



# Oregon

Theodore R. Kulongoski, Governor

## Public Utility Commission

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February 12, 2008

OREGON PUBLIC UTILITY COMMISSION  
ATTENTION: FILING CENTER  
PO BOX 2148  
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RE: **Docket No. UE 177** - In the Matter of PacifiCorp's SB 408 2006 Tax Report.

Enclosed for electronic filing in the above-captioned docket is the Public Utility Commission Staff's Motion for Leave to Submit Rebuttal Testimony and Staff Rebuttal Testimony.

*/s/ Lois Meerdink*

Lois Meerdink

Regulatory Operations Division

Filing on Behalf of Public Utility Commission Staff

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Email: Lois.Meerdink@state.or.us

cc: UE 177 Service List - parties

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**PUBLIC UTILITY COMMISSION  
OF OREGON**

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**UE 177**

**STAFF REBUTTAL TESTIMONY OF**

**Carla Owings  
Dustin Ball**

**In the Matter of  
PacifiCorp's SB 408 2006 Tax Report**

**February 12, 2008**

CASE: UE 177  
WITNESS: Carla Owings and  
Dustin Ball

**PUBLIC UTILITY COMMISSION  
OF  
OREGON**

**STAFF EXHIBIT 200**

**Rebuttal Testimony  
In the Matter of PacifiCorp's  
SB 408 2006 Tax Report**

**February 12, 2008**

1 **Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS**  
2 **ADDRESS.**

3 A. Our names are Carla Owings and Dustin Ball.

4 **Q. ARE YOU THE SAME ANALYSTS WHO TESTIFIED EARLIER IN THIS**  
5 **DOCKET IN STAFF/EXHIBIT 100/OWINGS – BALL?**

6 A. Yes. Our Witness Qualification Statements are found in Exhibit Staff/101 and  
7 102.

8 **Q. PLEASE STATE YOUR PURPOSE OF THIS TESTIMONY.**

9 A. The purpose of our testimony is to provide the Staff recommendation regarding  
10 the Direct Testimony provided by the Industrial Customers of Northwest  
11 Utilities (ICNU) as it relates to PacifiCorp's (PPL or the Company) Tax Report  
12 required by Senate Bill 408 (SB 408).

13 **Q. CAN YOU PLEASE SUMMARIZE ICNU'S TESTIMONY?**

14 A. Yes. ICNU's Witness Blumenthal testifies that PPL's tax report does not  
15 represent the difference between the actual taxes paid on the taxable income  
16 of its Oregon regulated utility operations and the taxes it has collected through  
17 rates from Oregon customers. Ms. Blumenthal presents three arguments. First,  
18 Ms. Blumenthal believes that the goals of SB 408 are not met through the  
19 administration of OAR 860-022-0041 and therefore, PPL should not be allowed  
20 to collect additional tax dollars reflected in its tax report (See  
21 ICNU/100/Blumenthal/3). Second, Ms. Blumenthal is concerned about the  
22 isolation of depreciation expense in the calculation of Stand-alone as well as  
23 the application of interest expense calculated "in a manner used by the

1 Commission in establishing rates.” (See ICNU/100/6). And, third, Ms.  
2 Blumenthal states that because utilities are more capital intensive than most  
3 businesses, the three-factor formula used to apportion the consolidated tax  
4 liability is inappropriate (See ICNU/100/9-10). We will address each of these  
5 issues individually.

6 **I. Goals of SB 408**

7 **Q. PLEASE SUMMARIZE MS BLUMENTHAL’S TESTIMONY AS IT**  
8 **RELATES TO THE GOALS OF SB 408.**

9 A. Ms. Blumenthal states that one reason the goals of SB 408 are not met is  
10 because of a provision in the statute that places a ceiling on the taxes paid that  
11 are properly attributable to regulated operations of the utility. This ceiling is the  
12 lesser of: 1) the taxes paid that result from the income generated by regulated  
13 operations; or 2) the total taxes paid by the utility or the affiliated group in which  
14 it is included (See ORS 757.268(12)).

15 **Q. DOES STAFF AGREE THAT SUCH A CEILING EXISTS?**

16 A. Yes. However, the point Ms. Blumenthal goes on to make is that because  
17 OAR 860-022-0041 establishes three separate methods for calculating “taxes  
18 paid” (Apportioned, Consolidated and Stand-alone) then, if the method relied  
19 upon for the outcome of the filing is Stand-alone, Ms. Blumenthal believes that  
20 the consolidated tax savings have not been captured through the  
21 administration of the rules. Therefore, she believes that ratepayers are not  
22 benefitting from consolidated tax savings.

23 **Q. DOES STAFF AGREE WITH THIS ASSERTION?**

1 A. Yes. But as described above, SB 408 established two comparators for the  
2 ceiling, one of which is “the taxes paid that result from the income generated by  
3 regulated operations,” which the Commission interpreted to mean a Stand-  
4 alone calculation based on the utility’s revenues and expenses. Nowhere in  
5 the law is there any suggestion that the Stand-alone calculation should include  
6 recognition of consolidated tax savings. Therefore, we believe the Stand-alone  
7 calculation required by OAR 860-022-0041 is entirely consistent with SB 408.

8 **Q. MS. BLUMENTHAL SEEMS TO BELIEVE THAT THERE IS NO TRUE**  
9 **CONNECTION TO THE CALCULATION OF TAX LIABILITY PURSUANT**  
10 **TO OAR 860-022-0041 AND THE INTENT OF ORS 757.268; THEREFORE,**  
11 **PPL’S SURCHARGE SHOULD BE IGNORED. DOES STAFF AGREE?**

12 A. No. Based on two extensive rulemakings, the Commission has determined  
13 that the current rule, including the Stand-alone calculation in OAR 860-022-  
14 0041(2)(p), meets the requirements of SB 408. Whether potential revisions to  
15 the rule are appropriate is a question for a subsequent rulemaking; the issue in  
16 UE 177 is whether PPL has calculated its “taxes paid” amount in a manner  
17 consistent with the existing administrative rules.

## 18 **II. Depreciation Expense and Interest Synchronization**

19 **Q. PLEASE SUMMARIZE MS. BLUMENTHAL’S TESTIMONY REGARDING**  
20 **DEPRECIATION EXPENSE.**

21 A. Ms. Blumenthal argues that the Stand-alone calculation should not require the  
22 use of a pro forma tax return and seems to be unclear why the Stand-alone  
23 calculation should be considered excluding any tax effects of depreciation and

1 using an interest deduction calculated similar to the method used by the  
2 Commission in establishing rates. Ms. Blumenthal states that a normalization  
3 violation can only occur if ratepayers benefit from accelerated forms of  
4 depreciation; therefore, Staff should use a straight-line depreciation deduction  
5 to calculate Stand-alone. Similarly, Staff should not use an interest deduction  
6 calculated in a manner similar to that used by the Commission to establish  
7 rates because this amount of interest only considers the debt portion of rate  
8 base while, in actuality, most utility companies have far larger interest  
9 deductions available to them, thereby creating a lower tax liability.

10 **Q. WHAT IS STAFF'S POSITION REGARDING THE TAX BENEFITS OF**  
11 **DEPRECIATION IN THE TAX REPORT FILING?**

12 A. We believe the tax benefits of depreciation have been included appropriately  
13 in PacifiCorp's filing. It is important to remember that for the Stand-alone  
14 calculation, as with the Apportionment Method and the Consolidated Method,  
15 all tax benefits related to depreciation of public utility property are excluded  
16 from initial stage of the "taxes paid" calculation. (See OAR 860-022-  
17 0041(2)(p), (3)(a)(A)(i), (3)(c)(A)(i), (3)(e)(A)(i), and (4)(a).)<sup>1</sup> Then, in the  
18 second phase of the calculation, those depreciation benefits related only to  
19 Oregon utility operations—based on straight-line deduction as Ms. Blumenthal  
20 suggests—are added back. (See OAR 860-022-0041(4)(d)(B) and (4)(j)(B).)  
21 The purpose of this two-step treatment is to clearly show that no benefits from  
22 accelerated depreciation are passed through to Oregon customers, which

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<sup>1</sup> The Commission explicitly referred to this treatment in Order No. 07-401 at 9: ". . .the stand-alone tax liability of Oregon operations, which is defined as to exclude all tax benefits resulting from PUP."

1 would cause a normalization violation. We believe a recent Private Letter  
2 Ruling<sup>2</sup> from the Internal Revenue Service (IRS) confirms that this treatment of  
3 depreciation under the rules is appropriate. The IRS states in part...”the  
4 calculation of taxes properly attributed to the regulated activity using just the  
5 tax liability of the utility and isolating the effects of accelerated  
6 depreciation...ensure that the effects of these tax benefits...is consistent with  
7 the normalization requirements...due to the isolation of the effects of  
8 accelerated depreciation and ITC-related tax benefits to ensure that the effects  
9 of these tax benefits on current and deferred taxes is consistent with the  
10 normalization requirements<sup>3</sup>” To date, Staff has received a copy of the PLR  
11 for Avista and one for Northwest Natural. The letters were nearly identical.  
12 Therefore, Staff would expect a similar ruling from IRS regarding the isolation  
13 of depreciation that pertains to PPL’s Public Utility Property.

14 **Q. WHAT IS STAFF’S POSITION REGARDING THE INTEREST EXPENSE**  
15 **CALCULATED IN A MANNER SIMILAR TO THAT USED BY THE**  
16 **COMMISSION IN ESTABLISHING RATES?**

17 A. Staff believes that it is appropriate to use the interest expense calculated in a  
18 manner similar to that used by the Commission in establishing rates because  
19 OAR 860-022-0041(2)(p) requires such a calculation as stated below:

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<sup>2</sup> The record in the proceeding does not currently contain PacifiCorp’s Private Letter Ruling. However, Staff expects PacifiCorp to submit its Private Letter Ruling with its rebuttal testimony. In the unexpected event that PacifiCorp’s Private Letter ruling is not included in its rebuttal testimony; Staff notes that it expects the Private Letter ruling to be nearly identical to Avista’s Private Ruling Letter. To the extent necessary, Staff requests that the Commission take official notice of Avista’s Private Letter Ruling under OAR 860-014-0050(e).

<sup>3</sup> Avista Private Letter Ruling, Docket UG 171, PLR-100960-07 at 5.



1 (2)(p) "Stand-alone tax liability' means the amount of income tax liability calculated  
2 using a pro forma tax return an revenues and expenses in the utility's results of  
3 operations report for the year, except using zero depreciation expense for public  
4 utility property, excluding any tax effects from invest tax credits, and calculating  
5 interest in the manner used by the Commission in establishing rates."

6 **Q. DOES STAFF BELIEVE THIS METHOD SHOULD BE REVIEWED IN A**  
7 **FUTURE RULEMAKING?**

8 A. Yes. Staff believes that while the interest expense calculation currently  
9 identified in the rules is appropriate for the 2006 tax period, the methodology  
10 should be revisited in a future rulemaking proceeding. The issue raised is  
11 whether or not the interest expense used to calculate the tax liability  
12 appropriately represents the approximate interest deduction available to the  
13 Company when performing the tax liability calculation. Most utility companies  
14 have an accumulation of interest expense available to it as an interest  
15 deduction on a tax return. Only a portion of this interest expense directly  
16 relates to the debt portion of its ratebase which is the basis of the calculation  
17 required in the rule<sup>4</sup>. In order to more accurately approximate the tax liability,  
18 Staff believes that on a going-forward basis, changes to the rule should be  
19 considered to more closely resemble the interest deduction available to the  
20 Company on a pro forma tax return.

21 **III. The Three-Factor Formula used to apportion Consolidated Tax Liability**

22 **Q. PLEASE DESCRIBE MS. BLUMENTHAL'S TESTIMONY REGARDING**  
23 **THE THREE-FACTOR FORMULA USED TO APPORTION**  
24 **CONSOLIDATED TAX LIABILITY.**

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<sup>4</sup> Often referred to as "interest synchronization" (i.e., ratebase x the wtd cost of debt).

1 A. Ms. Blumenthal states that because utilities are more capital intensive than  
2 most businesses, the three-factor formula used to apportion the consolidated  
3 tax liability is not a reasonable method to assign the consolidated tax liability  
4 to individual members of the consolidated group. She supports her assertion  
5 by stating that; “every tax sharing agreement I have seen assigns tax liability  
6 using taxable income” (See ICNU/100/Blumenthal/10; Lines 15 through 19).  
7 Ms. Blumenthal further states that a tax sharing agreement is used by  
8 consolidated groups to assign tax liability to the individual members of the  
9 group.

10 **Q. DOES STAFF AGREE WITH USING THE TAXABLE INCOME TO**  
11 **APPORTION THE CONSOLIDATED TAX LIABILITY?**

12 A. No, at least for purposes of this filing. The Commission has already made its  
13 determination to apportion consolidated tax liability to the utility using the  
14 average of ratios for the utility’s gross plant, wages and salaries, and sales. If  
15 the Commission decides to revisit that decision sometime in the future, it  
16 should be within a rulemaking proceeding.

17 **Q. WHAT IS STAFF’S RECOMMENDATION?**

18 A. Staff believes that PPL SB 408 tax filing adheres to OAR 860-022-0041 as  
19 currently written. Staff believes that the outcome of PPL’s filing reflects the  
20 intent of SB 408 without fear of a normalization violation and including the  
21 sharing of Consolidated Tax Savings. Staff recommends that the Commission  
22 issue an order approving the PPL filing as a reasonable outcome consistent

1 with the requirements outlined in ORS 757.268 and OAR 860-022-0041 as  
2 stated below:

Taxes Paid and Properly Attributed to the Regulated Operations	Taxes Authorized to be Collected in Rates	Difference between Taxes Paid and Collected Surcharge or (Refund)
<b>\$87.0 million</b>	<b>\$54.4 million</b>	<b>\$32.6 million</b>

3

4 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

5 A. Yes.

**CERTIFICATE OF SERVICE**

**UE 177**

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 12th day of February, 2008.



Lois Meerdink  
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**UE 177  
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