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January 14, 2011

VIA ELECTRONIC FILING AND U.S. MAIL

PUC Filing Center
Public Utility Commission of Oregon
PO Box 2148
Salem, OR 97308-2148

Re: Docket No. UE 177 (4)

Enclosed for filing in Docket UE 177(4) are an original and five copies of the Stipulation between Commission Staff, the Citizens' Utility Board of Oregon, and PacifiCorp. A copy of this filing has been served on all parties to this proceeding as indicated on the enclosed service list.

Very truly yours,

A handwritten signature in black ink, appearing to read "Amie Jamieson".

Amie Jamieson

Enclosure

cc: Service List

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CERTIFICATE OF SERVICE

I hereby certify that I served a true and correct copy of the foregoing document in Docket UE 177 on the following named person(s) on the date indicated below by email and first-class mail addressed to said person(s) at his or her last-known address(es) indicated below.

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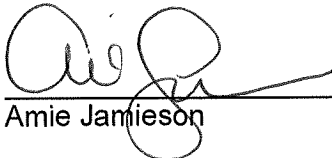
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DATED: January 14, 2011



Amie Jamieson
Of Attorneys for PacifiCorp

1 **BEFORE THE PUBLIC UTILITY COMMISSION**
2 **OF OREGON**

3 **UE 177(4)**

4 In the Matter of:

5 PACIFICORP, dba PACIFIC POWER &
6 LIGHT COMPANY

7 Filing of tariffs establishing automatic
8 adjustment clauses under the terms of
9 SB 408

STIPULATION

9 This Stipulation resolves issues among the parties to this Stipulation related to
10 PacifiCorp's 2009 Tax Report, filed in UE 177(4) pursuant to Senate Bill 408 (SB 408).
11 SB 408 is codified in ORS 757.267, 757.268 and 757.210. Those statutes are implemented
12 through OAR 860-022-0041.

13 **I. PARTIES**

14 The parties to this Stipulation are Staff of the Public Utility Commission of Oregon
15 (Staff), PacifiCorp (or the Company), and the Citizens' Utility Board of Oregon (CUB)
16 (together, the Parties). Other parties to this docket may join the Stipulation by signing and
17 filing a copy of the Stipulation.

18 **II. PROCEDURAL BACKGROUND**

19 SB 408 requires certain Oregon public utilities to file an annual tax report with the
20 Public Utility Commission of Oregon (Commission) that provides information on: (1) the
21 amount of taxes paid by the utility to units of government or that was paid by affiliated groups
22 and that is properly attributed to the utility's regulated operations; and (2) the amount of taxes
23 authorized to be collected in rates. ORS 757.268(1). Under ORS 757.268(13)(f)(C), the
24 Commission is required to adjust taxes paid "by deferred taxes related to the regulated
25 operations of the utility."
26

1 The law requires the Commission to review the tax report to determine whether the
2 amount of taxes paid differs from the amount of taxes included in rates by more than
3 \$100,000. ORS 757.268(4). If so, the Commission must require the public utility to establish
4 an automatic adjustment clause to account for the difference. *Id.* The Commission must
5 complete its review of the tax report and order an automatic adjustment clause (AAC) if
6 necessary within 180 days after the tax report is filed. ORS 757.268(4); OAR 860-022-
7 0041(7).

8 As required by SB 408, on October 15, 2010, PacifiCorp filed its tax report for calendar
9 year 2009 (2009 Tax Report). The Commission held a prehearing conference on
10 November 1, 2010, at which Administrative Law Judge Wallace adopted a full procedural
11 schedule for this docket, including testimony and a hearing.

12 Staff served discovery and convened a workshop on November 17, 2010 to review
13 issues raised by the 2009 Tax Report. All parties were invited to participate, and
14 representatives from Staff, PacifiCorp, CUB, ICNU, and Portland General Electric Company
15 (PGE) attended. The parties convened settlement conferences on December 2 and 9, 2010,
16 and on January 6 and 7, 2011, which the Company, Staff, CUB and ICNU attended. The
17 settlement conferences were noticed to all parties in the docket.

18 As a result of the settlement conferences, the Parties have reached a two-part
19 settlement in this case. The first part of the settlement is supported by Staff, PacifiCorp and
20 CUB; the second part of the settlement is supported by Staff and PacifiCorp.

21 III. DESCRIPTION OF FILING

22 As originally filed, PacifiCorp's 2009 Tax Report reflected \$29.3 million of federal,
23 state, and local taxes paid above taxes authorized to be collected in rates. Cover Letter to
24 2009 Tax Report (October 15, 2010). Under SB 408, this difference, plus interest, is to be
25 collected as a surcharge through an Automatic Adjustment Clause (AAC). ORS 757.268(6).
26 PacifiCorp's AAC for state and federal taxes is contained in Schedule 102 and its AAC for

1 local taxes is contained in Schedule 103. In its originally filed 2009 Tax Report, PacifiCorp's
2 taxes paid were determined under the deferred income tax floor in OAR 860-022-0041(4)(d),
3 which was added to the SB 408 rules in Order No. 07-401 (Docket AR 517) and is designed
4 to ensure compliance with normalization requirements of the Internal Revenue Code by fully
5 protecting deferred taxes related to depreciation on public utility property.¹ The Internal
6 Revenue Code requires the inclusion of deferred income taxes associated with accelerated
7 tax depreciation on public utility property in rates in order for public utility property to be
8 eligible for accelerated depreciation for income tax purposes. The inclusion of deferred
9 income taxes associated with the regulated operations of the utility in determining taxes paid
10 is also required by SB 408 (ORS 757.268(13)(f)(C)). The Company reported increased
11 levels of deferred income tax expense during 2009 primarily as the result of the combination
12 of significant capital investment and bonus depreciation.

13 As described in Staff's Issues List attached hereto as Exhibit A, three initial issues
14 surfaced during the parties' audit of the 2009 Tax Report: (1) the Company's exclusion of
15 certain supplemental schedules in the calculation of taxes authorized to be collected in rates;
16 (2) the Company's inclusion of the impact of depreciation flow-through in the calculation of
17 the deferred tax floor under OAR 860-022-0041(4)(d); and (3) the Company's methodology
18 for allocating to Oregon the total Company book-tax difference for book and tax depreciation.
19 The first issue addresses the calculation of taxes collected and decreases taxes collected by
20 \$5.06 million; the second and third issues address the calculation of the deferred tax floor
21 and reduce the floor by \$7.18 million.

22 In the parties' initial settlement discussions, the Company agreed to Staff's
23 adjustments for purposes of settlement, lowering the Company's surcharge to \$27.3 million.
24 As partially described in Staff's Issues List, a final issue emerged at the conclusion of Staff's
25 investigation regarding the application of the deferred tax floor under OAR 860-022-

26 ¹ See Order No. 06-532, pages 3-5, for a discussion of normalization requirements.

1 0041(4)(d) as currently written. While Staff concluded that the Company properly applied the
2 deferred tax floor as required by OAR 860-022-0041(4)(d), Staff also reasoned that the
3 application of the deferred tax floor to the taxes paid result produced by the standalone
4 method is not necessary to ensure compliance with the normalization requirements of the
5 Internal Revenue Code. Staff has proposed to promptly commence a temporary rulemaking
6 process, followed by a permanent rulemaking to amend OAR 860-022-0041(4)(d) to conform
7 the rule to Staff's and CUB's view of its proper scope.

8 Under Staff's and CUB's approach to the deferred tax floor, PacifiCorp's taxes paid
9 would be determined under the standalone method, and Staff would continue to apply its
10 adjustment for supplemental schedules to PacifiCorp's taxes collected. The result is an
11 adjusted surcharge of \$13.47 million.

12 **IV. AGREEMENT-PART 1 (STAFF, PACIFICORP, AND CUB)**

13 A. Based upon the assumptions that: (1) the Commission will amend OAR 860-022-
14 0041(4)(d) so that the deferred tax floor does not apply to taxes paid determined under the
15 standalone method; and (2) the IRS will conclude that OAR 860-022-0041(4)(d) as so revised
16 is consistent with the normalization requirements of the Internal Revenue Code², the Parties
17 agree that PacifiCorp's taxes paid in its 2009 Tax Report shall be determined by the
18 standalone method. The Parties further agree that taxes collected shall be adjusted for the
19 inclusion of RAC deferrals in taxes authorized to be collected in rates. The result is an
20 adjusted surcharge of \$13.47 million.³

21 B. Upon issuance of a temporary amendment to OAR 860-022-0041(4)(d) making
22 the deferred tax floor inapplicable to taxes paid determined under the standalone method,
23 PacifiCorp will file a revised 2009 Tax Report incorporating these changes (Revised 2009
24 Tax Report). The Parties agree that the Revised 2009 Tax Report, filed pursuant to this
25

26 ² See Section V below for discussion on a request for a new ruling from the Internal Revenue Service.

³ See Joint Testimony filed separately in this docket for specifics of the calculation of the \$13.47 million.

1 Stipulation, complies with SB 408 and OAR 860-022-0041, as amended, and results in rates
2 that are fair, just, and reasonable.

3 C. The Parties agree that the 2009 Federal and State taxes paid results in a
4 surcharge of \$13,474,662 and a refund of \$86,932 for local taxes. Following is a table
5 showing PacifiCorp's estimates of interest during the deferral and amortization periods:

6
7 **Table 1**
8 **Amortization Summary**
9 **PACIFICORP 2009 Tax Report**

	<u>State /</u> <u>Federal</u>	<u>Local</u>
Surcharge (Refund)	\$	(\$ 86,932)
	13,474,662	
Estimated interest through May 2011	\$ 2,137,802	(\$ 13,792)
Estimated interest June 2011 – May 2012	<u>\$ 157,295</u>	<u>(\$ 1,015)</u>
*		
Estimated amount to amortize	<u>\$15,769,759</u>	<u>(\$ 101,739)</u>

14 * Blended treasury rate of 2.01% calculated by PacifiCorp
15 per the methodology prescribed by Order No. 08-263 in
16 Docket UM 1147.

17 The total amortization for the combined 2009 Surcharge will be \$15,769,759 (including
18 interest) to be recovered during the 12-month period beginning June 1, 2011 through May 31,
19 2012 in Schedule 102 PacifiCorp's Income Tax Adjustment tariff. The proposed surcharge
20 will be allocated by customer rate schedule on an equal cents per kilowatt-hour basis, as
21 required by OAR 860-022-0041(8)(d). The local tax refund of \$101,739 reflected in the
22 Revised 2009 Tax Report will be implemented through Schedule 103, PacifiCorp's
23 Multnomah County Business Income Tax tariff.

24 Upon approval of this Stipulation, PacifiCorp will make a compliance filing to reflect (1)
25 the 2009 Surcharge of \$13,474,662, plus interest, in Schedule 102; and (2) the SB 408 local
26 tax refund of \$86,932, plus interest, in Schedule 103. The tariff schedules will reflect an

1 effective date of June 1, 2011, and reflect the 2011 Blended Treasury Rate (BTR) that will
2 apply to the amortization period.

3 The net change on June 1, 2011, will reflect the difference between the currently
4 effective Schedule 102 surcharge of approximately \$4.2 million implemented effective June
5 1, 2010, and the surcharge filed in the compliance filing in this docket. The resulting rate
6 impact will be an overall *increase* to net revenues of 1.2 percent.

7 **V. AGREEMENT-PART 2 (STAFF AND PACIFICORP)**

8 A. Under OAR 860-022-0041(8)(g), prior to the Commission implementing an
9 SB 408 rate adjustment, each utility was required to seek a Private Letter Ruling (PLR) from
10 the Internal Revenue Service (IRS) on whether the utility's compliance with SB 408 or OAR
11 860-022-0041 "would cause the utility to fail to comply with any provision of federal tax law,
12 including normalization requirements." Pursuant to OAR 860-022-0041(8)(g), PacifiCorp
13 initially submitted its PLR request to the IRS in December 2006.

14 After the Commission amended OAR 860-022-0041 in AR 517 to add the deferred tax
15 floor, the Company supplemented its PLR request by attaching the amended rules and
16 describing the deferred tax floor. The IRS issued PacifiCorp's PLR on January 9, 2008. The
17 ruling favorably determined that an adjustment to rates under SB 408, as constituted in ORS
18 statute and OAR rules presented at that time, would not violate the normalization
19 requirements of Internal Revenue Code §168(i)(9). PacifiCorp's favorable PLR was expressly
20 issued based on the representations and rule provisions cited in PacifiCorp's request. Priv.
21 Ltr. Rul. 101217-07 at 6 (Jan. 9, 2008). Because PacifiCorp's PLR was based in part on the
22 current language of OAR 860-022-0041(4)(d), PacifiCorp believes that it must submit any
23 revision of OAR 860-022-0041(4)(d) to the IRS and ask that a new, updated PLR be issued
24 in light of the proposed rule change. CUB does not agree that this step is necessary and
25 does not therefore support this Section V. of the Stipulation. CUB does not believe there is

1 any risk of a normalization violation, even with the amendment of the rule, or that a deferral is
2 needed.

3 B. Pending: (1) the Commission's adoption of a permanent amendment to
4 OAR 860-022-0041(4)(d) making the deferred tax floor inapplicable to taxes paid determined
5 under the standalone method; and (2) the IRS's issuance of a new PLR concluding that OAR
6 860-022-0041(4)(d) as so revised is consistent with the normalization requirements of the
7 Internal Revenue Code, Staff agrees to support before the Commission an application by
8 PacifiCorp to defer the difference between the surcharge produced by deferred tax floor
9 (\$27.3 million) and the surcharge agreed to in Part 1 (\$13.47 million) (2009 Tax Report
10 deferral). This difference is \$13.83 million.

11 Staff and PacifiCorp agree that PacifiCorp will file its application for deferral with the
12 Commission by no later than February 15, 2011, and that the application will request that
13 interest accrue during the deferral period at the Blended Treasury Rate (BTR); PacifiCorp's
14 agreement to request the BTR is expressly for settlement purposes only and is not
15 precedential.

16 Staff and PacifiCorp further agree that, if granted, the 2009 Tax Report deferral shall
17 not accrue interest beyond one year commencing with the date the Commission adopts a
18 permanent amendment to OAR 860-022-0041(4)(d). CUB does not agree to support the PLR
19 application.

20 C. Staff and PacifiCorp agree to work cooperatively on the new PLR request to the
21 IRS. Staff and PacifiCorp agree to submit the new PLR request to the IRS expeditiously upon
22 issuance of a permanent amendment to OAR 860-022-0041(4)(d).

23 D. If the Commission does not adopt a permanent amendment to OAR 860-022-
24 0041(4)(d) making the deferred tax floor inapplicable to taxes paid determined under the
25 standalone method; and/or the IRS concludes that OAR 860-022-0041(4)(d) as so revised is
26 not consistent with the normalization requirements of the Internal Revenue Code, Staff

1 agrees to support PacifiCorp's request to amortize the deferral balance of \$13.83 million plus
2 accrued interest.

3 VI. GENERAL PROVISIONS

4 A. The Stipulating Parties agree that the Stipulation represents a compromise of the
5 positions of the parties for the purpose of this docket. Without the written consent of all
6 parties, evidence of conduct or statements, including but not limited to term sheets or other
7 documents created solely for use in settlement conferences in this docket, are confidential
8 and not admissible in the instant or any subsequent proceedings, unless independently
9 discoverable or offered for other purposes allowed under ORS 40.190. Nothing in this
10 paragraph precludes a party from explaining as a factual matter what the Parties agreed to in
11 this Stipulation.

12 B. If this Stipulation is challenged by any other party to this proceeding, or any other
13 party seeks an adjustment amount that departs from the terms of this Stipulation, the
14 Stipulating Parties reserve the right to cross-examine witnesses and put in such evidence as
15 they deem appropriate to respond fully to the issues presented including the right to raise
16 issues that are incorporated in the settlement embodied in this Stipulation. Notwithstanding
17 this reservation of rights, the Stipulating Parties agree they will continue to support the
18 Commission's adoption of the terms of this Stipulation.

19 C. If the Commission rejects all or any material part of this Stipulation, or adds any
20 material condition to any final order that is not consistent with this Stipulation, each
21 Stipulating Party reserves its right, pursuant to OAR 860-001-0350(9), to present evidence
22 and argument on the record in support of the Stipulation or to withdraw from the Stipulation.
23 Parties shall be entitled to seek rehearing or reconsideration pursuant to OAR 860-001-0720.

24 D. This Stipulation will be offered into the record in this proceeding as evidence
25 pursuant to OAR 860-001-0350(7). The Stipulating Parties agree to support this Stipulation
26 throughout this proceeding and in any appeal, provide witnesses to support the Stipulation at

1 the hearing, and recommend that the Commission issue an order implementing the terms of
2 the Stipulation.

3 E. By entering into this Stipulation, no Stipulating Party shall be deemed to have
4 approved, admitted or consented to the facts, principles, methods or theories employed by
5 any other Stipulating Party in arriving at the terms of this Stipulation. Except as provided in
6 this Stipulation, no Stipulating Party shall be deemed to have agreed to any provision of this
7 Stipulation is appropriate for resolving issues in any other proceeding.

8 F. This Stipulation may be signed in any number of counterparts, each of which will
9 be deemed an original for all purposes, but all of which taken together will constitute one and
10 the same agreement.

11 This Stipulation is entered into by each party on the date entered below such Party's
12 signature.

13 ***Signature page follows***

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STAFF

PACIFICORP

By: Paul A. Mahoney for Jason W. Jones

By: _____

Date: Jan 14, 2011

Date: _____

CUB

By: _____

Date: _____

1 STAFF

PACIFICORP

2

By: _____

By: Andrea Kelly

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Date: _____

Date: 14 Jan 2011

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5 CUB

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By: _____

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Date: _____

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STAFF

PACIFICORP

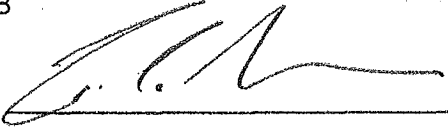
By: _____

By: _____

Date: _____

Date: _____

CUB

By:  _____

Date: 1-14-11 _____

UE 177 (4)

Exhibit A
To
Stipulation

January 14, 2011

**PUBLIC UTILITY COMMISSION
OF OREGON**

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

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

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

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 Parties¹ 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 violation² 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 conference³ 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:

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

² Discussed in section "Staff Review" on page 5 below.

³ Id.

Table 1-Original Filing

Federal and State Taxes Paid to units of Government	Taxes Collected	Surcharge	Interest⁴ (7/1/09 through 6/1/2011)	Total Surcharge
\$98.4 million	\$69.0 million	\$29.4 million	\$4.7 million	\$34.1 million
Local Taxes Paid to units of Government	Taxes Collected	Refund	Interest⁵ (7/1/09 through 6/1/2011)	Total Refund
\$132,000	\$45,000	(\$87,000)	\$14,000	(\$101,000)

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

Federal and State Taxes Paid to units of Government	Taxes Collected	Surcharge	Interest⁶ (7/1/09 through 6/1/2011)	Total Surcharge
\$91.2 million	\$63.7 million	\$27.3 million	\$4.3 million	\$31.6 million

⁴ Estimate includes interest through deferral period.

⁵ Estimate includes interest applied through deferral period.

⁶ Estimate includes interest applied through deferral period.

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

Staff proposes amendments⁸ 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 million⁹ 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 \$102,000¹⁰. 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

⁷ Estimate of Interest through deferral period.

⁸ See section on "Staff Review" for specific amendments.

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

¹⁰ 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, 2012¹¹. 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 limitation¹² 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.

¹¹ PPL's response to Staff DR No. 7

¹² 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 limitation¹³. 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

¹³ 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.