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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. UG 171(3) – In the Matter of AVISTA'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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c: UG 171 Service List (parties)

PUBLIC UTILITY COMMISSION OF OREGON

UG 171(3)

STAFF ISSUES LIST

Carla Owings
Dustin Ball
Deborah Garcia

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

December 18, 2009

SENATE BILL 408, TAX FILINGS
STAFF'S INITIAL FINDINGS
FOR AVISTA CORPORATION – UG 171(3)

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

RE: **AVISTA CORPORATION – UG 171(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, Avista Corporation (Avista) filed UG 171(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:

Avista reports the following for its Oregon 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 or (Refund)	Interest[1] (7/1/08 through 6/1/2011)	Total Refund
$3.047 million	**$3.897 million**	**($850,000)**	**($154,000)**	**($1.004 million)**

Avista relied upon the Stand-Alone Method for the outcome of its 2008 SB 408 filing.

Avista does not pay local taxes in the State of Oregon; therefore, there is no true-up of local taxes for Avista's SB 408 filing.

For the 2007 tax period, Avista refunded approximately $1.5 million. This refund was implemented in November of 2009, upon the conclusion of Avista's most recent general rate proceeding, UG 186. Any variances attributable to the refund (under- or over-amortizing) for the 2007 tax period will be reviewed during the Spring 2010 compliance filing, and included in the June 2010 rate implementation for the 2008 SB 408 impact.

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 or (Refund)	Interest[2] (7/1/08 through 6/1/2011)	Total Refund
$2.84 million	**$3.897 million**	**($1.057 million)**	**($194,000)**	**($1.251 million)**

The impact of a $1.25 million refund represents a decrease to Avista's retail revenues of approximately 0.96 percent.

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

Avista 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.

STAFF REVIEW:

Staff conducted face to face interviews on November 10, 2009 and November 23, 2009. Citizens' Utility Board (CUB) and Northwest Industrial Gas Users (NWIGU) were present at both meetings along with Staff and the Company. In addition, Staff sent seven Data Requests and conducted informal phone discussions.

Below is a detailed summary of Staff's review:

Staff requested the Company provide further clarification related to the following items:

- the calculation of the effective tax rate and net-to-gross revenues ratios;
- the use of tax credits and whether certain tax credits were generated through rates or in some other manner;
- the interest synchronization calculation along with the capital structure and cost of debt used in the calculation;
- a reconciliation between the Oregon tax depreciation and the tax depreciation related to Schedule M's;
- the calculation of gross revenues, effective tax rate, net-to-gross ratio and the effect of temporary rate increments;
- explain whether BETC's were generated through projects funded by Oregon ratepayers; and
- reconcile the apportionment factors as they relate to the Results of Operations.

As a result of our review, Staff identified the following issues related to Avista's original filing:

(1) How the capital structure and cost of debt used to calculate the interest deduction for purposes of the stand-alone method was 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 2006, 2007 and now in its 2008 filing, Avista uses the capital structure ratios for debt and preferred trust securities from 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 (Avista’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”).

Avista 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 has recommended in both prior years that Avista be required to use the annual average as this method has been adopted by the other utilities filing SB408 filings and because it most closely matches the rate base balance.

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 increases Avista’s refund for state and federal portion by approximately $78,495.

(2) The calculation of revenues collected when the Commission has authorized a rate change during the tax period;

OAR 860-022-0041(2)(s)(B) states: “When the Commission has authorized rate changes during the tax year for gross revenues, net revenues or effective tax rate, the amount of taxes authorized to be collected in rates will be calculated *using a weighted average of months* in effect.”

Staff believes that when a utility experiences a rate change, the timing of the rate change can have a huge impact in the actual revenues that are collected due to the seasonality of energy use. In other words, if the utility experiences a rate change in early spring, although the first three months of the year may represent 25 percent of the twelve-month tax period, in fact, nearly 40 percent of revenues may be collected during that same three-month period due to higher use during colder seasons.

When there is an authorized rate change during a tax year, the effective tax rate is also changed, and in Avista's case this rate decreased. Using Avista's example, if the utility were to calculate revenues collected weighted solely on the number of months in effect, then ratepayers would receive credit for paying less taxes than they actually paid during the year. This is because they paid 40 percent of their annual usage under a higher effective tax rate but are only receiving credit as if they paid only 25 percent of their usage at the higher rate and thereby understating the amount of taxes collected.

Staff recognizes that the current rule language requires that the effective tax rate, net to gross revenues ratio and revenues collected are to be calculated considering only the number of months in effect rather than the number of therms or kWh collected during the period of months that those rates were in effect. For this reason, Staff recommends that the Commission allow the utility to keep its current calculation related to taxes authorized to be collected for SB408 purposes.

However, Staff recommends that the Commission consider Staff's issue related to the seasonality of revenues collected and the issue that these collections should be weighted by the amount of revenues collected during the period of months that rates are in effect rather than simply weighting the number of months rates are in effect.

Staff recommends that the Commission open a rule-making proceeding to address the weighting method used to determine effective tax rate, net to gross revenue ratio and revenues collected.

(3) BETC's generated from projects funded by Oregon ratepayers;

In response to Staff's Data Request No. 42, Avista provided documentation of the BETCs and what funds were used that related to projects that derive a BETC tax credit. Avista indicated that one BETC of $128,992 relates to Avista's AMR plant; however, Avista states that the AMR plant was not in rates for the entire year and therefore a portion of the credit should be retained by the Company by adding back the tax benefit on page 6 of the Staff report.

Staff believes that because the entire project will be recovered through rates; therefore, ratepayers should retain the entire benefit of the BETC. This would require Avista to remove the add-back, associated with the AMR plant BETC, on page 6 of the Staff report.

In addition, for 2008 Avista's state tax liability was not large enough to consume the entire BETC generated from the project; therefore, Staff believes it is appropriate for the Company to carry-forward the BETC. Staff will need to review Avista's individual tax credits to determine which credits should be carried forward.

Staff recommends Avista remove the add-back on page 6, line12 of the Staff report. This will result in an increase of $128,992 to Avista's refund.

Summary: *Total revisions recommended by Staff and applied to Avista's original filing would result in an increased refund to Avista's customers of approximately $207,487 plus associated interest. The refund amount indicated by Avista's 2008 tax report filing is subject to resolution of the Company's claim under OAR 860-022-0041(10).*

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CERTIFICATE OF SERVICE

UG 171(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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