

August 30, 2005

Via Electronic Mail

Judy Johnson
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Oregon Public Utility Commission
PO Box 2148
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Re: Senate Bill 408
Response to Letter of August 12, 2005

Dear Ms. Johnson:

Following please find the responses of Portland General Electric Company (“PGE”) to the questions raised in your letter of August 12, 2005, regarding implementation of Senate Bill 408 (“SB 408”). PGE is also providing separately our proposed language for temporary rules.

Please note that the following are draft responses that have been prepared at your request in a very short period of time and in advance of the Temporary Rulemaking proceeding instituted in docket AR 499. PGE reserves the right to modify or change these responses as time and the AR 499 proceedings permit. PGE also reserves the right to modify any responses provided herein, or in AR 499, in a permanent rulemaking docket. Given the compressed time period required for production of the first tax report, it is simply not possible to expect that we will be able properly analyze the structure and language of SB 408 at this time. We believe that the permanent rulemaking docket will provide the proper forum for a more definitive look at the implementation of this complex bill.

Please also be aware that PGE may not have responded fully to certain questions to the extent those questions pertained solely to the operation of the automatic adjustment clause provided for in Section 3(6).

- 1. In Section 3(1), does “determined without regard to the tax year for which taxes were paid” mean that, for example, 2006 taxes paid equal net cash payments during calendar or fiscal year 2006?**

Response of PGE:

Section 3(1)(a) requires the utility to provide information regarding taxes paid on a fiscal year basis (per Section 3(13)(g)) for the three years preceding the tax report. PGE uses a calendar year for its fiscal year, so for PGE the tax report due on October 15, 2005 would include net cash payments made in each of the calendar years 2002, 2003, and 2004.

2. In Section 3(1), what provision should be made for a utility whose fiscal year ends close enough to October 15 that not all the pertinent data is available for the tax report?

Response of PGE:

This issue does not directly pertain to PGE because it uses a calendar year as its fiscal year. PGE defers consideration of this issue to utilities that have an interest in this matter.

3. In Section 3(3), what does “directly or indirectly” mean with respect to taxes collected as part of rates?

Response of PGE:

The term “indirectly” refers to taxes, such as federal or state income taxes, included in the revenue requirement used to set the rates under tariffs of general applicability for electricity service. The term “directly” refers to taxes collected as an explicit line item on a customer’s bill, such as the Multnomah County Business Tax.

The meaning of “taxes collected” and the way that might be impacted by the phrase “directly or indirectly” is discussed in more detail in Question 5.

4. In Section 3(3), is disclosure limited to a difference based on the entire amount paid by the affiliated group with no attribution to regulated operations?

Response of PGE:

Yes.

5. Do the following phrases all have the same meaning: “amount of taxes authorized to be collected in rates” (3(1) and 3(13)(e)); “amount of costs for taxes collected, directly or indirectly, as part of rates paid by customers” (3(3)); “amount of taxes assumed in rates or otherwise collected from ratepayers” (3(4)); and “taxes that are authorized to be collected through rates” (3(6))?

Response of PGE:

The phrase “amount of taxes authorized to be collected in rates” used in Section 3(1)(b) is a defined term set forth at Section 3(13)(e). The phrase used in Section 3(6) appears to track the defined term. PGE notes, however, that even the definition provided under 3(13)(e) will require interpretation and application by the Commission.

The phrase “amount of costs for taxes collected, directly or indirectly, as part of rates paid by customers,” referenced in Section 3(3), and the phrase “amount of taxes assumed in rates or otherwise

collected from ratepayers,” used in Section 3(4), on the other hand, are different from the defined term in Section 3(13)(e). At this point, we assume that difference was intended and that Sections 3(3) and 3(4) contemplate a different type of calculation than that set forth in Section 3(13)(e).

Unfortunately, it is impossible to determine on a retrospective basis what a utility actually collected with respect to taxes included in base rates for a given year. Because taxes are a derivative figure based on the net income of the utility, such a determination would require allocating revenues in an arbitrary process. It might be possible for the Commission to **estimate** taxes collected indirectly from utility revenues through a retrospective test year. This could be done by reference to the information utilities provide in their annual Results of Operations reports to the Commission. Much more time and study would be required to determine how such a calculation would be accomplished and how the result of that calculation might differ from the amount calculated by reference to the formula established in Section 3(13)(e), as the Commission ultimately interprets and applies that section.

Because of the complexity involved in creating rules that interpret and reflect the meaning of these different terms and the time necessary to adequately study the possible means of implementing the legislature’s intent, PGE recommends that **for purposes of the temporary rulemaking only** these phrases are all interpreted to have the same meaning, i.e., that set forth in Section 3(13)(e). PGE may recommend a different interpretation of these phrases in a future proceeding.

6. In Section 3(6), how should “properly attributed to the regulated operations of the utility” be defined and calculated?

Response of PGE:

PGE would prefer to address this question when the Commission is determining how to design and implement the automatic adjustment clause. As a preliminary matter, we note that Section 3(1) also uses this term and that both uses will be affected by the interpretation of Section 3(12). This is the subject of Question 9.

7. In Section 3(7), how should “properly attributed to any unregulated affiliate” be defined and calculated?

Response of PGE:

This term should be interpreted to mean the portion of taxes paid (as defined in Section 3(13)(f)) that is greater than the tax expense attributable solely to the regulated operations of the utility.

8. In Section 3(9), does the use of the term “establishing” mean that any determination of material adverse impact should be made when the Commission considers requiring a utility to set up an automatic adjustment clause?

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[PGE HAS NOT PROVIDED A RESPONSE TO THIS QUESTION PURSUANT TO THE
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9. In Section 3(12)(a), how should “portion of the total taxes paid that is incurred as a result of income generated by the regulated operations of the utility” be defined and calculated? Also explain how this section works in combination with 3(12)(b).

Response of PGE:

In the context of the tax report, section 3(1)(a) and 3(4), the phrase “portion of the total taxes paid that is incurred as a result of income generated by the regulated operations of the utility” should equate to the tax liability attributable solely to the regulated operations of the utility, limited by the amount of “taxes paid” by the utility or affiliated group.

This definition would apply as illustrated in the following examples (these examples use a tax rate of 40%).

Case One

Parent: Net Income (NI) 50; Stand-Alone Taxes (SAT) 20
Utility: NI 100; SAT 40
Subsidiary1: NI 200; SAT 80
Subsidiary2: NI (100); SAT --
Consolidated: NI 250; Taxes 100
3(12) application: Tax report states taxes paid of 100.
Portion of taxes paid properly attributed to the regulated operation of the utility: 40.

Case Two

Parent: NI (50); SAT --
Utility: NI 100; SAT 40
Subsidiary1: NI (100); SAT --
Subsidiary2: NI 50; SAT 20
Consolidated: NI 0; Taxes 0
3(12) application: Tax report states taxes paid of 0
Portion of taxes paid properly attributed to the regulated operation of the utility: 0.

These two examples are not exhaustive, of course. Numerous permutations exist and it may be helpful to expand the set until the Commission and all of the utilities understand the expected application of 3(12) in the context of 3(1)(a) and 3(4).

PGE will address the application of 3(12) to the automatic adjustment clause (Section 3(6)) when the Commission prepares rules for that section.

10. Assume that an automatic adjustment clause is established. Show each step of the calculation required by, in particular, Sections 3(6), 3(12) and 3(13), identifying all information that must be available in the tax report to perform the calculation.

Response of PGE:

[PGE HAS NOT PROVIDED A RESPONSE TO THIS QUESTION PURSUANT TO THE AUGUST 24, 2005 LETTER FROM JASON JONES.]

11. Assume the following tax data for three different utilities and their affiliates for a particular year:

	<u>Utility A</u>	<u>Utility B</u>	<u>Utility C</u>
Regulated Utility Operations (tax liability)	130	130	130
Affiliate X (tax liability)	130	65	-20
Affiliate Y (tax liability)	<u>-60</u>	<u>-95</u>	<u>-60</u>
Tax Payment to Governments	200	100	50

For each utility, what is the amount of:

- (a) “taxes paid. . .that are properly attributed to regulated operations of the utility” under Section 3(6); and
- (b) “portion of the total taxes paid that is incurred as a result of income generated by the regulated operations of the utility” under Section 3(12)(a)?
- (Assume no adjustments are required under Section 3(13)(f).)

Response of PGE:

First, we would like to note that this example omits net income information. Taxes only relate to net income which, in turn, only relates to the difference between costs and revenues. In all examples, the negative tax liability would result only because of negative net income in those affiliates. We also assume that the term “tax liability” refers to a tax expense for each entity calculated as if it did not file and pay taxes on a consolidated basis.

- a. As noted above, PGE will address the automatic adjustment clause under section 3(6) when the Commission prepares rules regarding its design and implementation.
- b. Based on the understanding PGE described above in Question 9, the answer for Utility A is 130; the answer for Utility B is 100; the answer for Utility C is 50.

12. Should adjustments to rates under the automatic adjustment clause be prospective (an estimate for the next year)’ retroactive (a “true up” based on actual known results), or both?

Response of PGE:

First, regardless whether the Commission implements the automatic adjustment clause on a prospective, retroactive, or combined basis, the Commission will be engaged in ratemaking and all of the statutory requirements of ORS 756 and 757 apply. In particular, the rates must meet the standards of 756.040 and 757.210. Second, because taxes are derived from net income, which is derived in turn from revenues and costs, the automatic adjustment clause must also address these variances, whether prospectively or retroactively. Any other implementation will violate the noted ratemaking standards. In either case, however, the statute clearly precludes either a prospective *or* retroactive adjustment to rates based on data regarding taxes paid and collected from ratepayers prior to January 1, 2006. *See* Section 4(2).

This being said, PGE believes that the Commission should address adjustments to rates under the automatic adjustment clause in the permanent rulemaking proceedings to follow AR 499. The implementation and operation of the automatic adjustment clause should not be at issue in AR 499.

13. If the automatic adjustment clause includes a retroactive true-up feature, does that require authorization under ORS 757.259?

Response of PGE:

[PGE HAS NOT PROVIDED A RESPONSE TO THIS QUESTION PURSUANT TO THE AUGUST 24, 2005 LETTER FROM JASON JONES.]

14. If the automatic adjustment clause includes a deferred or balancing account, at what date are amounts added to the account? Does the account accrue interest, and if so, from what point in time?

Response of PGE:

[PGE HAS NOT PROVIDED A RESPONSE TO THIS QUESTION PURSUANT TO THE AUGUST 24, 2005 LETTER FROM JASON JONES.]

15. In Section 3(13)(d)(A), does income in “federal, state or local tax or fee that is imposed on or measured by income” mean (a) gross income; (b) net income; (c) revenues/receipts, gross or net; or (d) all of the above? Also, provide a list of taxes and fees that would be subject to the legislation.

Response of PGE:

The word “income” should be read consistently with the definition used by the taxing authority in imposing a tax or fee measured by income. Federal, State and local income taxes are subject to this

legislation. Franchise fees and privilege taxes are specifically exempted from this legislation in Section 3(13)(d)(C).

16. What is the definition of “revenues the utility collects from ratepayers in Oregon” in Section 3(13)(e)(A)? Does it include sales for resale?

Response of PGE:

For purposes of the temporary rulemaking, “revenues the utility collects from ratepayers in Oregon” should be defined as the non-temperature normalized Type 1 revenues, including adjustments for other operating revenue, as reported in the utility’s Results of Operations report to the Commission.

The permanent rulemaking docket should examine this question in more detail, as the proper definition for revenues the utility collects may be informed or need to be modified after a more thorough and in-depth study into the proper interpretation and calculation of Section 3(13)(e).

17. What is the definition of “effective tax rate” in Section 3(13)(e)(C)?

Response of PGE:

The complete phrase in that Section is “[t]he effective tax rate used by the commission in establishing rates.” The effective tax rate in a rate case is the ratio of tax expense (both current and deferred) to the pre-tax book regulatory income in the test year, adjusted for rate proceedings other than general rate cases (i.e., PGE’s Resource Valuation Mechanism (RVM)). If the Commission is applying this term in a test year context, it is the outcome of the revenues and expenses recognized for ratemaking purposes.

18. How should local income taxes, which are collected as a line item in the bill rather than in a utility’s base rates, be considered under Section 3(13)(e)?

Response of PGE:

While included in rates for affected customers, local incomes taxes that are collected as a line item in a customer's bill rather than in base rates are not included in revenues for the utility's rate case. Consistent with these rate case procedures, collections for local income taxes should not be included in the revenues considered as part of revenues in calculating “taxes authorized to be collected in rates.”

19. For the adjustments to taxes paid described in 3(13)(f), what tax rate (e.g., statutory, effective) should be used to calculate the “tax savings?”

Response of PGE:

The statutory marginal rate should be used because it reflects the marginal effect of the adjustment on revenue.

20. Does “charitable contributions made by the utility” in Section 3(13)(f)(A) require any allocation between the regulated operations of the utility, and the unregulated operations of the utility? If so, on what basis would the allocation be done?

Response of PGE:

No, the language of the bill does not provide for any allocation of charitable contributions to the unregulated operations of the utility.

21. Does “tax savings realized as a result of tax credits associated with investment by the utility” in Section 3(13)(f)(B) mean only direct tax credits, or alternatively, any tax savings (deductions) related to investment that is new, previously disallowed, or otherwise not included in the utility’s most recent general rate case?

Response of PGE:

The tax savings referred to should include savings realized as a result of investments that were not taken into account by the commission in the utility’s last general rate case.

22. How much time should the Commission use under Section 3(4) to “make the determinations described in this section” and “require the utility to establish an automatic adjustment clause,” respectively?

Response of PGE:

[PGE HAS NOT PROVIDED A RESPONSE TO THIS QUESTION PURSUANT TO THE AUGUST 24, 2005 LETTER FROM JASON JONES.]

23. If you wish, provide comments on any questions or other sections of the bill that you believe the Commission needs to consider in its temporary rulemaking.

Response of PGE:

24. If you wish, provide proposed temporary rules that address information that should be provided in the tax report and how the automatic adjustment clause should be calculated.

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Response of PGE:

Brief proposed temporary rules addressing the tax report are submitted herewith.