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January 19, 2010

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 (3)

Enclosed for filing in Docket UE 177 are an original and five copies of the Joint Explanatory Brief. This is being filed concurrently with the Stipulation of Staff, PacifiCorp and CUB. 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", written in a cursive style.

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 (3) 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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DATED: January 19, 2010



Amie Jamieson

Of Attorneys for PacifiCorp

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UE 177(3)

In the Matter of:

PACIFICORP, dba PACIFIC POWER

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

JOINT EXPLANATORY BRIEF

This brief ("Explanatory Brief") explains and supports the Stipulation dated January 19, 2010, in this proceeding between PacifiCorp dba Pacific Power (the "Company"), Staff of the Public Utility Commission of Oregon ("Staff"), and the Citizens' Utility Board of Oregon ("CUB") (together, the "Parties").¹ The Stipulation resolves all issues among the Parties related to PacifiCorp's 2008 Tax Report, filed in UE 177 pursuant to Senate Bill 408 ("SB 408").²

BACKGROUND

SB 408 requires most Oregon public utilities to file an annual tax report with the Public Utility Commission of Oregon ("Commission") that provides information on: (1) the amount of taxes paid by the utility to units of government or that was paid by an affiliated group and that is properly attributed to the utility's regulated operations; and (2) the amount of taxes authorized to be collected in rates. ORS 757.268(1). The law requires the Commission to review the tax report to determine whether the amount of taxes paid differs from the amount of taxes included in rates by more than \$100,000. ORS 757.268(4). If so, the Commission must require the public utility to establish an automatic adjustment clause to account for the difference. *Id.* The Commission must complete its review of the tax report and order an automatic adjustment clause ("AAC") if necessary within 180 days after the tax report is filed.

¹ The Industrial Customers of Northwest Utilities ("ICNU") is not a party to this Stipulation, but has stated to the Parties that it does not oppose it.

² SB 408 is codified in ORS 757.267, 757.268, and 757.210.

1 ORS 757.268(4); OAR 860-022-0041(7). The Commission has discretion to set the
2 amortization period for a refund or surcharge under the AAC. OAR 860-022-0041(8)(c).

3 As required by SB 408, on October 15, 2009, PacifiCorp filed its tax report for calendar
4 year 2008 ("2008 Tax Report"). PacifiCorp used the tax template developed by Staff to
5 produce the 2008 Tax Report, as it did with its 2006 and 2007 Tax Reports. PacifiCorp's 2008
6 Tax Report reflected a difference of approximately \$38.2 million of federal, state, and local
7 taxes paid above taxes authorized to be collected in rates.

8 Staff served a number of data requests on PacifiCorp to obtain additional information
9 about the 2008 Tax Report. Staff convened a workshop on November 13, 2009 to review
10 issues raised by the 2009 Tax Report. All parties were invited to participate and
11 representatives from Staff, PacifiCorp, CUB, and ICNU attended. The two central issues
12 raised by Staff as a result of its review of the 2008 Tax Report were the calculation of the
13 deferred income taxes floor and calculation of interest expense.

14 The parties to this docket convened settlement conferences on November 23, 2009
15 and December 9, 2009 that were noticed to all parties in the docket. PacifiCorp, Staff, CUB,
16 and ICNU attended the settlement conferences. The Parties to the Stipulation were able to
17 resolve the issues of the calculation of the deferred income taxes floor and the calculation of
18 interest expense for purposes of the 2008 Tax Report, as described in Section A below.

19 DISCUSSION

20 A. Issues Raised in Staff's Audit of the 2008 Tax Report

21 After Staff conducted its audit of the 2008 Tax Report, two issues remained
22 unresolved: calculation of the deferred income taxes floor and calculation of interest expense.

23 1. Deferred Income Taxes Floor

24 In Docket AR 517, the Commission issued an order adding the deferred income taxes
25 floor to the SB 408 rules to provide additional protection against a normalization violation.

26 Order No. 07-401. The floor is designed to ensure compliance with normalization

1 requirements of the Internal Revenue Code by fully protecting deferred taxes related to
2 depreciation on public utility property when the utility's current tax expense is negative. The
3 deferred taxes floor was potentially implicated in the 2008 Tax Report because PacifiCorp's
4 current tax expense for 2008 was significantly reduced by a major tax deduction related to a
5 change in application of tax regulations and by bonus depreciation. Bonus depreciation also
6 generated a significantly increased amount of deferred income taxes on public utility property.

7 In its Tax Reports for 2007 and 2008, the Company tracked its deferred taxes in two
8 categories: (1) deferred taxes related to tax depreciation on public utility property were
9 reported on lines 5, 14, and 23³ of the SB 408 Staff template (*i.e.*, "deferred taxes related to
10 depreciation of public utility property for Oregon regulated operations including normalized
11 excess deferred taxes"); and (2) all other deferred taxes, including deferred taxes related to
12 book depreciation on public utility property, were recorded on lines 4, 13, and 22 of the
13 SB 408 Staff template (*i.e.*, "deferred taxes related to Oregon regulated operations, excluding
14 deferred taxes related to depreciation of public utility property and any rate adjustment under
15 this rule.") Lines 5, 14, and 23 contain the amount that forms the basis for the deferred taxes
16 floor, subject to further adjustment for tax refunds.

17 The Company's approach was based on the fact that the "taxes paid" calculations
18 required by the SB 408 rules consistently isolate and track tax depreciation separately from
19 book depreciation as evidence of compliance with normalization. In the 2008 Tax Report, the
20 Company's deferred taxes reported on lines 5, 14, and 23 exceeded the stand-alone tax
21 result, which was the lowest of the three "taxes paid" calculations, so the deferred taxes floor
22 constituted the final taxes paid amount.

23 Staff interpreted lines 5, 14, and 23 of the template differently from the Company.

24 Under Staff's interpretation, the deferred income taxes generated by the net difference

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26 ³ The references here and hereinafter to numbered lines on the SB 408 Staff template are all found on
page 6 of 8 within that template.

1 between book and tax depreciation are reported on lines 5, 14, and 23 of Staff's template.
2 Staff believes that its method ensures that customers retain the benefits of book depreciation
3 while avoiding a normalization violation. The result of Staff's interpretation is that the deferred
4 income taxes floor would no longer be implicated because the amount is reduced to a level
5 below the stand-alone tax result, which is the lowest of the three "taxes paid" calculations.
6 Based on the private letter ruling issued by the Internal Revenue Service on January 9, 2008
7 regarding SB 408 and its administrative rules, the parties believe that the Company's use of
8 the stand-alone method for determining taxes paid as agreed to in this stipulation is consistent
9 with the normalization requirements of the Internal Revenue Code. The Commission has not
10 previously interpreted the meaning of the template or opined upon this issue.

11 **2. Calculation of Interest Expense**

12 Staff and the Company have not agreed on the appropriate method for calculating
13 interest expense under OAR 860-022-0041(2)(p). Staff has proposed the use of a five-quarter
14 or 13-month average to calculate the weighted cost of debt for purposes of calculating interest
15 expense, while PacifiCorp has proposed the use of 2008 year-end weighted cost of debt. The
16 Parties understand that this issue is expected to be resolved through a future rulemaking to be
17 proposed by Staff. In this Stipulation, however, the Parties have agreed on a reasonable
18 compromise level of interest expense for purposes of the 2008 Tax Report as described
19 below. The Parties also agreed to participate in a rulemaking commenced by the Commission
20 to address the appropriate method for calculating interest expense under OAR 860-022-
21 0041(2)(p). Stipulation ¶ 11.

22 **B. Revisions to the 2008 Tax Report.**

23 PacifiCorp filed a revised 2008 Tax Report ("Revised 2008 Tax Report") concurrently
24 with the Stipulation. Stipulation ¶ 12. The Parties agree that the Revised 2008 Tax Report
25 complies with SB 408 and OAR 860-022-0041. *Id.* The Revised 2008 Tax Report contains
26

1 revisions that the Parties agree resolve the issues raised in Staff's audit for purposes of the
2 2008 Tax Report:

3 • The amount of deferred taxes reported on Lines 5, 14, and 23 of the template will
4 reflect deferred taxes generated by the net difference between book and tax
5 depreciation on public utility property. With this change, by arithmetic result the
6 deferred income taxes floor is no longer used in the 2008 Tax Report. Instead, the
7 taxes paid result is produced by the stand-alone method because the deferred taxes
8 floor is reduced to a level below the stand-alone tax result which is the lowest of the
9 three "taxes paid" calculations. This change decreases PacifiCorp's state and federal
10 taxes paid, and the total state and federal SB 408 surcharge, by approximately \$35.9
11 million. Stipulation ¶ 9.

12 • The interest expense for PacifiCorp's taxes paid under the stand-alone method
13 will be equal to a decrease of approximately \$0.9 million to PacifiCorp's state and
14 federal taxes paid and the total state and federal SB 408 surcharge. Stipulation ¶ 10.

15 **C. SB 408 State and Federal Surcharge and Local Credit.**

16 The Revised 2008 Tax Report reflects a surcharge of \$1,790,814 for federal and state
17 taxes ("2008 Surcharge"), plus interest of \$285,872 that accrues from July 2008 through May
18 2010. Stipulation ¶ 13. The 2008 Surcharge will be amortized concurrently with the
19 amortization of any residual portions of the 2006 and 2007 surcharges ("Residual Surcharge").
20 Stipulation ¶ 13. The Residual Surcharge is currently estimated to be \$2,677,539, including
21 interest. *Id.* The 2008 Surcharge and the Residual Surcharge will be amortized over one year
22 and will accrue interest during amortization at the 2010 Blended Treasury Rate.⁴ *Id.*;
23 Stipulation ¶ 15.

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26 ⁴ The 2008 Surcharge will accrue additional interest of approximately \$21,340 during amortization. The
Residual Surcharge will accrue additional interest of approximately \$27,514 during amortization between
June 2010 and May 2011.

1 The refund for local taxes should be \$342,361, plus approximately \$54,652 in interest
2 that accrues from July 2008 and May 2011. Stipulation ¶¶ 14. The local refund will be
3 amortized over one year and will accrue interest during amortization at the 2010 Blended
4 Treasury Rate.⁵ *Id.*; Stipulation ¶¶ 15.

5 The 2008 Surcharge and the Residual Surcharge will be implemented through
6 Schedule 102, PacifiCorp's Income Tax Adjustment tariff. Stipulation ¶¶ 15. The proposed
7 surcharge will be allocated by customer rate schedule on an equal cents per kilowatt-hour
8 basis, as required by OAR 860-022-0041(8)(d). *Id.* The local refund will be implemented
9 through Schedule 103, Pacific Power's Multnomah County Business Income Tax tariff. *Id.*
10 Upon approval of the Stipulation, PacifiCorp will make a compliance filing to reflect revised
11 Schedules 102 and 103 with an effective date of June 1, 2010. *Id.*

12 The resulting rate impact of the Stipulation will be a decrease to net revenues of
13 approximately 1.5 percent. Stipulation ¶¶ 15.

14 **D. The Stipulation and Revised 2008 Tax Report Filing Will Result in Just and**
15 **Reasonable Rates.**

16 The Stipulation and Revised 2008 Tax Report filing represent a reasonable
17 compromise of positions among the Parties and will result in just and reasonable rates. Staff
18 conducted a thorough audit of PacifiCorp's 2008 Tax Report, convened a workshop and
19 conducted discovery on the tax report. Staff's audit and the settlement discussions resulted in
20 proposed recalculations to which PacifiCorp agreed and performed in the Revised 2008 Tax
21 Report. The 2008 SB 408 surcharge contained in the Stipulation was calculated in the
22 Revised 2008 Tax Report. As a result, the 2008 SB 408 surcharge falls within a "range of
23 reasonableness" for resolution of the 2008 Tax Report. *See Re US West*, Docket UM 773,
24 Order No. 96-284 at 31 (Nov. 1, 1999).

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26 ⁵ The local refund will accrue interest of approximately \$4,080 during amortization.

1 In addition, the surcharge is consistent with SB 408, OAR 860-022-0041, and
2 Commission precedent on utility tax reports. First, the surcharge fulfills SB 408's intent that
3 rates reflect taxes paid to units of government to be considered fair, just, and reasonable.
4 See ORS 757.267(1)(f). Second, Staff explicitly found that the Revised 2008 Tax Report
5 complies with both SB 408 and OAR 860-022-0041. Finally, the Revised 2008 Tax Report
6 uses the same tax template that the Commission found to be "consistent with and in
7 compliance with both OAR 860-022-0041 and ORS 757.268" when it approved the
8 Company's 2006 SB 408 surcharge. See *re PacifiCorp Filing of Tariffs Establishing Automatic*
9 *Adjustment Clauses Under the Terms of SB 408*, Docket UE 177, Order No. 08-201 at 5 (Apr.
10 11, 2008) (supplemented and affirmed by Order No. 09-177 (May 20, 2009)). For these
11 reasons, the rates resulting from the Stipulation and 2008 Revised Tax Report filing will be
12 just and reasonable.

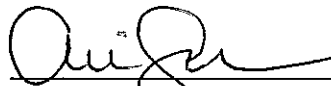
13 **CONCLUSION**

14 For the reasons set forth above, the Parties respectfully request that the Commission
15 approve the Stipulation.

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DATED: January 19, 2010.

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