



# Oregon

Theodore R. Kulongoski, Governor

## Public Utility Commission

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December 23, 2010

### ***Via Electronic Filing and U.S. Mail***

OREGON PUBLIC UTILITY COMMISSION  
ATTENTION: FILING CENTER  
PO BOX 2148  
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**RE: Docket No. UE 177(4) – In the Matter of PACIFICORP's, Senate Bill 408 Tax Filing for 2009 Tax Period.**

Enclosed for electronic filing in the above-captioned docket is the Public Utility Commission's Staff Issues List.

*/s/ Kay Barnes*

Kay Barnes

Regulatory Operations Division

Filing on Behalf of Public Utility Commission Staff

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c: UE 177 Service List (parties)

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**PUBLIC UTILITY COMMISSION  
OF OREGON**

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**UE 177(4)**

**STAFF ISSUES LIST**

**Carla Owings  
Dustin Ball  
Deborah Garcia**

**In the Matter of  
PACIFICORP's  
Senate Bill 408 Tax Filing  
for 2009 Tax Period**

**December 23, 2010**

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**SENATE BILL 408, TAX FILINGS  
STAFF'S INITIAL FINDINGS  
FOR PACFICORP – UE 177(4)**

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**TO:** LEE SPARLING, MAURY GALBRAITH, JUDY JOHNSON AND  
JASON JONES

**RE: PACIFICORP – UE 177 (4)  
SB 408 TAX FILINGS  
2009 TAX PERIOD**

**FROM:** CARLA OWINGS, SENIOR UTILITY ANALYST,  
DUSTIN BALL, SENIOR UTILITY ANALYST, AND  
DEBORAH GARCIA, SENIOR UTILITY ANALYST  
PUBLIC UTILITY COMMISSION

**DATE:** DECEMBER 23, 2010

**CC:** ALL PARTIES

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On October 15, 2010, PacifiCorp (PPL or Company) filed UE 177(4), its tax report covering the 2009 calendar year pursuant to Senate Bill 408 (SB 408) (codified at ORS 757.267, 757.268 and OAR 860-022-0041).

Much of the information contained in these tax reports represents highly confidential and sensitive information. Staff has structured its initial findings in this report in a generic manner in order to avoid the possibility of disclosing confidential, or sensitive, information.

Staff has thoroughly reviewed each calculation and all documentation provided by the Company.

*At the conclusion of Staff's review and after some of the Parties<sup>1</sup> had reached an agreement in principle for settlement Staff discovered a potential inconsistency between SB 408 and OAR 860-022-0041. The inconsistency involves the manner for determining the existence of a normalization violation<sup>2</sup> under (4)(d) of the commission rule and under Staff's template. The impact of improperly applying the normalization violation test (on Page 8 of Staff's template) results in a significant surcharge proposed by PPL's 2009 SB408 filing.*

*Upon discovering this issue, Staff immediately consulted with the Assistant Attorney General's (AAG or Staff's Counsel) office and our upper management team. As a result of those discussions, Staff requested a delay of six days from December 17, 2010 to December 23, 2010 to publish this issues list. In addition, Staff and its Counsel held phone discussions with each of the Utility companies as well as the Parties represented at the Settlement conference<sup>3</sup> to notify them of the potential impacts of this issue. Staff also informed the Parties that we could not go forward with the initial agreements made at the Settlement Conferences.*

*The basis of the Staff recommendation in this report outlines the foundation of Staff's findings and agreements made in Settlement discussions. Most importantly, these recommendations are based upon rule implementation prior to Staff's discovery of the issue described above.*

*Staff is in the process of investigating the validity of the assumption that the rules and Staff's template conflict with the original intent of the test for a Normalization Violation. If Staff concludes there is a conflict in the rules and Staff's template from the intent of SB408, then the findings in the report below would change significantly. Staff's Testimony is scheduled to be published on January 11, 2011 which would incorporate the findings of Staff's investigation into this matter. If Staff's investigation concludes that there is no conflict between the current rules and Normalization Violations, Staff will likely propose settlement based upon the original agreements described below.*

#### **SUMMARY OF 2009 SB 408 IMPACT:**

PPL reports the following for its Regulated Results of Operations for the 2009 tax period:

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<sup>1</sup> The Parties to the Stipulated Agreements are defined in the section "Summary of Review" section on Page 4 below.

<sup>2</sup> Discussed in section "Staff Review" on page 5 below.

<sup>3</sup> Id.

**Table 1-Original Filing**

| <b>Federal and State Taxes</b><br>Paid to units of Government | <b>Taxes Collected</b> | <b>Surcharge</b>      | <b>Interest<sup>4</sup></b><br>(7/1/09 through 6/1/2011) | <b>Total Surcharge</b> |
|---|------------------------|-----------------------|--|------------------------|
| <b>\$98.4 million</b>   | <b>\$69.0 million</b>  | <b>\$29.4 million</b> | <b>\$4.7 million</b>                                     | <b>\$34.1 million</b>  |
| <b>Local Taxes</b><br>Paid to units of Government             | <b>Taxes Collected</b> | <b>Refund</b>         | <b>Interest<sup>5</sup></b><br>(7/1/09 through 6/1/2011) | <b>Total Refund</b>    |
| <b>\$132,000</b>  | <b>\$45,000</b>        | <b>(\$87,000)</b>     | <b>\$14,000</b>  | <b>(\$101,000)</b>     |

PPL's original filing reflected a total surcharge related to the Federal and State tax true-up for the 2009 tax period of approximately \$34.1 million including interest through the deferral period of approximately \$4.7 million.

The variance between local taxes paid and taxes collected results in a refund of approximately \$87,000. Interest of approximately \$14,000 will accrue on this balance beginning July 1, 2009 through June 1, 2011. PPL estimates an additional \$1,100 of interest will accrue during the amortization phase, based upon the current Blended Treasury rate.

Table 2 below shows the summary of changes proposed by Staff.

**Table 2- Staff Recommendation**

| <b>Federal and State Taxes</b><br>Paid to units of Government | <b>Taxes Collected</b> | <b>Surcharge</b>      | <b>Interest<sup>6</sup></b><br>(7/1/09 through 6/1/2011) | <b>Total Surcharge</b> |
|---|------------------------|-----------------------|--|------------------------|
| <b>\$91.2 million</b>   | <b>\$63.7 million</b>  | <b>\$27.3 million</b> | <b>\$4.3 million</b>                                     | <b>\$31.6 million</b>  |

<sup>4</sup> Estimate includes interest through deferral period.

<sup>5</sup> Estimate includes interest applied through deferral period.

<sup>6</sup> Estimate includes interest applied through deferral period.

| Local Taxes Paid to units of Government | Taxes Collected | Refund     | Interest <sup>7</sup><br>(7/1/09 through 6/1/2011) | Total Refund |
|---|-----------------|------------|--|--------------|
| \$132,000                               | \$45,000        | (\$87,000) | \$14,000   | (\$101,000)  |

Staff proposes amendments<sup>8</sup> resulting in a surcharge of approximately \$27.3 million. Staff estimates interest accruing during deferral period to be approximately \$4.3 million, resulting in a total surcharge of approximately \$31.6 million. Additional interest will accrue during the amortization phase at the 2011 Blended Treasury rate. Currently that rate is 2.24 percent and represents an interest accrual of approximately an additional \$358,000.

PPL's surcharge based on Staff's findings total approximately \$31.6 million<sup>9</sup> and would represent an increase of approximately 3.2 percent to PPL's retail rates without consideration of the removal of the current SB 408 surcharge that relates to prior periods.

*For local taxes, Staff proposes no amendments and is in support of the amounts proposed by PPL for a refund of approximately \$102,000<sup>10</sup>. This refund would be implemented simultaneously with the surcharge generated from the true-up related to the State and Federal tax true-up. For this reason, PPL's Multnomah County ratepayers will experience a slightly smaller rate increase than those outside of the Multnomah County jurisdiction.*

Prior to rate implementation June 1, 2011, Staff will review the balance remaining of the 12-month amortization for the prior year's SB 408 implementation related to 2008 tax period. Any estimates of over or under collections of previous years' surcharges will be updated and included in the compliance filing implemented June 1, 2011.

#### **SUMMARY OF REVIEW:**

At the conclusion of a settlement discussion held December 9, 2010, Staff, and the Company were able to reach an agreement in principal based upon modifications described in the Staff Review section below. The Citizens' Utility Board (CUB) and the Industrial Customers of Northwest Utilities (ICNU)(collectively, the Customer Groups) were unable to support a stipulation as of the time of this filing. Due to Staff's investigation of Normalization

<sup>7</sup> Estimate of interest through deferral period.

<sup>8</sup> See section on "Staff Review" for specific amendments.

<sup>9</sup> Including interest during deferral and an estimate of interest during amortization based upon the current Blended Treasury rate.

<sup>10</sup> Includes interest during deferral period and an estimate of interest during amortization.

Violations, Staff withdrew from the agreements made in the settlement conference described above.

#### **STAFF REVIEW:**

Staff conducted face to face interviews on November 17, 2010, December 2, 2010, and again on December 9, 2010. CUB and ICNU were present for each meeting and participated in these discussions. Staff sent data requests and conducted informal phone discussions.

The Company provided several work papers, an electronic version of Staff's Tax form and responses to Staff's data requests.

In general, SB408 defines taxes paid as the "lesser of" three alternative calculations: (1) the utility's stand alone tax liability; (2) the total consolidated tax liability of the affiliated group; and (3) the total consolidated tax liability of the affiliated group "properly attributed" to the regulated operations of the utility.

Commission Order 07-401 adopted specific rules to preclude "taxes paid" from falling below the utility's deferred tax balance related to the depreciation of its public utility property. Such a scenario would create a normalization violation by allowing ratepayers to share in the benefits received from accelerated depreciation. Specifically, OAR 860-022-0041(4)(d) requires that we rely upon the lowest of the three "taxes paid" methods except that the lowest method cannot produce a result that is *less* than the deferred taxes related to public utility property for regulated operations of the utility, reduced by any tax refunds recognized in the reporting period, and allocated to the regulated operations of the utility.

Page 8 of Staff's template, provides for this alternative calculation. Here the reporting utility must enter the amount of deferred taxes related to depreciation of public utility property (hereafter referred to as the "4(d) tax limitation") for the regulated operations in Oregon. This amount is then reduced by the amount of refund recognized in the reporting period that is allocable to the regulated operations.

For the 2009 tax period, PPL falls under the 4(d) tax limitation. The outcome of the three alternative calculations (described above) results in the deferred tax balance related to the depreciation of public utility property that is higher than the lowest of the three alternative methods. Choosing the any of the alternative methods would result in a normalization violation. Therefore, Staff supports the use of the 4(d) tax limitation.

One of the driving forces for this result is the extremely high level of accelerated depreciation associated with the renewable resources that PPL has

acquired during the 2009 tax period. As a result of our review, Staff identified the following issues regarding PPL's original filing:

**(1) Taxes Paid – 4(d) Tax Limitation:**

- **Flow-Through;**
- **Allocation method verses separate Power Tax Report; and**

**(2) Taxes Collected – Net to Gross and Effective Tax Ratios.**

**(1) Taxes Paid – 4(d) Tax Limitation:**

After the application of the three methods described above, PPL reports that its balance of its 4(d) tax limitation is greater than the lowest of the three methods to calculate “taxes paid” described above.

Although PPL does acknowledge receipt of a tax refund during the same tax period, PPL states that this refund is not “allocable” to the Oregon regulated operations and further, that the status of the refund is non-final as current estimates of final determination are June 30, 2012<sup>11</sup>. Staff concurs, the refund does not appear to be allocable to the Oregon jurisdiction.

**Flow-through** - PPL includes approximately \$5.2 million of “flow-through” in the amount attributable to the 4(d) tax limitation which represents flow-through depreciation for pre-1981 assets. Flow-through is simply allowing the benefit of depreciation to “flow-through” to ratepayers. In years prior to 1981, the sharing of the benefit of depreciation was allowed by the Internal Revenue Service. Currently, the sharing this benefit is referred to as a normalization violation and is the very purpose of establishing the 4(d) tax limitation.

Commission Order No. 07-401 adopts the 4(d) tax limitation<sup>12</sup> to protect against normalization violations. Since the \$5.2 million of flow-through represents the benefit of depreciation that has *already* passed to ratepayers prior to 1981, excluding it from the 4(d) tax limitation does not create a normalization violation. As pointed out at page 6 of the above-referenced Order; “a normalization violation is not a matter of degree; it either *is* or *is not* a normalization violation.” It is Staff’s position that the benefit of depreciation cannot be passed a second time, therefore, Staff believes it is appropriate to remove this amount from the balance of deferred taxes.

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<sup>11</sup> PPL's response to Staff DR No. 7

<sup>12</sup> See Commission Order 07-401 at 6.



After discussions with Staff, PPL has agreed to remove this adjustment in an effort to resolve differences and come to a Stipulated agreement with Staff.

*Staff recommends that PPL remove \$5.2 million from the balance reported on the Staff Template, page 8, Line 1 resulting in a decrease to PPL's surcharge of \$5.2 million.*

**Allocation method verses separate Power Tax Report** - In previous SB 408 filings, PPL has calculated the balance of deferred taxes that relate to depreciation of public utility property by using the values determined for PPL's total system operations and then allocating those amounts to Oregon using the factors that are generated when preparing the Results of Operations Report for Oregon.

For the 2009 tax period, PPL ran a separate report using its power tax system to determine the value of the balance for deferred taxes. During the review process, Staff compared the outcome of the two methods and determined that the variance between the two methods creates a significant gap in amounts attributable to the deferred tax balance for the Oregon jurisdiction and thus, to the balance of the 4(d) tax limitation<sup>13</sup>. The tax benefit related to the larger amount of deferred taxes determined in the Power Tax program results in an increase to PPL's surcharge of approximately \$2.9 million.

PPL believes that the separate report provides better accuracy as well as more clarity by separately identifying the exact balances attributable to each asset.

Staff believes that since deferred tax balances are established in rates on a jurisdictional allocation basis, that using the allocations would more properly reflect what is being collected in rates.

*Staff recommends that PPL allocate the amount attributable to the deferred tax balance of depreciation for public utility property to the Oregon Regulated Operations rather than to run a separate Power Tax report to determine the balance. Using allocations to determine the balance results in a reduction of approximately \$2.9 million to PPL's proposed surcharge.*

## **(2) Taxes Collected – Net to Gross and Effective Tax Ratios;**

OAR 860-022-0041(2)(A)(i)-(ii) states that the revenue reported in a utility's results of operations shall be multiplied by the ratio of *net revenues to gross revenues* using the pretax income and revenue the Commission authorized in establishing rates and revenue requirement; and, the effective tax rate used by the Commission in establishing rates for the time period covered by the tax report

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<sup>13</sup> Discussed in "Staff Review" on page 5 above.

as set forth in the most recent general rate order or *other order that establishes an effective tax rate*, calculated as the ratio of the total income tax expense in the revenue requirement to pre-tax income.

Further, OAR 860-022-0041(2)(n) describes “revenue” as being the utility’s Oregon retail revenues, excluding supplemental schedules or other revenues not included in the utility’s revenue requirement and adjusted for any *rate adjustment* imposed under this rule.

Staff believes that to determine the net to gross and effective tax ratios, Staff must rely upon the most recent general rate proceeding modified for any rate revisions that take place during the tax period. Any schedule that includes a revenue requirement and thus includes a tax component for the collection of taxes in rates should be included in the calculation of these ratios.

PPL originally excluded supplemental schedules related to its renewable adjustment clauses (or RAC) filings from the calculation of net to gross and effective tax ratios due to the language in the rule that allows for the exclusion of supplemental schedules.

Due to the generous tax credits available to the utilities for renewable resources, RAC filings have a negative tax component set in the proposed rate structure in order to pass the benefit of tax credits to ratepayers through rates. Including these schedules in the calculation of the ratios increases PPL’s surcharge by approximately \$5.8 million. However, Staff believes that this modification is consistent with OAR 860-022-0041(2)(n) and recommends that PPL modify its filing to reflect the change.

*Staff recommends PPL recalculate the net to gross and effective tax rate ratios to include all schedules that contain a tax component and reflect a rate modification during the tax period. This modification increases PPL’s surcharge by approximately \$5.8 million.*

UE 177  
SERVICE LIST (PARTIES)

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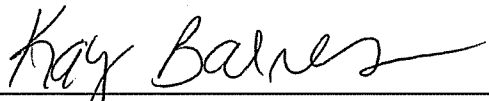
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**CERTIFICATE OF SERVICE**

**UE 177(4)  
Staff Issues List**

I certify that I have this day served the foregoing document upon all parties of record in this proceeding by delivering a copy in person or by mailing a copy properly addressed with first class postage prepaid, or by electronic mail pursuant to OAR 860-001-0180, to the following parties or attorneys of parties.

Dated this 23rd day of December 2010, at Salem, Oregon.



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