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October 14, 2005

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Public Utility Commission of Oregon  
Post Office Box 2148  
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**Re: Submission of 2005 Tax Report by Northwest Natural Gas Company**

Northwest Natural Gas Company ("NW Natural") attaches the October 15, 2005 tax report ("the Report") that Senate Bill 408 requires us to file with the Oregon Public Utilities Commission ("the Commission"). The Report shows for each of the calendar years 2002, 2003 and 2004, calculated in the manner set out in Senate Bill 408, the amounts of "taxes paid" by NW Natural, as compared with the amounts of taxes that NW Natural was "authorized to collect in rates."

This cover letter, which is not confidential, contains information for each year about the difference between the taxes paid and the taxes authorized to be collected in rates. The attached Report and supporting materials, however, are submitted as confidential information subject to the projections required by Senate Bill 408.

Tax Report Conclusions

Senate Bill 408 provides for either rate refunds or rate increases, depending on whether the "taxes paid" by a utility were higher or lower than the taxes the utility was "authorized to collect in rates." If "taxes paid" were less than the taxes the utility was "authorized to collect in rates," the company would be required to make a rate refund of its supposed tax savings. If "taxes paid" were more than the taxes the utility was "authorized to collect in rates," the company would be entitled to increase its rates to recover the supposed additional tax payments.

Based on the calculations required by Senate Bill 408, in each of 2002, 2003 and 2004, NW Natural's "taxes paid" were more than the amount of taxes it was "authorized to collect in rates." Thus, had Senate Bill 408 been in effect for those years, NW Natural would have been entitled to a rate increase in each of years 2002, 2003 and 2004. Based on our interpretation of the provisions of Senate Bill 408, the total rate increase would have been \$22,137,000, broken down as follows: \$14,369,000 for 2002; \$4,315,000 for 2003; and \$3,453,000 for 2004. Because Senate Bill 408 only applies to taxes collected on or after January 1, 2006, there will be no adjustment of our rates as a result of the Report.

## Accounting for Deferred Taxes

In our preparation of the Report, we have identified various aspects of the reporting requirements that we find to be unclear. In each case, we have applied what we believe is a reasonable interpretation of the bill. Only one interpretation choice – how to allocate deferred taxes among tax years – could for any year change the conclusion that NW Natural would have been entitled to a rate increase under Senate Bill 408.

With respect to annual accounting for deferred taxes, we do not know whether this item should be included in the Report for each of 2002, 2003, and 2004 as it appeared in (a) NW Natural's tax returns for the applicable year or (b) NW Natural's income statement for the applicable year. These approaches produce different results for each year as a result of true-up adjustments made to deferred taxes in later years. We record such adjustments on our books for the year to which they apply, but we report the adjustments in tax returns in the year the adjustments are made. We resolved this issue by using the deferred taxes as included in our tax returns, in order to match each year's reported deferred taxes with the deferred taxes we used to compute the same year's tax liability.

While the choice of income statement versus tax return reporting of deferred taxes may shift deferred taxes between years, the same total amount of deferred taxes will be reported over time with each method. We note that if the income statement allocation approach were used, our retail rates would have been less stable. For 2003, rather than being entitled to a rate increase of \$4,315,000, under the alternate accounting for deferred taxes, NW Natural would have owed a refund of \$3,163,000. However, for 2002, rather than being entitled to a rate increase of \$14,369,000, under the alternate accounting for deferred taxes, NW Natural would have been entitled to a larger rate increase of \$17,894,000. For 2004, rather than being entitled to a rate increase of \$3,453,000, under the alternative accounting for deferred taxes, NW Natural would have been entitled to a larger rate increase of \$6,905,000.

NW Natural requests that the issue of how to allocate deferred taxes to tax years be added as a workshop topic in the Docket AR 499, to create permanent rules for application of Senate Bill 408.

## Tax Savings from Unrecognized Utility Investments

Senate Bill 408 allows a utility to add to "taxes paid" the tax savings it realizes from utility investments, to the extent that the expenditures giving rise to the tax savings were not taken into account by the Commission in the utility's last general ratemaking proceeding. The Commission's temporary rules do not provide guidance as to what types of expenditures and tax savings are to be included in this adjustment. In the absence of such guidance, we have included no such items in computing its "taxes paid." When we receive direction from the permanent rules, we would expect to include such items, which would increase the amount calculated as "taxes paid." The result for 2002, 2003, and 2004 would be to raise the amount of the tax-related rate increase to which NW Natural would have been entitled.

Two final points merit mention. First, we note again that the preparation of the Report involved the interpretation of a number of new and ambiguous statutory terms. Different, and perhaps equally reasonable, interpretations would have produced somewhat different numbers. Second, we do not expect the three-year pattern of overpayment/undercollection reflected in the Report to be repeated in every future year. Rather, we expect future calculations will reveal overcollections in some years and undercollections in others, with potentially large swings in each direction. The potential for rate volatility is another issue we urge the Commission to address in the permanent rulemaking to implement Senate Bill 408.

Sincerely,

A handwritten signature in cursive script, appearing to read "Gregg S. Kantor".

Gregg S. Kantor  
Senior Vice President

Attachments