

Avista Corp.
1411 East Mission P.O. Box 3727
Spokane, Washington 99220-3727
Telephone 509-489-0500
Toll Free 800-727-9170



July 31, 2006

Sent Via email and U.S. Mail

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

Re: DOCKET AR 499: Avista Corporation's Opening Comments on Interim Order

Enclosed please find Avista Corporation's Opening Comments on Interim Order No. 06-400 entered July 14, 2006 in the above-referenced docket.

Please direct any questions to Ron McKenzie at (509) 495-4320.

Sincerely,

A handwritten signature in cursive script that reads "Kelly Norwood".

Kelly Norwood
Vice President State and Federal Regulation

Enclosure

C: AR 499 Service List

SUBMITTED: July 31, 2006

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

In the Matter of the Adoption of Permanent)
Rules implementing SB 408 Relating to Utility)
Taxes) AR 499

**AVISTA CORPORATION'S OPENING COMMENTS
ON INTERIM ORDER NO. 06-400 ENTERED JULY 14, 2006**

On July 14, 2006 the Commission issued an Interim Order addressing proposed rules on “properly attributed” and issued preliminary decisions on related issues. Avista respectfully submits its opening comments on the Interim Order and suggests ways to modify the proposed apportionment methodology to avoid normalization violations and other problems associated with the proposed rules.

I. FEDERAL INCOME TAXES ARE DETERMINED ON A STAND-ALONE BASIS

While the apportionment method is widely used to determine an allocation of a corporation's income for determining state income taxes, the method is not used to determine federal income taxes for the business entities of the corporation. Federal income taxes are determined on a stand-alone basis. The separate business entities of a corporation, both regulated and non-regulated, determine taxable incomes for federal income tax based on the revenues and expenses of the separate business entities.

**II. FEDERAL INCOME TAXES ASSOCIATED WITH REGULATED
OPERATIONS IN ONE STATE SHOULD NOT BE APPORTIONED TO
REGULATED OPERATIONS IN ANOTHER STATE**

The issue of determining the amount of federal income tax “properly attributed” to Oregon regulated utility operations has to do with apportioning federal income tax benefits associated with affiliate operations to regulated operations, not apportioning federal income taxes

associated with regulated operations in other states to the Oregon jurisdiction. The property, payroll, and sales apportionment factor proposed in the Interim Order results in an allocation of stand-alone federal income taxes of non-Oregon regulated operations being allocated to Oregon regulated operations. It also results in Oregon stand-alone federal income taxes being allocated to non-Oregon regulated operations.

No apportionment of federal income taxes from regulated operations in one state should be apportioned to the regulated operations in another state. Regulated utility operations in each state have their own stand-alone federal income tax amounts. An apportionment based on property, payroll and sales could be used to allocate federal income tax benefits from the combined group of non-regulated affiliates to the regulated operations in each jurisdiction. Avista believes that such an allocation would more properly be based on net taxable income of the regulated operations in each jurisdiction. However, use of the property, payroll and sales allocation factor could be used and would avoid the problem of what happens when the taxable income of a regulated operation is negative.

Assuming the combined group of non-regulated affiliates has positive taxable income, there is no need to do an apportionment of the stand-alone federal income tax of the affiliate operations to regulated operations. In this instance, the taxable incomes from regulated operations in the various jurisdictions are not being reduced or offset by losses from the combined group of non-regulated affiliates. In fact, the taxable income of a regulated operation may be negative with the positive taxable income from non-regulated affiliates offsetting the negative regulated amount.

Assuming the combined group of non-regulated affiliates has negative taxable income, an apportionment based on property payroll and sales could be used to allocate federal income

tax benefits from the combined group of non-regulated affiliates to the regulated operations in each jurisdiction. However, in no instance should federal income taxes from regulated operations in one state be apportioned to the regulated operations in another state.

**III. APPORTIONING FEDERAL INCOME TAXES ASSOCIATED WITH
REGULATED OPERATIONS IN ONE STATE TO REGULATED
OPERATIONS IN ANOTHER STATE RESULTS IN A NORMALIZATION
VIOLATION**

An apportionment of federal income taxes paid to Oregon related to utility operations in other states will result in a normalization violation if the apportioned amount is used for a SB 408 rate adjustment. Under the interim order, federal income taxes paid are “properly attributed” to Oregon using a 3-factor apportionment of property, payroll and sales. The apportionment factor is applied to federal income taxes paid for the consolidated group. Federal income taxes paid for the consolidated group reflects the benefit of accelerated tax depreciation, including accelerated tax depreciation related to utility operations in jurisdictions other than Oregon. The apportionment of federal income taxes paid to Oregon results in accelerated tax benefits from non-Oregon utility operations being allocated to Oregon. If the Oregon apportioned amount of taxes paid is then used for a SB 408 rate adjustment, a normalization violation occurs.

The apportionment method takes tax benefits associated with accelerated tax depreciation from non-Oregon utility operations and apportions those tax benefits to Oregon. The apportioned amount of Oregon federal income taxes paid is then compared to the stand-alone amount of Oregon income taxes paid. If the apportioned amount is less than the stand-alone amount, then the “lesser” apportioned amount is compared to taxes collected to determine the amount of SB 408 rate adjustment. Should such a rate adjustment occur, accelerated tax benefits are being passed through to ratepayers faster than ratably over the book life of the depreciable asset and a normalization violation has occurred.

While there is an adjustment made for deferred taxes in the draft rule, Section (2)(n)(C), the adjustment relates only to Oregon deferred taxes. A normalization violation still exists because of accelerated tax benefits related to other jurisdictions being apportioned to Oregon. Also, the adjustment for Oregon deferred taxes is no longer appropriate since a portion of accelerated tax benefits related to Oregon regulated operations has been apportioned to other jurisdictions.

There are two ways to remedy the situation. The preferred remedy is to not apportion federal income taxes from regulated operations in one state to the regulated operations in another state. This remedy keeps taxes paid intact for each regulated jurisdiction. The only apportionment would be from non-regulated affiliate operations to regulated operations. The other remedy, if the Commission decides to apportion federal income taxes from regulated operations in one state to the regulated operations in another state, is to adjust taxes paid for deferred taxes before the apportionment is made. Either way avoids a normalization violation. The preferred method avoids other problems as discussed below.

IV. OTHER PROBLEMS ASSOCIATED WITH APPORTIONING FEDERAL INCOME TAXES ASSOCIATED WITH REGULATED OPERATIONS IN ONE STATE TO REGULATED OPERATIONS IN ANOTHER STATE

The apportionment of federal income taxes among regulated operations in different jurisdictions results in tax costs, tax benefits and tax credits from non-Oregon regulated operations being allocated to Oregon regulated operations. The opposite also occurs, with a portion of Oregon costs, benefits and credits being allocated to other jurisdictions. While this is true for all revenues, expenses and tax credits, two specific examples are given below:

1. Actual purchased gas costs and actual electric power costs are expensed currently for tax purposes. A portion of these costs may be deferred for later recovery in rates and associated deferred taxes are also recorded. These deferred taxes are then amortized as the deferred costs are recovered in rates. The tax effect of currently expensing purchased gas costs and electric

power costs in non-Oregon jurisdictions would be allocated to Oregon under the apportionment method. Also, the tax effect of revenue recovering deferred gas and power costs in non-Oregon jurisdictions would also be allocated to Oregon. Likewise, a portion of the tax effect of Oregon purchased gas costs and Oregon revenues recovering deferred gas costs would be apportioned to non-Oregon jurisdictions.

2. Avista receives a tax credit related to electric generation from its wood waste fired Kettle Falls electric generation facility. Under the apportionment method a portion of this tax credit would be allocated to Oregon gas operations. Oregon gas customers have no right to the tax credit.

Again, the remedy to the situation is not to apportion federal income taxes from regulated operations in one state to the regulated operations in another state. This remedy keeps taxes paid intact for each regulated jurisdiction. The only apportionment would be from non-regulated affiliate operations to regulated operations.

V. **THE APPORTIONMENT METHOD RESULTS IN LESS THAN 100% OF
FEDERAL INCOME TAXES BEING RECOVERED BY A MULTI-STATE
UTILITY**

While the apportionment method is intended to fairly determine a multi-state 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, the apportionment method proposed to apportion federal income taxes results in a multi-state utility recovering less than one hundred percent of its federal taxes. The apportionment as proposed applies whether there are non-regulated affiliate losses, or not. The Oregon apportioned amount of federal income tax is compared to the Oregon stand-alone amount, and the consolidated group amount, and the "lesser of" the three amounts is used as the taxes paid amount. The apportioned amount is only used when it is less than the stand-alone amount. The apportioned amount can be less simply because the apportionment percentage results in a lesser amount. If the Oregon apportioned amount is less than the Oregon stand-alone amount of federal income taxes, and assuming no non-regulated affiliate operations, that means that some portion of tax benefit from another regulated rate

jurisdiction has been transferred from that jurisdiction to Oregon. The results being that the utility will recover less than 100% of its federal income tax expense. Again, the remedy to the situation is not to apportion federal income taxes from regulated operations in one state to the regulated operations in another state. This remedy keeps taxes paid intact for each regulated jurisdiction.

VI. THE SITUS METHOD IS DIFFERENT FROM THE METHOD USED FOR UTILITY RATEMAKING

The situs basis of determining the Oregon allocation factors for the apportionment percentage is not appropriate. Property, plant, and sales that exist in states other than Oregon may all be considered part of Oregon regulated operations for ratemaking purposes. Oregon situs amounts may be considered as part of regulated operations in jurisdictions other than Oregon. An Oregon electric utility may have production and transmission facilities in another state. In Avista's case, Oregon receives an allocation of general plant and administrative and general labor not sited in Oregon. For purposes of deriving an apportionment percentage, the plant, payroll and sales that are used for ratemaking purposes should be used in the numerators for Oregon and non-Oregon regulated operations. Again, the apportionment should not be applied to regulated operations in a manner that apportions federal income taxes from regulated operations in one state to the regulated operations in another state. The apportionment factor should only be used to allocate federal income tax benefits from the combined group of non-regulated affiliates to the regulated operations in each jurisdiction.

VII. THE WITH AND WITHOUT APPROACH SHOULD APPLY TO ALL REGULATED OPERATIONS

The with and without approach to determine Oregon stand-alone federal taxes treats Oregon as the most favored jurisdiction. The same tax benefit that may occur in an Oregon with


and without calculation could occur if the with and without calculation were made using another rate jurisdiction. If multiple jurisdictions get the same with and without benefits, then the Company recovers less than 100% of its federal income tax. A solution would be to do the with and without calculation using all regulatory jurisdictions combined and then allocate any benefit based on the net taxable incomes of the individual regulatory jurisdictions compared to the total for the regulatory jurisdictions.

VIII. CONCLUSION

No apportionment of federal income taxes from regulated operations in one state should be apportioned to the regulated operations in another state. Regulated utility operations in each state have their own stand-alone federal income tax amounts. An apportionment based on property, payroll and sales could be used to allocate federal income tax benefits from the combined group of non-regulated affiliates to the regulated operations in each jurisdiction. The use of the property, payroll and sales allocation factor could be used to make such an allocation. The apportionment factor should use amounts for property, payroll and sales that are used for ratemaking purposes.

RESPECTFULLY SUBMITTED this 31st day August, 2006.

AVISTA CORPORATION

By: 
Kelly Norwood
Vice President, State and Federal
Regulation

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served Avista Corporation's Opening Comments on Interim Order No. 06-400 Entered July 14, 2006 in Docket AR 499, upon the parties listed below by sending a copy via electronic mail and U.S. Mail.

JIM ANDERSON
JD ANDERSON ASSOCIATES
910 SAHALEE CT SE
SALEM OR 97306

GARY BAUER
NORTHWEST NATURAL
220 NW 2ND AVE
PORTLAND OR 97209

LAURA BEANE
PACIFICORP
825 MULTNOMAH STE 2000
PORTLAND OR 97232

SCOTT BOLTON
PACIFICORP
825 NE MULTNOMAH
PORTLAND OR 97232

JULIE BRANDIS
ASSOCIATED OREGON INDUSTRIES
1149 COURT ST NE
SALEM OR 97301-4030

LOWREY R BROWN
CITIZENS' UTILITY BOARD OF
OREGON
610 SW BROADWAY - STE 308
PORTLAND OR 97205
REP TOM BUTLER
H-289 STATE CAPITOL
SALEM OR 97310

ED BUSCH
PUBLIC UTILITY COMMISSION OF
OREGON
PO BOX 2148
SALEM OR 97308-2148

RANDALL DAHLGREN
PORTLAND GENERAL ELECTRIC
121 SW SALMON ST. 1WTC 0702
PORTLAND OR 97204

MELINDA J DAVISON DAVISON VAN
CLEVE PC 333 SW TAYLOR - STE 400
PORTLAND OR 97204

JIM DEASON
ATTORNEY AT LAW
521 SW CLAY ST STE 107
PORTLAND OR 97201-5407

MICHAEL EARLY
INDUSTRIAL CUSTOMERS OF
NORTHWEST UTILITIES
333 SW TAYLOR STE 400
PORTLAND OR 97204

JASON EISDORFER
CITIZENS' UTILITY BOARD OF
OREGON
610 SW BROADWAY STE 308
PORTLAND OR 97205

STEVE EVANS
MIDAMERICAN ENERGY HOLDINGS
COMPANY
666 GRAND AVE
DES MOINES IA 50303

EDWARD A FINKLEA
CABLE HUSTON BENEDICT HAAGENSEN &
LLOYD LLP
1001 SW 5TH - STE 2000
PORTLAND OR 97204

ANN L FISHER
AF LEGAL & CONSULTING SERVICES
2005 SW 71ST AVE
PORTLAND OR 97225-3705

ANDREA FOGUE
LEAGUE OF OREGON CITIES
PO BOX 928
SALEM OR 97308

KELLY FRANCONI ENERGY STRATEGIES
215 SOUTH STATE ST - STE 200
SALT LAKE CITY UT 84111

PAUL GRAHAM DEPARTMENT OF JUSTICE
REGULATED UTILITY & BUSINESS
SECTION 1162 COURT ST NE
SALEM OR 97301-4096

ROBERT JENKS CITIZENS' UTILITY BOARD
OF OREGON
610 SW BROADWAY STE 308
PORTLAND OR 97205

JUDY JOHNSON
PUBLIC UTILITY COMMISSION
PO BOX 2148
SALEM OR 97308-2148

JASON W JONES
DEPARTMENT OF JUSTICE
REGULATED UTILITY & BUSINESS SECTION
1162 COURT ST NE
SALEM OR 97301-4096

GREGG KANTOR
NORTHWEST NATURAL
220 NW SECOND
PORTLAND OR 97209

MARGARET D KIRKPATRICK
NORTHWEST NATURAL
220 NW 2ND AVE
PORTLAND OR 97209

ELISA M LARSON
NORTHWEST NATURAL
220 NW 2ND AVE
PORTLAND OR 97209

PAMELA G LESH
PORTLAND GENERAL ELECTRIC
121 SW SALMON ST 1 WTC 1703
PORTLAND OR 97204

KEN LEWIS
PO BOX 29140
PORTLAND OR 97296

RAUL MADARANG
PORTLAND GENERAL ELECTRIC
121 SW SALMON ST
PORTLAND OR 97204

LARRY O MARTIN
PACIFIC POWER & LIGHT
825 NE MULTNOMAH STE 800
PORTLAND OR 97232

DENNIS J MAURER
DEPARTMENT OF REVENUE

KATHERINE A MCDOWELL
MCDOWELL & ASSOCIATES PC
520 SW SIXTH AVE - SUITE 830
PORTLAND OR 97204

DANIEL W MEEK
ATTORNEY AT LAW
10949 SW 4TH AVE
PORTLAND OR 97219

SENATOR RICK METSGER
STATE CAPITOL
900 COURT ST NE S-307
SALEM OR 97301

ALEX MILLER
NORTHWEST NATURAL GAS COMPANY
220 NW SECOND AVE
PORTLAND OR 97209-3991

JAN MITCHELL
PACIFIC POWER & LIGHT
825 NE MULTNOMAH - STE 2000
PORTLAND OR 97232

MARK NELSON
PUBLIC AFFAIRS COUNSEL
PO BOX 12945
SALEM OR 97309

RICHARD PEACH
PACIFICORP
825 NE MULTNOMAH
PORTLAND OR 97232

MATTHEW W PERKINS
DAVISON VAN CLEVE PC
333 SW TAYLOR - STE 400
PORTLAND OR 97204

DAN PFEIFFER IDAHO PUBLIC UTILITY
COMMISSION 472 WEST WASHINGTON ST
BOISE ID 83720

PAULA E PYRON NORTHWEST INDUSTRIAL
GAS USERS 4113 WOLF BERRY COURT
LAKE OSWEGO OR 97035-1827

LISA F RACKNER
ATER WYNNE LLP
222 SW COLUMBIA ST STE 1800
PORTLAND OR 97201-6618

PORTLAND GENERAL ELECTRIC CO.
RATES & REGULATORY AFFAIRS
PORTLAND GENERAL ELECTRIC COMPANY
121 SW SALMON ST 1WTC0702
PORTLAND OR 97204

DAVE ROBERTSON
PORTLAND GENERAL ELECTRIC
121 SW SALMON ST
PORTLAND OR 97204

AUSEY H ROBNETT III
PAINE HAMBLIN COFFIN BROOKE & MILLER
PO BOX E
COEUR D'ALENE ID 83816-0328

INARA K SCOTT
PORTLAND GENERAL ELECTRIC
121 SW SALMON ST
PORTLAND OR 97204

BOB TAMLYN
PORTLAND GENERAL ELECTRIC
121 SW SALMON ST
PORTLAND OR 97204

DOUGLAS C TINGEY
PORTLAND GENERAL ELECTRIC
121 SW SALMON 1WTC13
PORTLAND OR 97204

JAY TINKER
PORTLAND GENERAL ELECTRIC
121 SW SALMON ST 1WTC-0702
PORTLAND OR 97204

RICK TUNNING
MIDAMERICAN ENERGY HOLDINGS CO
666 GRAND AVENUE
DES MOINES IA 50303

SENATOR VICKI L WALKER
STATE CAPITOL
900 COURT ST NE S-210
SALEM OR 97301

BENJAMIN WALTERS
CITY OF PORTLAND
OFFICE OF CITY ATTORNEY
1221 SW 4TH AVE - RM 430
PORTLAND OR 97204

LINDA K WILLIAMS
KAFOURY & MCDUGAL
10266 SW LANCASTER RD
PORTLAND OR 97219-6305

MARCUS A WOOD
STOEL RIVES LLP
900 SW FIFTH AVE - STE 2600
PORTLAND OR 97204

PAUL M WRIGLEY
PACIFIC POWER & LIGHT
825 NE MULTNOMAH STE 800
PORTLAND OR 97232

I declare under penalty of perjury that the foregoing is true and correct.
Dated at Spokane, Washington this 31st. day of July 2006.

Patty Olsness

