

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



April 24, 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: Revised Straw Proposal of Avista Corporation**

Enclosed please find Avista Corporation's Revised Straw Proposal, in the above-referenced docket, related to "properly attributed and earnings test/expenses between rate cases."

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

Sincerely,

A handwritten signature in cursive script, appearing to read "Kelly Norwood".

Kelly Norwood
Vice President State and Federal Regulation

Enclosures

C: AR 499 Service List

Certificate of Service

I HEREBY CERTIFY that I have this day served Avista Corporation's Revised Straw Proposal in Docket AR 499, upon the parties listed below by sending a copy via electronic mail and U.S. Mail.

Rep. Tom Butler
H-289 State Capitol
Salem, OR 97310
tom@butlert.com
cpatom@fntc.com

Jim Deason
Attorney at Law
521 SW Clay St. Ste. 107
Portland, OR 97201-5407
jimdeason@comcast.net

Ken Lewis
PO Box 29140
Portland, OR 97296
kl04@mailstation.com

Portland General Electric Co.
Rates & Regulatory Affairs
121 SW Salmon St. 1WTC0702
Portland, OR 97204
pge.opuc.filings@pgn.com

Ann L. Fisher
Attorney At Law
AF Legal & Consulting Services
2005 SW 71st Ave.
Portland, OR 97225-3705
energylaw@aol.com

Julie Brandis
Associated Oregon Industries
1149 Court St. NE
Salem, OR 97301-4030
jbrandis@aol.org

Lisa F. Rackner
Attorney
Ater Wynne LLP
222 SW Columbia St. Ste. 1800
Portland, OR 97201-6618
lfr@aterwynne.com

Edward A Finklea
Cable Huston Benedict
Haagensen & Lloyd LLP
1001 SW 5th - Ste. 2000
Portland, OR 97204
efinklea@chbh.com

Lowrey R. Brown lowrey@oregoncub.org
Jason Eisdorfer dockets@oregoncub.org
Robert Jenks bob@oregoncub.org
Citizens' Utility Board of Oregon
610 SW Broadway – Ste. 308
Portland, OR 97205

Melinda J. Davison mail@dvclaw.com
Matthew W. Perkins mwp@dvclaw.com
Davison Van Cleve PC
333 SW Taylor – Ste. 400
Portland, OR 97204

Daniel W. Meek
Attorney At Law
10949 SW 4th Ave.
Portland, OR 97219
dan@meek.net

Paul Graham paul.graham@state.or.us
Jason W. Jones Jason.w.jones@state.or.us
Department of Justice
Regulated Utility & Business Section
1162 Court St. NE
Salem, OR 97301-4096

Certificate of Service

Kelly Francone
Energy Strategies
215 South State St. – Ste. 200
Salt Lake City, UT 84111
kfrancone@energystrat.com

Michael Early
Industrial Customers of Northwest Utilities
333 SW Taylor Ste. 400
Portland, OR 97204
meearly@icnu.org

Andrea Fogue
League of Oregon Cities
PO Box 928
1201 Court St. NE Ste. 200
Salem, OR 97308
afogue@orcities.org

PacifiCorp
825 NE Multnomah, Ste. 800
Portland, OR 97232
Laura Beane laura.beane@pacificorp.com
Scott Bolton scott.Bolton@pacificorp.com
Blair Loftis blair.loftis@pacificorp.com
Christy Omohundro
christy.omohundro@pacificorp.com
Richard Peach
richard.peach@pacificorp.com

Paula E. Pyron
Northwest Industrial Gas Users
4113 Wolf Berry Court
Lake Oswego, OR 97035-1827
ppyron@nwigu.org

Benjamin Walters
City of Portland – Office of City Attorney
1221 SW 4th Ave. – Rm. 430
Portland, OR 97204
bwalters@ci.portland.or.us

Dan Pfeiffer
Idaho Public Utility Commission
472 West Washington St.
Boise, ID 83720
dan.pfeiffer@puc.idaho.gov

Linda K. Williams
Kafoury & McDougal
10266 SW Lancaster Rd.
Portland, OR 97219-6305
linda@lindawilliams.net

Midamerican Energy Holdings Company
Rick Tunning
Steve Evans srevans@midamerican.com
666 Grand Avenue
Des Moines, IA 50303
rrtunning@midamerican.com

Northwest Natural
220 NW 2nd Ave.
Portland, OR 97209
Gary Bauer
Gregg Kantor
Margaret D. Kirkpatrick
Elisa M. Larson
gary.bauer@nwnatural.com
gsk@nwnatural.com
margaret.kirkpatrick@nwnatural.com
elisa.larson@nwnatural.com

Ausey H. Robnett III
Paine, Hamblen, Coffin, Brooke &
Miller LLP
PO Box E
Coeur D'Alene, ID 83816-0328

Stoel Rives LLP
Katherine A. McDowell
Marcus A. Wood
900 SW Fifth Ave., Ste. 1600
Portland, OR 97204-1268
kamcdowell@stoel.com
mwood@stoel.com

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Portland General Electric
Rates & Regulatory Affairs
121 SW Salmon St.
Portland, OR 97204
Randy Dahlgren
Pamela G. Lesh
Raul Madarang
Dave Robertson
Inara K. Scott
Bob Tamlyn
Douglas C. Tingey
Jay Tinker

randy.dahlgren@pgn.com
pamela.lesh@pgn.com
raul.madarang@pgn.com
dave.robertson@pgn.com
inara.scott@pgn.com
bob.tamlyn@pgn.com
doug.tingey@pgn.com
jay.tinker@pgn.com

Judy Johnson
Public Utility Commission
PO Box 2148
Salem, OR 97308-2148
judy.johnson@state.or.us

Kathryn Logan
Administrative Hearings Division
Public Utility Commission
PO Box 2148
Salem, OR 97308-2148
kathryn.logan@state.or.us


Ed Busch
Public Utility Commission of Oregon
PO Box 2148
Salem, OR 97308-2148
edbusch@state.or.us

Senator Rick Metsger
State Capitol
900 Court St. NE S-307
Salem, OR 97301
Sen.rickmetsger@state.or.us

Senator Vicki L. Walker
State Capitol
900 Court St. NE S-210
Salem, OR 97301
Sen.vickiwalker@state.or.us

Pacific Power & Light
825 NE Multnomah Ste. 2000
Portland, OR 97232
Larry O. Martin
Jan Mitchell
Paul Wrigley
larry.martin@pacificorp.com
jan.mitchell@pacificorp.com
paul.wrigley@pacificorp.com

I declare under penalty of perjury that the foregoing is true and correct.
Dated at Spokane, Washington this 24th day of April 2006.



Patty Olsness

**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

**REVISED STRAW PROPOSAL OF AVISTA CORPORATION
PROPERLY ATTRIBUTED AND EARNINGS TEST/EXPENSES
BETWEEN RATE CASES**

Summary of Proposal

No attribution from non-Oregon regulated utility operations.

Taxes associated with non-regulated affiliate operations are grouped together.

Positive or negative tax liability of affiliate group determined.

If positive, no attribution to regulated utility operations is made.

If negative, adjustments made for deferred taxes.

Adjusted amount of negative non-regulated, affiliate group tax liability then allocated to all regulated operations.

Allocation to regulated utility operations based on each utility operation's share of the sum of the positive tax liabilities of all the regulated utility operations.

Adjust for tax impact of net cost changes since last rate case and regulatory disallowances or apply earnings test.

Introduction

The Attorney General's Opinion dated December 27, 2005 gives the Commission discretion to define and implement the term "properly attributed," subject to the general policy and specific limits expressed in chapter 845, Oregon Laws 2005, herein referred to as Senate Bill 408 (SB 408). Section 3 (12) of SB 408 requires that the "lesser of" the amount of taxes incurred as a result of income generated by Oregon regulated utility operations (Oregon stand-alone) or the total amount of taxes paid by the affiliated group is the amount properly attributed to Oregon regulated utility operations.

It is important to note up front that the proposal presented by Avista represents a compromise by the Company in an effort to try to find some common ground among the parties in the implementation of SB 408. We believe that Section 3 (12) (a) provides a solid foundation

for the determination of "properly attributed" for Oregon utility operations when it identifies taxes paid for the utility as "taxes paid that is incurred as a result of income generated by the regulated operations of the utility." Section 3 (12) (b) then goes on to say that if the total taxes paid by the "affiliated group" is less than that determined for the Oregon operations, the taxes paid by customers is to be limited to the lesser amount. We believe that this language, as well as the balance of the language in the Bill, specifies that the only time that Oregon utility customers would pay less taxes than the amount determined based on the "income generated by the regulated operations of the utility," is if the total taxes paid by the affiliated group is a lower number.

In Avista's compromise proposal, the taxes attributed to Oregon regulated operations could be lower than the amount determined based on the "income generated by the regulated operations of the utility," and could also be lower than the total taxes paid by the affiliated group. In Avista's compromise proposal the tax liabilities of non-Oregon regulated utility operations are not used to offset a negative tax liability of the non-regulated affiliate group in determining the "lesser of" provision of Section 3 (12). Oregon regulated utility operations, non-Oregon regulated utility operations, and non-regulated affiliate operations are each considered separately. An attribution is made only if the tax liability of the non-regulated affiliate group is negative. In that instance, the negative tax liability of the non-regulated affiliate group is allocated to Oregon regulated utility operations and non-Oregon regulated utility operations.

Explanation of Proposal

In the case of a company like Avista with utility operations in other jurisdictions, Oregon regulated utility operations cannot receive an attribution of tax benefits from regulated operations in other jurisdictions. To do so would cause a violation of IRS normalization rules. Also, no

amount of positive taxes paid pertaining to regulated operations in other jurisdictions can be assigned to Oregon utility operations. To do so would violate the “lesser of” provision of Section (3)(12).

Taxes associated with non-regulated affiliates, or a sub-group of non-regulated affiliates with a nexus to the utility, are reviewed to determine if the combined group or sub-group of non-regulated affiliates have a positive or negative tax liability. If the combined non-regulated affiliates have a positive tax liability, there is no attribution of such positive tax liability to the Oregon and non-Oregon regulated utility operations. To do so would violate the “lesser of” provision of Section 3 (12). In this instance the Oregon stand-alone amount is the amount that is properly attributed to Oregon regulated operations.

If the combined non-regulated affiliates have a negative tax liability, then the tax liabilities of the Oregon and non-Oregon regulated operations and the tax liabilities of the non-regulated affiliates within the group or nexus sub-group are adjusted for deferred income taxes. It is necessary to make adjustments for deferred income taxes before making attribution calculations since income tax liabilities for regulated utility operations may be negative before adjusting for deferred taxes. Negative regulated utility tax liabilities would primarily be caused by accelerated tax depreciation and deferred power or purchased gas costs. Also, adjusting for accelerated tax depreciation related deferred taxes eliminates any potential normalization violation. Deferred tax adjustments to non-regulated affiliate tax liabilities are necessary to reflect book/tax timing differences that reverse in subsequent periods. To not recognize those deferred tax adjustments could attribute tax benefits, but not attribute the corresponding tax costs in subsequent periods due to the one-way nature of the “lesser-of” provision of Section (3)(12). Once the adjustments for deferred taxes are made, the net negative tax liability of the non-

regulated affiliate group is allocated to Oregon and non-Oregon regulated utility operations based on their shares of the sum of the positive tax liabilities of the regulated utility operations.

Application of Proposal

	<u>Tax Return</u>	<u>Deferred Tax Adjustments</u>	<u>Adjusted</u>	<u>Attribution</u>	<u>Attributed</u>
Regulated Oregon Utility Operations	\$100	\$50	\$150	-\$83	\$67
Regulated Non-Oregon Utility Operations					
Utility Operation 1	-50	150	100	-56	44
Utility Operation 2	10	100	110	-61	49
Total Non-Oregon Utility Operations	-40	250	210	-117	93
Affiliate X	50	10	60	-60	0
Affiliate Y	-280	20	-260	260	0
Total Affiliates	-230	30	-200	200	0
Total Consolidated	-\$170	\$330	\$160	\$0	\$160

The example above shows how the proposal would work. The amounts are tax liability amounts. The first column shows amounts from the tax return. The second column shows adjustments for deferred taxes and the third column reflects the sum of the tax return amounts and the deferred tax adjustments. The fourth column labeled 'Attribution' shows how the -\$200 net negative tax liability of the non-regulated affiliate group is allocated to Oregon and non-Oregon regulated utility operations based on their shares of the sum of the positive tax liabilities of the regulated utility operations. The attribution to regulated Oregon utility operations is calculated as follows: $-\$200 \times \$150 / (\$150 + \$210) = -\$83$. The final column shows the result after attributing the -\$200 net negative tax liability of the non-regulated affiliate group to regulated Oregon and non-Oregon utility operations. It is important that each of the regulated utility operations receive its share of the negative tax liability of the non-regulated group, as shown in this example.

Earnings Test/Expenses Between Rate Cases and Regulatory Disallowances

As stated earlier, the Attorney General's Opinion dated December 27, 2005 gives the Commission discretion to define and implement the term "properly attributed." Avista believes that it is within the discretion of the Commission to allow adjustments for the income tax impacts of net cost changes (revenues and expenses) since the last rate case and for regulatory disallowances. It would not be fair to pass-through the income tax benefit of net costs incurred by the utility that are not borne by ratepayers. In the case of a disallowed utility cost, it would not be fair to deny the utility the recovery of the cost and, in addition, require the utility to pass-through the tax benefit of the disallowed cost. Adjustments need to be made to the amount of taxes paid that are properly attributed to Oregon regulated utility operations to remove the taxes associated with net cost changes since the last rate case and for regulatory disallowances.

An alternative to removing taxes associated with net costs changes since the last rate case is to have an earnings test where a SB 408 income tax rebate would not be made if the utility earned less than its authorized return, and where a SB 408 income tax surcharge would not be made if the utility earned more than its authorized return. If a utility earns less than its authorized return, most likely, its costs have increased since the last rate case. The increased costs are offset by lower income taxes with the net result being lower after-tax earnings. Again, it would not be fair to pass-through the income tax benefit of net costs incurred by the utility that are not borne by ratepayers. The earnings test would keep this from happening. Likewise, the earnings test would keep SB 408 income tax surcharges from happening where the increased income taxes were caused by reduced costs/increased earnings since the last rate case.

DATED: this 24th day of April 2006

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Kelly Norwood".

Kelly Norwood
Vice President State and Federal Regulation