Ch. 183, 756, 757 & 759
Stats. Implemented: ORS 756.040, 756.060, 757.267 & 757.268
Hist.: NEW

ORDER NO. 07-401

ENTERED 09/18/07

# BEFORE THE PUBLIC UTILITY COMMISSION

# OF OREGON

AR 517

| | | |
|---|---|---|
| In the Matter of Housekeeping and Clarification Changes to OAR 860-022-0041. | ) ) ) | ORDER |

DISPOSITION: RULE AMENDED

In this order, the Public Utility Commission of Oregon (Commission) amends OAR 860-022-0041 governing Annual Tax Reports and Automatic Adjustment Clauses Relating to Utility Taxes. The amended rule, attached as Appendix A, will become effective upon filing with the Secretary of State and will be used by utilities in making their October 15 tax filings.

**Background**

Senate Bill 408, passed by the 2005 Legislative Assembly, establishes a new method for the rate treatment of utility income taxes. Generally, SB 408 requires a utility to true-up any differences between the amounts of income taxes collected in rates from customers and amounts of taxes paid to the government that are "properly attributed" to the utility's regulated operations. *See* ORS 757.268(4). If amounts collected and amounts paid differ by more than $100,000, the utility must adjust rates accordingly through an automatic adjustment clause. *See* ORS 757.268 (4), (6)(a).

To implement SB 408, we adopted OAR 860-022-0041. *See* AR 499, Order No. 06-532. The rule set forth procedures for quantifying taxes that are "properly attributed" to the utility, as well as other items necessary to determine whether tax-related rate adjustments are necessary. In adopting the rule, we made efforts to ensure that utilities would retain all tax benefits necessary to comply with the normalization requirements of federal tax law. *See* ORS 757.268(8). To this end, we directed the affected utilities to seek private letter rulings from the Internal Revenue Service (IRS) as to whether compliance with the adopted rule would cause the utility to fail to comply with any provision of the normalization rules. *See* Order No. 06-532 at 4. Those requests are currently pending before the IRS.

Following the adoption of OAR 860-022-0041, the AR 499 rulemaking participants identified the need to make certain "housekeeping" amendments to the rule. They also explored whether other amendments should be made to address the normalization issue and recently enacted legislation relating to Oregon business energy tax credits (BETCs). Following a series of informal workshops, the Commission Staff (Staff) proposed rule amendments addressing five separate issues.

On June 14, 2007, the Commission filed a Notice of Proposed Rulemaking Hearing and Statement of Need and Fiscal Impact with the Secretary of State. The Commission also provided notice to legislators specified in ORS 183.335(1)(d), and to all interested persons on the service lists maintained pursuant to OAR 860-011-0001. Notice of the rulemaking was published in the Oregon Bulletin on July 1, 2007.

On July 31, 2007, the Commission held a hearing on the proposed rulemaking. Representatives from PacifiCorp, dba Pacific Power (PacifiCorp); Portland General Electric Company (PGE); Northwest Natural Gas Company, dba NW Natural (NW Natural); Avista Corporation, dba Avista Utilities (Avista Utilities); Industrial Customers of Northwest Utilities (ICNU); and Staff appeared and provided comments. The rulemaking participants also submitted written opening comments on July 18, 2007, and reply comments on August 10, 2007.

## DISCUSSION

The notice of proposed rulemaking identified amendments to OAR 860-022-0041 to address the following issues: (1) to remove an iterative effect caused by calculating a tax effect on the amount either refunded or collected from customers; (2) to allow a change in methodology if ownership of the utility changes; (3) to remove a potential federal tax law normalization problem caused by drawing down current deferred taxes; (4) to reflect legislative changes relating to the treatment of the BETC tax credit; and (5) to correct the calculation of the "floor" for the three-factor Apportionment Method. We address each issue separately.

### I. Iterative Effect

Staff Proposal

Staff proposes three amendments to address the so-called "iterative effect" that occurs when SB 408-related rate adjustments are taxed as increased or decreased revenue in subsequent years. To prevent the possibility of rate adjustments caused solely by SB 408-related adjustments, Staff first proposes that "iterative tax effect" be added in a new subsection in (2)(g). That proposed definition reads:

> **(g) "Iterative tax effect" means the tax effect of a rate adjustment for taxes related to ORS 757.267 or ORS 757.268 in the tax reporting period that includes the rate adjustment;**

Next, Staff proposes amending the definition of "deferred taxes" in subsection (2)(b) to eliminate the iterative effect under the automatic adjustment clause:

> (b) "Deferred taxes" for purposes of the utility means the total deferred tax expense of regulated operations~~, as reported in the deferred tax expense accounts as defined by the Federal Energy Regulatory Commission,~~

that relate to the year being reported in the utility's results of operations report or tax returns**, excluding deferred taxes related to the establishment of a regulatory receivable or payable account for any rate adjustment imposed under ORS 757.268, in the year the deferred tax is established but not thereafter, to eliminate the iterative tax effect of the rate adjustment**;

Finally, Staff proposes amendments to paragraphs (4)(d)(E) and (4)(j)(C) to require utilities to remove the iterative effect when calculating the amount of taxes paid.

Comments

All utilities support Staff's proposed amendments to remove the iterative effect. ICNU also supports the goal of Staff's proposed amendments, but cautions that the Commission should carefully scrutinize any adjustments made to eliminate the iterative tax effect to ensure that such adjustments are consistent with the narrow intent of these amendments. Specifically, ICNU contends that adjustments for iterative tax effects should be limited to "rate adjustments made through the automatic adjustment clause called for in SB 408 rather than adjustments to base rates in general rate cases." ICNU Opening Comments, pg 2 (July 18, 2007).

Resolution

We adopt Staff's proposed amendments. As PacifiCorp explains, the fair and rational operation of SB 408 requires the elimination of iterative tax effects. We note that Staff's draft rule in AR 499 contained similar provisions to remove the iterative effect under SB 408. *See* AR 499 Draft Rule Revisions, 2 (July 17, 2006). No participant opposed that provision, and its omission in the final rule appears to have been inadvertent. We make a minor housekeeping change to both paragraph (4)(d)(E) and (4)(j)(C) to correct the word "subsection" to "paragraph."

We reject ICNU's proposed narrow interpretation of "iterative tax effect." The definition in (2)(g) refers generally to "the tax effect of a rate adjustment for taxes related to ORS 757.267 or ORS 757.268." We interpret this language to mean any rate adjustment made pursuant to SB 408, whether accomplished through the automotive adjustment clause set forth in ORS 757.268, or through an adjustment to base rates pursuant to ORS 757.267.

**II. One-Time Election**

Staff Proposal

Currently, OAR 860-022-0041(3)(c)(C) provides two alternative methodologies for calculating multi-sate tax rates and requires a utility to make a one-time election as to what method it will use. Staff proposes the rule be amended to allow a utility the opportunity to change its election if it is purchased by a new owner. Specifically, Staff proposes the rule be amended as follows:

(C) If a utility's taxes collected in rates reflect non-Oregon state income taxes, the utility must make a one-time permanent election in its October 15, 2006, tax report filing**, or in the case of a utility ownership change pursuant to ORS 757.511, in the first tax report filing that includes a tax reporting period reflecting the new ownership,** to either:

Comments

All rulemaking participants support Staff's proposed amendment to allow a new utility owner the opportunity to make an election between the two methodologies. PacifiCorp and PGE, however, make one clarification as to the intended scope of the change. While ORS 757.511 governs actual changes in utility ownership as well as changes in affiliate status, the amendment is intended to apply only when there is a *bona fide* change of ownership. The utilities define a *bona fide* change in ownership as a change in ownership of 51 percent or more of the utility's voting shares.

Resolution

We agree that a new utility owner should be allowed the opportunity to revisit the election of which methodology to use in calculating the multi-state tax rate. We revise Staff's proposed amendment, however, to eliminate any ambiguity as to its intended scope. Staff's proposed amendment is revised to read:

(C) If a utility's taxes collected in rates reflect non-Oregon state income taxes, the utility must make a one-time permanent election in its October 15, 2006, tax report filing, **or in the case of a change of the majority ownership of the utility's voting shares ~~utility ownership change~~ pursuant to ORS 757.511, in the first tax report filing that includes a tax reporting period reflecting the new ownership,** to either:

**III. Drawing Down Current Deferred Taxes**

Staff Proposal

As discussed above, the rule adopted in AR 499 defines the amount of taxes paid that are "properly attributed" to the Oregon regulated operations of the utility. Generally, this amount is defined as the "lesser of" amount of three alternative calculations: (1) the utility's "stand-alone" tax liability; (2) the total consolidated tax liability of the affiliated group; and (3) the total consolidated tax liability of the affiliated group as apportioned under a methodology the compares the respective amounts of the utility's and affiliated groups amounts of payroll, property and sales. This latter methodology has been dubbed the "Apportionment Method." *See generally* Order No. 06-532 at 2.

During the preparation of the utilities' Private Letter Ruling (PLR) requests, the AR 499 participants discovered that the Apportionment Method could operate in such a manner to produce a negative amount for taxes paid. To avoid such a result—one that would likely result in a normalization violation—Staff proposes OAR 860-022-0041(4)(d) be modified to replace any negative taxes paid result with $0. As revised, OAR 860-022-0041(4)(d) would read:

> (d) The lowest of the amounts in subsections (4)(a), (4)(b) and (4)(c) of this rule, after making adjustments ~~for~~ **in paragraphs (4)(d)(A), (4)(d)(B), (4)(d)(C), (4)(d)(D), and (4)(d)(E), but no less than the deferred taxes related to depreciation of public utility property for regulated operations of the utility, except the deferred tax amount must be reduced by any tax refunds recognized in the reporting period and apportioned to the regulated operations of the utility**:

This amendment precludes a "taxes paid" result that falls below the level of the utility's deferred taxes related to the depreciation of its public utility property (PUP).

Comments

All rulemaking participants agree that a rule change to eliminate a negative "taxes paid" result is necessary to protect against a violation of normalization standards. All support Staff's proposal, which they characterize as the most important amendment in this rulemaking.

The utilities, however, contend that the amendment should go further to strengthen the protection against a normalization violation. They believe that Staff's proposal may be inadequate, as it provides the absolute minimum amount of required protection with no margin for error. They also express concern about how the Internal Revenue Service (IRS) may interpret Staff's proposed language to reduce the deferred tax amount by the amount of any tax refunds "apportioned" to the utility. The utilities believe that "apportioned" may be interpreted to mean apportioned based on the Apportionment Method factors, which would reduce deferred taxes by an amount not tied to the utility's tax accounting methodologies. They also question the continued—albeit modified—use of a methodology that produces a flawed result.

To provide greater protection against a normalization violation, the utilities propose an amendment that would preclude the use of any methodology that produces a negative current taxes paid result in a given year. In other words, rather than arbitrarily setting current taxes paid at zero, the utilities propose the Commission invalidate any calculation producing a negative taxes paid amount and, in such a case, rely solely on a comparison of the remaining two calculations in the "lesser of" analysis to determine the final taxes paid amount. They believe this approach is more fundamentally sound and provides a more conservative solution to the identified problem with existing rule. Given its simplicity, the utilities also suggest that this proposal provides a clearer, easier approach for the IRS to review and approve the PLR requests.

Resolution

We agree with the rulemaking participants that, as the rule is currently written, the calculation of taxes paid could produce a negative taxes paid amount. As PacifiCorp notes, its PLR includes such an example where the stand-alone result is $490, the consolidated result is $468, and the Apportionment Methodology result is -$19. While such a result might represent an unusual example, the fact that it is plausible requires a change in our rule to prevent a likely violation of normalization requirements.

Any amendment, however, must be consistent with our prior determination as to what amounts are "properly attributed" to the Oregon regulated operations of a utility. In the AR 499 rulemaking, we concluded the Apportionment Method provided a sound basis for calculating taxes paid by a utility, because it fairly balances the interests of the utility and its ratepayers. *See* Order Nos. 06-532 and 06-400.

For this reason, we reject the utilities' proposal, which would eliminate the use of the Apportionment Method when it results in a negative taxes paid amount. Such an amendment would, in our opinion, detrimentally impact the balance of interests between the utility and its ratepayers that the Apportionment Method provides. Indeed, the invalidation of the Apportionment Method could result in a considerable difference in the taxes paid amount under our rules. For instance, in the example cited in PacifiCorp's PLR request, the amount of taxes paid would significantly increase to $468, the amount calculated under the consolidated result.

Accordingly, we adopt Staff's proposed amendment. As the utilities acknowledge, Staff's proposal to reset any negative result to zero safeguards against potential normalization violations associated with the reduction of deferred taxes. This change eliminates the possibility that any tax benefits related to deferred taxes on PUP will be passed through to customers. Unlike the utilities' proposal, the amendment also retains the use of the Apportionment Method for purposes of determining amounts properly attributed to the utility. Thus, Staff's proposal both protects against normalization violations while also adhering to our prior determination that the Apportionment Method best reflects the amounts of taxes "properly attributed" to the utility.

In reaching this decision, we acknowledge the utilities' concern about the possible misinterpretation of the use "apportioned" in Staff's proposed rule change and will replace that word with "allocated." We do not agree, however, with the utilities' other arguments that we should adopt a "stronger response" to protect against a normalization violation. At issue is whether the rule could be interpreted as flowing through in rates any tax benefit related to deferred taxes on PUP. As Staff points out, either it does or it does not—it is not a matter of degree. Staff's amendments to eliminate the possibility of a negative "taxes paid" amount sufficiently ensure the answer to that question is "it does not."

**IV. BETCs**

Staff Proposal

SB 408 allows this Commission, in determining amounts of taxes paid that are "properly attributed" to the utility, to add-back of tax savings realized as a result of charitable contributions and other tax savings realized as a result of tax credits. *See* ORS 757.268(13)(f)(A) and (B). In exercising this discretion, we concluded, in part, that tax credits associated with BETCs should be added back when determining taxes paid. We explained:

> Further, we agree that certain tax credits should be added to taxes paid for purposes of determining amounts properly attributed to the utility. On the state level, we agree BETCs related to conservation and renewable resources for all affiliates should be added back so that these kinds of investments are encouraged. This will allow the benefits of these credits go to shareholders as intended under law and not be flowed through to ratepayers except when they bear the associated cost.

Order No. 06-532 at 5.

After our rulemaking, the 2007 Legislative Assembly expanded the scope of Oregon's BETC law. To ensure that the provisions of SB 408 do not discourage utilities from making BETC investments, the Assembly, in HB 3201,[1] amended ORS 469.206(3) by adding the following language:

> Notwithstanding any other provision of law, a tax credit transferred pursuant to this section does not decrease the amount of taxes required to be reported by a public utility.

Staff and the utilities read this amendment as requiring an add-back of all purchased BETCs from the operation of SB 408—not just those BETCs related to conservation and renewable resources. Accordingly, Staff proposes amending OAR 860-022-0041 to require, when determining the amount of taxes paid that is properly attributed to the utility, to add-back all BETC credits. Specifically, Staff proposes the "properly attributed" calculation include the following adjustment identified in paragraph 4(d)(D):

> **An increase equal to the tax benefit of Oregon business energy tax credits, including those credits transferred pursuant to ORS 469.206 and ORS 469.208, of the unitary group, excluding those credits covered by subsection (4)(d)(A); and**

Comments

All utilities support Staff's proposed amendment to expand the add-back requirement to all BETCs. They explain that utilities generally purchase BETCs as a service to

[1] The Governor signed HB 3201 into law on July 31, 2007.

customers to promote energy efficiency. Without Staff's amendment, they claim that utilities will not be able to provide this service.

ICNU opposes Staff's proposal and contends the Commission should retain the add-back limit to conservation and renewable resources. It also contends that customers should retain the benefit of any BETC if customers are paying, in rates, for the action that gives rise to the credit.

Resolution

We adopt Staff's proposed amendments with one clarifying revision to modify the amendment to refer specifically to the tax credit portion of the law, ORS 757.268(13)(f)(B), instead of "Subsection (4)(d)(A)"of the rule. We agree that an expansion of the add-back provision to cover all BETCs is required under HB 3201. Moreover, we agree that the amendment is required to align the party that pays for the BETCs with the party that enjoys the tax benefit.

Contrary to ICNU's apparent belief, this amendment applies only to benefits obtained when a utility purchases a BETC on behalf of other entities. It does not apply to BETCs the utility may acquire due to its own capital investments or internal operations. Consequently, ICNU's concern is misplaced. As the PGE and PacifiCorp explain, the utility's shareholders—not ratepayers—pay the cost of purchasing BETCs not related to utility service.

**V. Calculation of Floor for Apportionment Method**

Staff Proposal

The AR 499 rule establishes a "floor" for the Apportionment Method to avoid a result whereby Oregon customers receive more than 100 percent of the benefit from the tax losses of the utility's taxpaying group. The calculation of the floor begins with the stand-alone tax liability for the utility's Oregon regulated operations, which is then reduced by an apportioned share of the imputed negative tax of all losses of the taxpayer group. To guard against a normalization violation, the rule also requires the utilities to add-back any tax related benefits of depreciation and investment tax credits (ITC). *See* OAR 860-022-0041(3)(b)(A); OAR 860-022-0041(3)(d)(A) and (B)(i).

Staff believes that these provisions provide an improper result by requiring the utilities to add back all tax benefits from PUP depreciation, not just those benefits related to regulated utilities with losses. Staff first contends that the rule goes beyond what is necessary to protect against a normalization violation. Second, because the tax effect of depreciation on all PUP would, in most cases, more than offset the taxpaying entity's losses, Staff contends that this floor calculation would equal the utility's stand-alone tax liability and result in the effective elimination of the Apportionment Method.

Accordingly, Staff proposes a correction to the floor calculation that limits the add-back of tax benefits related to PUP depreciation to individual regulated entities in the taxpaying group with losses. In other words, the proposed rule changes modify the floor calculation by adding back the identified tax benefits only to the extent those benefits were included in the income tax losses used to reduce the original "stand-alone" tax liability calculation.

Comments

ICNU support Staff's proposal. The utilities oppose it, and argue that the proposed amendments will increase the risk of normalization violations. Generally, the utilities contend that the modified rule fails to present a clear and complete isolation of all PUP depreciation and ITC and decreases the buffer effect the floor has on extreme results under the Apportionment Method. They argue that the continuation of the Commission's conservative approach toward normalization is the safest way to obtain a favorable and timely response from the IRS on the utilities' respective PLRs.

Resolution

We adopt Staff's proposed amendments. We agree that removing tax related benefits for depreciation and ITC from the floor calculation only for those regulated entities that have losses is consistent with our original intent in adopting the AR 499 rule. As Staff notes, the pending PLR request reflects this intent in its description of the floor calculation:

> The standalone floor is the amount that results after Adjustment 2 of Method 1 (an adjusted standalone tax liability) reduced by an allocation of the imputed negative tax liability with tax losses. This imputed negative tax liability is computed after eliminating depreciation and ITC *claimed by each loss affiliate with respect to its PUP.*

PacifiCorp Request for Private Letter Ruling, pg 6 (Dec. 29, 2006) (emphasis added).

The utilities' assertion that the modified floor calculation does not isolate all PUP depreciation and ITC is based on an erroneous interpretation of the rule. As noted above, the floor calculation begins with the stand-alone tax liability of Oregon operations, which is defined as to exclude all tax benefits resulting from PUP. *See* OAR 860-022-0041(2). The calculation then reduces the stand-alone liability by the Oregon regulated operations share of all losses in the taxpaying group. We agree with Staff that:

> If the effects of tax benefits from public utility property are brought into the floor calculation, that amount must be removed through an "add back." If those benefits are not included in the floor calculation in the first place, there's no need to do any add back.

Staff's Reply Comments, pg 4 (Aug 10, 2007) (emphasis in original).

## CONCLUSION

Staff's proposed rule changes are adopted, with the minor modifications noted herein. These rule amendments will improve our administration and implementation of Senate Bill 408. Moreover, at our Staff's request, they have been reviewed by an independent tax expert, who agrees that the rule amendments will protect against a violation of federal tax law normalization requirements.

We appreciate the rulemaking participants' efforts to improve our rules. We also acknowledge that unanticipated issues may likely emerge as the law begins to operate. Accordingly, we remind the utilities to identify in their tax reports any unanticipated normalization concerns and to propose solutions to those concerns. The early identification and reporting of such issues, contemplated in OAR 860-022-0041(4)(o), will help the Commission and interested parties address unanticipated problems in a manner that will not delay implementation of any required tax-related rate adjustment.

## ORDER

IT IS ORDERED that:

(1) The rule amendments set forth in Appendix A, are adopted and become effective upon filing with the Secretary of State.

(2) PacifiCorp, dba Pacific Power, Portland General Electric Company, Northwest Natural Gas Company, and Avista Corporation, dba Avista Utilities, shall submit draft amended requests for a Private Letter Ruling from the Internal Revenue Service to this Commission and all participants in this docket on or before November 1, 2007.

(3) Participants shall submit proposed edits and comments on the draft amended requests for Private Letter Ruling to this Commission on or before November 15, 2007.

(4) PacifiCorp, dba Pacific Power, Portland General Electric Company, Northwest Natural Gas Company, and Avista Corporation, dba Avista Utilities, shall submit final requests for a Private Letter Ruling to the Internal Revenue Service by November 30, 2007.

Made, entered, and effective SEP 18 2007.

**Lee Beyer**
Chairman

**John Savage**
Commissioner

**Ray Baum**
Commissioner

A person may petition the Commission for the amendment or repeal of a rule pursuant to ORS 183.390. A person may petition the Court of Appeals to determine the validity of a rule pursuant to ORS 183.400.

**860-022-0041**
**Annual Tax Reports and Automatic Adjustment Clauses Relating to Utility Taxes**

(1) This rule applies to regulated investor-owned utilities that provided electric or natural gas service to an average of 50,000 or more customers in Oregon in 2003, or to any successors in interest of those utilities that continue to be regulated investor-owned utilities.

(2) As used in this rule:

(a) "Affiliated group" has the meaning given to "affiliated group" in ORS 757.268(13)(a);

(b) "Deferred taxes" for purposes of the utility means the total deferred tax expense of regulated operations~~, as reported in the deferred tax expense accounts as defined by the Federal Energy Regulatory Commission,~~ that relate to the year being reported in the utility's results of operations report or tax returns**, excluding deferred taxes related to the establishment of a regulatory receivable or payable account for any rate adjustment imposed under ORS 757.268, in the year the deferred tax is established but not thereafter, to eliminate the iterative tax effect of the rate adjustment**;

(c) "Income" means taxable income as determined by the applicable taxing authority, except that income means regulatory taxable income when reporting or computing the stand-alone tax liability resulting from a utility's regulated operations;

**(d) "Income tax losses" means the negative taxable income of an entity in the federal taxpayer or unity group, excluding the current deduction of tax depreciation on public utility property and federal investment tax credits related to public utility property;**

(~~d~~**e**) "IRC" means Internal Revenue Code;

(~~e~~**f**) "Investment" means capital outlays for utility property necessary or useful in providing regulated service to customers;

**(g) "Iterative tax effect" means the tax effect of a rate adjustment for taxes related to ORS 757.267 or ORS 757.268 in the tax reporting period that includes the rate adjustment;**

(~~f~~**h**) "Local taxes collected" means the total amount collected by the utility from customers under the local tax line-item of customers' bills calculated on a separate city or county basis;

(~~g~~**i**) "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;

(~~h~~**j**) "Properly attributed" means the share of taxes paid that is apportioned to the regulated operations of the utility as calculated in section (3), subject to subsections (4)(a), (4)(b), (4)(g) and (4)(h), of this rule;

(~~i~~**k**) "Public utility property" means property as defined by the Code of Federal Regulations, Title 26, ~~s~~**S**ection 168(i)(10);

(~~j~~**l**) "Regulated operations of the utility" has the meaning given to "regulated operations of the utility" in ORS 757.268(13)(c);

(~~k~~**m**) "Results of operations report" means the utility's annual results of operations report filed with the Commission;

(~~l~~**n**) "Revenue" means utility retail revenues received from ratepayers in Oregon, excluding supplemental schedules or other revenues not included in the utility's revenue requirement and adjusted for any rate adjustment imposed under this rule;

(~~m~~o) "Revenue requirement" means the total revenue the Commission authorizes a utility an opportunity to recover in rates pursuant to a general rate proceeding or other general rate revision, including an annual automatic adjustment clause under ORS 757.210;

(~~n~~p) "Stand-alone tax liability" means the amount of income tax liability calculated using a pro forma tax return and revenues and expenses in the utility's results of operations report for the year, except using zero depreciation expense for public utility property, excluding any tax effects from investment tax credits, and calculating interest expense in the manner used by the Commission in establishing rates;

(~~o~~q) "System regulated operations" means those activities of the utility, in Oregon and other jurisdictions, that are subject to rate regulation by any state commission;

(~~p~~r) "Tax" has the meaning given to "tax" in ORS 757.268(13)(d);

(~~q~~s) "Taxes authorized to be collected in rates" means:

(A) The following for federal and state income taxes calculated by multiplying the following three values:

(i) The revenue the utility collects, as reported in the utility's results of operations report;

(ii) 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; and

(iii) The effective tax rate used by the Commission in establishing rates for the time period covered by the tax report as set forth in the most recent general rate order or other order that establishes an effective tax rate, calculated as the ratio of total income tax expense in revenue requirement to pre-tax income;

(B) For purposes of paragraph (2)(~~q~~s)(A) of this rule, when the Commission has authorized a change during the tax year for gross revenues, net revenues or effective tax rate, the amount of taxes authorized to be collected in rates will be calculated using a weighted average of months in effect;

(~~r~~t) "Taxes paid" has the meaning given to "taxes paid" in ORS 757.268(13)(f);

(~~s~~u) "Taxpayer" means the utility, the affiliated group or the unitary group that files income tax returns with units of government;

(~~t~~v) "Tax report" means the tax filing each utility must file with the Commission annually, on or before October 15 following the year for which the filing is being made, pursuant to ORS 757.268;

(~~u~~w) "Unitary group" means the utility or the group of corporations of which the utility is a member that files a consolidated state income tax return; and

(~~v~~x) "Units of government" means federal, state, and local taxing authorities.

(3) The amount of income taxes paid that is properly attributed to regulated operations of the utility is calculated as follows:

(a) The amount of federal income taxes paid to units of government that is properly attributed to the regulated operations of the utility is the product of the values in paragraphs (3)(a)(A) and (B), subject to subsection (3)(b) of this rule:

(A) The total amount of federal income taxes paid by the federal taxpayer, to which is added:

(i) The current tax benefit, at the statutory federal income tax rate, of tax depreciation on public utility property;

(ii) The tax benefits associated with federal investment tax credits related to public utility property; and

(iii) Imputed tax benefits on charitable contributions and IRC section 45 renewable electricity production tax credits of the affiliated group, except those tax benefits or credits associated with regulated operations of the utility; and

(B) The average of the ratios calculated for the utility's gross plant, wages and salaries and sales, using amounts allocated to regulated operations of the utility as set forth in the utility's results of operations report in the numerator and amounts for the federal taxpayer in the denominator;

(b) The amount of federal income taxes paid that is properly attributed to the regulated operations of the utility under subsection (3)(a) of this rule shall not be less than the amount of the federal stand-alone tax liability calculated for the regulated operations of the utility, reduced by the product of:

(A) The imputed negative tax associated with all federal income tax losses of entities in the utility's federal taxpayer group~~; after making the adjustments in subparagraphs (3)(a)(A)(i) and (ii) of this rule;~~ and

(B) The average of the ratios for the utility's gross plant, wages and salaries and sales, using amounts allocated to the regulated operations of the utility as set forth in the utility's results of operations report in the numerator and amounts for the system regulated operations in the denominator;

(c) The total 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 values in paragraphs (3)(c)(A) and (B), subject to paragraphs (3)(c)(C) and (D) and subsection (3)(d) of this rule:

(A) The total amount of Oregon income taxes paid by the Oregon unitary group taxpayer, to which is added:

(i) The current tax benefit, at the state statutory rate, of tax depreciation on public utility property; and

(ii) Imputed Oregon tax benefits on charitable contributions ~~and state business energy tax credits related to conservation and renewable energy production~~ of the unitary group, except those tax benefits ~~or credits~~ associated with regulated operations of the utility; and

(B) The average of the ratios calculated for the utility's gross plant, wages and salaries and sales using amounts allocated to regulated operations of the utility as set forth in the utility's results of operations report in the numerator and amounts for the unitary group taxpayer in Oregon, adjusted to reflect amounts allocated to regulated operations of the utility, in the denominator;

(C) If a utility's taxes collected in rates reflect non-Oregon state income taxes, the utility must make a one-time permanent election in its October 15, 2006, tax report filing, **or in the case of a change of the majority ownership of the utility's voting shares pursuant to ORS 757.511, in the first tax report filing that includes a tax reporting period reflecting the new ownership,** to either:

(i) Multiply the total amount of Oregon income taxes paid in paragraph (3)(c)(A) of this rule before adjustments by the ratio calculated as the state income tax rate used by the Commission in establishing rates divided by the Oregon statutory tax rate set forth in ORS 317.061; or

(ii) Calculate the total state taxes paid using the formula set forth in paragraphs (3)(c)(A) and (B) of this rule on a state by state basis, apportioned to Oregon by multiplying the total state taxes paid by the average of the ratios calculated for gross plant, wages and salaries and sales using amounts allocated to the regulated operations of the utility in the numerator and amounts for the system regulated operations in the denominator;

(D) When Oregon income tax attributable to system regulated operations is 100 percent allocated to Oregon in setting rates, 100 percent of the Oregon income tax of system regulated operations must be attributed to the regulated operations of the utility;

(d) The amount of state income taxes paid that is properly attributed to the regulated utility operations of the utility under subsection (3)(c) of this rule must not be less than:

(A) For a utility for which Oregon state income taxes are the only state income taxes included in rates, the amount of the Oregon state stand-alone tax liability calculated for the regulated operations of the utility, minus the imputed negative tax associated with all Oregon state income tax losses of entities in the utility's unitary group**;** ~~**after making the adjustment in subparagraph (3)(c)(A)(i) of this rule;**~~ or

(B) For a utility for which non-Oregon state income taxes are included in rates, the product of:

(i) The sum of the state stand-alone tax liability calculated for the applicable system regulated operations in each state in which the utility is a member of a unitary group, minus the sum of the imputed negative tax associated with all state income tax losses of entities in the utility's unitary group in each state**;** ~~**, after making the adjustment in subparagraph (3)(c)(A)(i) of this rule for each state;**~~ and

(ii) The average of the ratios calculated for gross plant, wages and salaries and sales using amounts allocated to the regulated operations of the utility in the numerator and amounts for the system regulated operations in the denominator;

(e) The amount of local income taxes paid to units of government that is properly attributed to the regulated operations of a utility is the product of the values in paragraphs (3)(e)(A) and (B) of this rule for each local taxing authority in Oregon:

(A) The total amount of income taxes paid by the taxpayer to the local taxing authority, as adjusted to include the imputed effect on local income taxes of:

(i) The current tax benefit of tax depreciation on public utility property; and

(ii) Imputed tax benefits on charitable contributions of the taxpayer except those associated with regulated operations of the utility; and

(B) The ratio calculated using the method for apportioning taxable income used by the local taxing authority, with the amount for the regulated operations of the utility in the local taxing authority in the numerator and the amount for the taxpayer in the local taxing authority in the denominator.

(4) On or before October 15 of each year, each utility must file a tax report with the Commission. The tax report must contain the following applicable 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 taxpayer, as adjusted pursuant to subparagraphs (3)(a)(A)(i)**,** ~~**and**~~ (ii) **and (iii)** of this rule;

(b) The amount of the utility's federal and state income taxes paid that is incurred as a result of income generated by the regulated operations of the utility, where:

(A) The amount of federal income taxes paid is equal to the federal stand-alone tax liability calculated for the regulated operations of the utility;

(B) For a utility for which Oregon state income taxes are the only state income taxes included in rates, the utility's state income taxes paid is the Oregon state stand-alone tax liability calculated for the regulated operations of the utility; and

(C) For a utility for which non-Oregon state income taxes are included in rates, the amount of state income taxes paid is the product of:

(i) The sum of the state stand-alone tax liability calculated for the applicable system regulated operations in each state in which the utility is a member of a unitary group; and

(ii) The ratio calculated as the income of the regulated operations of the utility divided by the income of the system regulated operations;

(c) The amount of federal and state income taxes paid to units of government by the taxpayer that is properly attributed to the regulated operations of the utility, as calculated in section (3) of this rule;

(d) The lowest of the amounts in subsections (4)(a), (4)(b) and (4)(c) of this rule, after making adjustments ~~for~~ **in paragraphs (4)(d)(A), (4)(d)(B), (4)(d)(C), (4)(d)(D), and (4)(d)(E), but no less than the deferred taxes related to depreciation of public utility property for regulated operations of the utility, except the deferred tax amount must be reduced by any tax refunds recognized in the reporting period and allocated to the regulated operations of the utility**:

(A) The items defined in subsection (2)(~~r~~**t**) of this rule;

(B) A reduction equal to the current tax benefit related to tax depreciation of public utility property for regulated operations of the utility; ~~and~~

(C) A reduction equal to the tax benefit related to federal investment tax credits recognized by the Commission in establishing rates;

**(D) An increase equal to the tax benefit of Oregon business energy tax credits, including those credits transferred pursuant to ORS 469.206 and ORS 469.208, of the unitary group, excluding those credits covered by ORS 757.268(13)(f)(B); and**

**(E) Elimination of the iterative tax effect to the extent such iterative tax effect has not been eliminated by paragraph (4)(d)(A) of this rule;**

(e) The amount of federal and state income taxes authorized to be collected in rates;

(f) The amount of the difference between the amounts in subsections (4)(d) and (4)(e) of this rule;

(g) The amount of local income taxes paid to units of government by the taxpayer, calculated for each local taxing authority, and to which is added the imputed effect on local income taxes of the amount in subparagraph (3)(e)(A)(i) of this rule;

(h) The amount of local income taxes paid to units of government by the taxpayer that is incurred as a result of income generated by the regulated operations of the utility, calculated as the stand-alone tax liability in each local taxing authority;

(i) The amount of local income taxes paid to units of government by the taxpayer that is properly attributed to the regulated operations of the utility, as calculated in section (3) of this rule for each local taxing authority;

(j) The lowest of the amounts in subsections (4)(g), (4)(h) and (4)(i) of this rule, calculated for each local taxing authority, after making adjustments for:

(A) The items defined in subsection (2)(~~r~~**t**) of this rule; and

(B) A reduction equal to the local tax effect of the current tax benefit related to tax depreciation of public utility property for regulated operations of the utility; **and**

**(C) Elimination of the iterative tax effect to the extent such iterative tax effect has not been eliminated by paragraph (4)(j)(A) of this rule;**

(k) The amount of local income taxes collected from Oregon customers, calculated for each local taxing authority;

(l) The amount of the difference between the amounts in subsection (4)(j) and (4)(k) of this rule, calculated for each local taxing authority;

(m) The proposed surcharge or surcredit rate adjustments for each customer rate schedule to charge or refund customers the amount of the differences in subsections (4)(f) and (4)(l) of this rule;

(n) If the utility claims the minimum taxes paid amount set by subsections (3)(b) and (3)(d) of this rule, the total federal and state income tax losses in the utility's affiliated and unitary groups associated with the imputed negative tax claimed; and

(o) Any adjustments, in addition to the adjustments required in section (3) and subsections (4)(a) through (4)(n) of this rule, that the utility proposes to avoid probable violations of federal tax normalization requirements.

(5) In calculating the amount of taxes paid under sections (3) and (4) of this rule:

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

(A) For any tax return prepared for the preceding tax year and filed on or before the date the tax report is due for such tax year, the utility must allocate each reported tax liability to the tax year for which such return is filed;

(B) For each 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, the utility must allocate the tax liability or tax adjustment to the tax year that is recognized by the utility for accounting purposes;

(C) Taxes paid must include any interest paid to or interest received from units of government with respect to tax liabilities;

(b) When a utility's fiscal year or parent changes, and a partial year consolidated federal income tax return is filed during the year, taxes paid must be calculated in the manner defined by ORS 314.355 and OAR 150-314.355. For purposes of this rule, the amount of taxes paid must reflect a weighted average of the months in effect related to each tax return filing.

(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) The Commission will establish an ongoing docket for each of the October 15 tax report filings. Upon signing a protective order prepared by the Commission, any intervenor may have access to all such tax report filings, subject to the terms of the protective order;

(a) Within 20 days following the tax report filings, an Administrative Law Judge will conduct a conference and adopt a schedule;

(b) Within 180 days of the tax report filings, the Commission will issue an order that contains 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 is properly attributed to the regulated operations of the utility;

(B) For the preceding fiscal year, the difference between the amount of federal and state income taxes paid to units of government by the taxpayer that is properly attributed to the regulated operations of the utility and the amount of taxes authorized to be collected in rates;

(C) For the preceding fiscal year, the difference between the amount of local income taxes paid to units of government by the taxpayer that is properly attributed to the regulated operations of the utility and the amount of local taxes collected in rates; and

(c) Any other finding or determination necessary to implement the automatic adjustment clause.

(8) Upon entry of an order finding a difference of $100,000 or more in section (7) of this rule, the utility must file an amended tariff, to be effective each June 1 unless otherwise authorized by the Commission, to implement a rate adjustment applying to taxes paid to units of government and collected from ratepayers for each fiscal year beginning on or after January 1, 2006;

(a) The utility must establish a balancing account and automatic adjustment clause tariff to recover or refund the difference determined by the Commission in paragraph (7)(b)(B) of this rule through a surcharge or surcredit rate adjustment;

(b) A utility that is assessed a local income tax must establish a separate balancing account and automatic adjustment clause tariff for each local taxing authority assessing such tax. The utility must apply a surcharge or surcredit on the bills of customers within the local taxing authority assessing the tax. The amount of the surcharge or surcredit must be calculated to recover or refund the difference determined by the Commission in paragraph (7)(b)(C) of this rule;

(c) Any rate adjustment must be calculated to amortize the difference determined by the Commission in paragraphs (7)(b)(B) and (7)(b)(C) of this rule over a period authorized by the Commission;

(d) Any rate adjustment must be allocated by customer rate schedule according to equal percentage of margin for natural gas utilities and equal cents per kilowatt-hour for electric utilities, unless otherwise authorized by the Commission;

(e) Each balancing account must 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 July 1 of the tax year;

(f) The automatic adjustment clause must 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) On or before December 31, 2006, each utility must seek a Private Letter Ruling from the Internal Revenue Service on whether the utility's compliance with ORS 757.268 or this rule would cause the utility to fail to comply with any provision of federal tax law, including normalization requirements. Each utility must file a draft of its Private Letter Ruling Request with the Commission on or before November 15, 2006. While a utility's

request for a Private Letter Ruling is pending, or a related Revenue Ruling is pending, no rate adjustment will be implemented, but interest will accrue according to subsection (8)(e) of this rule on the amount of any rate adjustment determined by the Commission pursuant to paragraphs (7)(b)(B) and (7)(b)(C) of this rule.

(9) No later than 30 days following the Commission's findings in section (7) of this rule, any person may petition to terminate the automatic adjustment clause on the basis that it would result in a material adverse effect on customers. In the event of a filing under this section, the applicable rate adjustment will not be implemented until the Commission makes its determination. If the Commission denies the request to terminate the rate adjustment, interest will accrue according to subsection (8)(e) of this rule on the final amount of the rate adjustment.

(10) At any time, a utility may file a claim that a rate adjustment under the automatic adjustment clause violates ORS 756.040 or other applicable law. 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.

Stat. Auth.: ORS 183, 756, 757 & 759
Stats. Implemented: ORS 756.040, 756.060, 757.267 & 757.268
Hist.:PUC 8-2006, f. & cert. ef. 9-18-06

## CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the foregoing **REBUTTAL TESTIMONY AND EXHIBITS OF BOB TAMLYN AND JAY TINKER** to be served by electronic mail to those parties whose email addresses appear on the attached service list, and by First Class US Mail, postage prepaid and properly addressed, to those parties on the attached service list who have not waived paper service from OPUC Docket No. UE 178.

Dated at Portland, Oregon, this 25th day of February, 2009.

DOUGLAS C. TINGEY

**SERVICE LIST**

OPUC DOCKET # UE 178

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