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SENT VIA OVERNIGHT MAIL

January 12, 2011

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

**Re: 2009 Tax Report Filing of Avista Corporation, Docket UG 171(4)
Avista's Claim that Staff's Proposed Refund Violates ORS 756.040**

On October 15, 2010 Avista filed its 2009 Senate Bill 408 (SB 408) Tax Report in UG-171(4) in compliance with OAR 860-022-0041. On October 26, 2010 and on October 29, 2010 Avista filed amended 2009 Tax Reports that contained corrections. Avista's amended Tax Report shows taxes paid to be greater than taxes collected by \$1,267,000 before interest, which would result in a surcharge under Avista's automatic adjustment clause (AAC). Avista's taxes paid calculation fell under the deferred tax floor provision of section (4)(d) of OAR 860-022-0041, which states:

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

While Staff acknowledges in its direct testimony that Avista's filing comports with the existing rules, Staff believes that the (4)(d) deferred tax floor provision needs to be changed through an emergency rulemaking, and that rather than a surcharge, Avista should refund \$1,024,000 before interest.

Avista hereby advises the Commission and all parties in UG 171(4) that Avista claims that Staff's proposed refund in connection with its tax report for 2009 will violate ORS 756.040 and would result in confiscatory rates. Accordingly, Avista is claiming that no refund should be made in connection with its tax report for 2009. Specifically, ORS 756.040 provides, in part, that rates are fair and reasonable if the rates provide a return to the equity holder that is "commensurate with the return on investments in other enterprises having corresponding risks."

ORS 756.040 General powers. (1)... In respect thereof the commission shall make use of the jurisdiction and powers of the office to protect such customers, and the public generally, from unjust and unreasonable exactions and practices and to obtain for them adequate service at fair and reasonable rates. The commission shall balance the interests of the utility investor and the consumer in establishing fair and

reasonable rates. Rates are fair and reasonable for the purposes of this subsection if the rates provide adequate revenue both for operating expenses of the public utility or telecommunications utility and for capital costs of the utility, with a return to the equity holder that is:

(a) Commensurate with the return on investments in other enterprises having corresponding risks; and

(b) Sufficient to ensure confidence in the financial integrity of the utility, allowing the utility to maintain its credit and attract capital.

(2) – (3) [omitted]

Avista's position finds support in the Attorney General's Opinion of December 27, 2005, addressing several questions concerning the implementation of SB 408. In its Opinion, at page 16, the Office of Attorney General opined that "[r]egardless of the approach finally adopted by the Commission, the rate ultimately allowed must be 'fair and reasonable' under ORS 756.040(1)." The Opinion noted that ORS 756.040 "essentially codifies" the constitutional standard established by the United States Supreme Court for avoiding confiscatory utility rates. *See Federal Power Commission v. Hope Natural Gas Pipeline ("Hope")*, 320 US 591, 64 SCt 281, 88 LEd 333 (1944). It went on to observe, at page 16, that:

ORS 756.040 thus limits utilities' exposure to rate reductions, regardless of how the Commission exercises its discretion in the application of the expression "properly attributed." In other words, chapter 845 addresses the tax component of rates. ORS 756.040 deals more broadly with the Commission's obligation to set rates at or above the constitutional floor.

Consideration of such a claim was previously allowed by OAR 860-022-0041(10). As originally adopted the rule provided:

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.

A temporary rule was put in place that modified the earnings review period to be the utility's projected earnings during the period the automatic adjustment clause would be in effect. In Docket AR 537 by Order No. 09-383 entered 10/1/09, the temporary rule was repealed and OAR 860-022-0041(10) was eliminated. In its decision at page 3 of the order the Commission stated: "We clarify that deletion of section 10 is not intended to affect a utility's right to raise a claim under ORS 756.040 or the United States Constitution." As previously stated, Avista hereby makes such a claim.

The imposition of a \$1.211 million dollar refund (\$1.024 million plus \$0.187 million of interest) would violate ORS 756.040, based on an earnings review for Avista using its earnings test results for the 2009 tax year. The earnings test results show a return on equity (ROE) of only 4.64% for its Oregon operations for the calendar year 2009 including the impact of the SB 408 refund (Attachment A). The allowed return on equity is 10.10%. The 4.64% ROE is well below any measure of what would be considered to be a return on equity that is "commensurate with the return on investments in other enterprises having corresponding risks."

Avista believes that the earnings review should be based on the utility's results of operations report for the applicable tax year for the reasons stated in its Joint Comments filed in AR 537. Since SB 408 is a true-up mechanism that uses a retrospective analysis of the tax year to determine taxes paid and taxes collected, it is consistent with SB 408, consistent with the accounting matching principle under which deferrals are recorded, and consistent with sound ratemaking principles to use the same retrospective tax period for the earnings review. The Commission has used retrospective periods for earnings reviews for purchased gas cost adjustment mechanisms and in deferral amortizations under the deferral statute, ORS 757.259. In UM 1224, Order No. 09-316 (August 18, 2009) the Commission concluded that a utility's earnings should be reviewed for an interval that includes the deferral period, and that reviewing earnings that are entirely distinct for the deferral period would be inconsistent with general principles of ratemaking and deferred accounting.

If you have any questions, please contact 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

Service List
Enclosure

Avista Corporation
Oregon Gas
Impact of SB 408 on Return on Equity
2009

Line No.	Revised Earnings Test Results	Remove 2009 SB 408 Accrual in 2009	Adjusted	Include Staff's Tax Report Amount Incl Interest	Adjusted
1	\$7,196,208		\$7,196,208		\$7,196,208
2		\$750,000	750,000		750,000
3		-262,500	-262,500		-262,500
4			0	-\$1,210,934	-1,210,934
5			0	423,827	423,827
6	\$7,196,208	\$487,500	\$7,683,708	-\$787,107	\$6,896,601
7	3,994,511		3,994,511		3,994,511
9	\$3,201,697		\$3,689,197		\$2,902,090
10	2.56%		2.95%		2.32%
11	50.00%		50.00%		50.00%
12	5.12%		5.90%		4.64%
13	\$125,219,795		\$125,219,795		\$125,219,795
14	3.19%		3.19%		3.19%
15	\$3,994,511		\$3,994,511		\$3,994,511

	Capital Structure	Cost	Weighted Cost
16 Long-Term Debt	50.00%	6.37%	3.19%
17 Common Equity	50.00%	10.10%	5.05%
18 Total	100.00%		8.24%

Notes:

Capital structure and return on equity from UG 186. Interest cost at 12/31/09 as reflected in earnings test. The "Revised Earnings Test Results" reflect FIT corrections made in UG 201. The SB 408 accruals for years prior to 2009 were removed in the earnings test Type 1 adjustments.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served Avista Utilities 2009 Tax Report Filing of Avista Corporation, Docket UG-171(4) Avista's Claim that Staff's proposed Refund Violates ORS 756.040, upon the parties listed below by electronic mail or by mailing a copy thereof, where paper service has not been waived.

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Dated at Spokane, Washington this 12th day of January 2011.



Patty Olsness, Rates Coordinator