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December 18, 2009

Via Electronic Filing and U.S. Mail

OREGON PUBLIC UTILITY COMMISSION
ATTENTION: FILING CENTER
PO BOX 2148
SALEM OR 97308-2148

RE: Docket No. UE 177(3) – In the Matter of PACIFICORP's, Senate Bill 408 Tax Filing for 2008 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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Email: kay.barnes@state.or.us

c: UE 177 Service List (parties)

PUBLIC UTILITY COMMISSION OF OREGON

UE 177(3)

STAFF ISSUES LIST

Carla Owings
Dustin Ball
Deborah Garcia

In the Matter of PACIFICORP's Senate Bill 408 Tax Filing for 2008 Tax Period

December 18, 2009

SENATE BILL 408, TAX FILINGS
STAFF'S INITIAL FINDINGS
FOR PACIFICORP – UE 177(3)

TO: LEE SPARLING, ED BUSCH, JUDY JOHNSON AND JASON JONES

RE: **PACIFICORP – UE 177 (3)**
SB 408 TAX FILINGS
2008 TAX PERIOD

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

DATE: DECEMBER 18, 2009

CC: ALL PARTIES

On October 15, 2009, PacifiCorp (PPL or Company) filed UE 177(3), its tax report covering the 2008 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.

SUMMARY OF 2008 SB 408 IMPACT:

PPL reports the following for its Regulated Results of Operations for the 2008 tax period:

Table 1-Original Filing

Federal and State Taxes Paid to units of Government	Taxes Collected	Surcharge	Interest[1] (7/1/08 through 6/1/2011)	Total Surcharge
$120.8 million	**$82.3 million**	**$38.5 million**	**$6.1 million**	**$44.6 million**

PPL's original filing reflected a total surcharge related to the Federal and State tax true-up for the 2008 tax period to be $44.6 million including interest.

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

Table 2- Staff Recommendation

Federal and State Taxes Paid to units of Government	Taxes Collected	Surcharge	Interest[2] (7/1/08 through 6/1/2011)	Total Surcharge
$84.1 million	**$82.3 million**	**$1.8 million**	**$281,600**	**$2.0 million**

PPL has not yet provided a revised filing of its tax report that includes the Staff's recommended revisions. Staff will file updated accrued and estimated interest amounts concurrent with the filing of a stipulation, or in testimony, if the Parties are not able to reach agreement.

The impact of PPL's surcharge of approximately $2.0 million would represent an increase of approximately 0.2 percent to PPL's retail rates without consideration of the removal of the surcharge that relates to prior periods. For the 2007 tax period, PPL would have surcharged approximately $5.1 million. However, this surcharge was in addition to a surcharge of approximately $14.7 million related to the 2006 tax period that was amortized over a two-year period. Therefore, in June 2010, the effect of removing this much larger surcharge

[1] This is an estimate of all interest that will apply until amortization is complete.

[2] See footnote above.

related to the prior periods will actually reduce rates by approximately 1.2 percent of 2008 retail revenues due to the much smaller surcharge implemented related to the 2008 tax period.

PPL paid $0 in local taxes for the 2008 tax period and collected $342,361 in rates. The variance between taxes paid and taxes collected is a refund of $342,361. Interest of approximately $55,000 has accrued on this balance since July 1, 2008. On June 1, 2010, PPL will implement a refund to Multnomah County ratepayers of $397,361 (including interest). This refund will 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 larger rate reduction than those outside of the Multnomah County jurisdiction.

By June of 2010, Staff will review the balance remaining of the 12-month amortization related to the surcharge for the 2007 tax period. Any over- or under-collection of these amortizations will be either included in, or netted against, the total 2008 tax variance plus interest on June 1, 2010.

STAFF REVIEW:

Staff conducted face to face interviews on November 13, 2009, November 23, 2009 and December 9, 2009. Citizens' Utility Board and the Industrial Customers of Northwest Utilities were present for each meeting and participated in these discussions. Staff sent seven 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. While Staff raises numerous issues in this document, it reserves the opportunity to raise new issues during the time remaining in this proceeding.

Following is a detailed summary of Staff's review:

Staff requested the Company provide responses to the following items:

- the deferred tax add-back on Page 6 of the tax report;
- the carry-forward amounts shown on work paper TP 10-4;
- the justification for the Oregon allocated amount of flow-through shown on work paper TP 10-4;
- the 13-month or 5-quarter average of cost of debt and capital structure; and

- the justification for the total system amount of flow-through shown on work paper TP 10-4.

As a result of our review, Staff identified the following issues regarding PPL's original filing:

(1) Deferred Tax add-back;

On Page 6 of the tax report, PPL is required to add-back deferred taxes that relate to depreciation of public utility property. Staff believes that the tax report contemplates the add-back of deferred taxes that relate to all depreciation; both book and tax depreciation.

On Lines 5, 14 and 23 of the tax report PPL included only the deferred taxes that relate to tax depreciation while the deferred taxes associated with book depreciation were included with the amounts on Lines 4, 13 and 22 of Page 6.

In its response to Staff Data Request No. 45, PPL states that this method was used in prior tax reports and that it appropriately isolates book and tax depreciation and demonstrates that there is no normalization violation in the SB408 calculation.

Staff believes that this adjustment is inappropriate. Although Staff acknowledges that PPL employed this method in prior years' tax reports, there was no impact of the adjustment because the deferred tax amount reported for tax depreciation in the previous reports was less than the overall taxes paid amount. The purpose of separating out the tax effects of depreciation through the filings is to ensure that the accelerated tax benefits of depreciation are retained by the company and not flowed through to ratepayers, thus creating a normalization violation. Staff believes that no normalization violation occurs when both book and tax depreciation is included on Lines 4, 13 and 22.

Staff recommends that PPL revise Lines 4, 13 and 22 of Page 6 of the tax report to include both book and tax depreciation. Doing so results in a reduction of approximately $35.9 million to PPL's surcharge.

(2) Flow-through;

The deferred tax amounts reported by PPL not only include deferred taxes related to temporary Schedule M (book-tax differences) items, but also include substantial "deferred tax only adjustments" related to pre-1981 flow-through.

PPL explained that the deferred tax-only adjustments are related to flow-through depreciation from pre-1981 assets. The Company has included in deferred taxes amounts related to the reversal of pre-1981depreciation that were previously passed through to ratepayers.

Staff has reviewed this issue with PPL in each of the past SB 408 filings. This year PPL was able to provide documentation that demonstrates the amount that is attributable to the Oregon jurisdiction for the 2008 tax period.

Staff believes that the type of reports generated by PPL for this reported period could be used to verify each of the prior tax periods to demonstrate that the flow-through has been appropriately calculated and allocated.

Staff recommends that PPL provide reports in a format similar to those provided to Staff for the 2008 tax period for future filings in order to verify the flow-through for the Oregon jurisdiction as well as on a system-wide basis.

(3) How the capital structure and cost of debt used to calculate the interest deduction in the stand-alone method were derived;

As stated in OAR 860-022-0041(2)(p) the interest expense used to calculate the stand-alone method should be calculated "in a manner similar to that used by the Commission in establishing rates." In its 2008 tax report PPL uses the capital structure ratios and weighted cost of debt as of the last day of the reporting period, purportedly similar to that used in its most recent rate case.

Staff disagrees with this method and believes the appropriate method – reflecting the "manner similar to that used by the Commission in establishing (PPL's) rates" is to use the *average* actual capital structure, the *average* actual cost of debt for the year and multiply those by the *average* 2008 rate base from the Results of Operations report to derive the interest expense (referred to as interest synchronization). In addition, Staff believes the use of annual average capital structure and annual average cost of debt most closely match with how rate base is stated in the Company's Results of Operations report (it is stated as "annual average").

PPL objects to Staff's method because the Company believes that requiring the use of the average *actual* capital structure and the average *actual* cost of debt for the tax period (as opposed to the specific amounts assigned in the most recent rate case) unwinds the agreements that were made in the prior rate proceeding. However, Staff believes that the intent of SB408 is to measure what actually took place during the tax period. Using proxy ratios, such as those assigned in the rate proceeding, does not give an accurate measure of the changes that are representative of the resulting tax liability.

Staff recommends that interest expense used for the purposes of stand-alone tax liability be revised to reflect the average actual weighted cost of debt multiplied by the average rate base for the tax period. This revision decreases PPL's surcharge for state and federal portion by approximately $0.8 million.

***Summary**. The summary of Staff's initial findings results in a total decrease to PPL's federal and state refund of $36.7 million. Staff has no recommended revisions to PPL's total refund of local taxes of $342,361.*

UE 177
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CERTIFICATE OF SERVICE

UE 177(3)
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 860-13-0070, to the following parties or attorneys of parties.

Dated at Salem, Oregon, this 18th day of December, 2009.

Kay Barnes

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