ORDER NO. 10-126
ENTERED 04/06/10

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 177(3)

In the Matter of PACIFICORP, dba Pacific Power, SB 408 Tax Report for Calendar Year 2008.	ORDER

DISPOSITION: STIPULATION ADOPTED

I. INTRODUCTION

In this order, the Public Utility Commission of Oregon (Commission) approves a stipulation that resolves all issues related to the tax report for calendar year 2008 (2008 Tax Report) filed by PacifiCorp, dba Pacific Power (Pacific Power), in compliance with Senate Bill 408 (SB 408). The stipulation authorizes Pacific Power to surcharge customers an additional $1,760,814 for state and federal taxes, plus an estimated $285,872 in accrued interest. The stipulation also authorizes Pacific Power to refund to customers $342,361 for local taxes, plus an estimated $54,652 in accrued interest. Both the surcharge and the refund will be amortized over one year.

SB 408, primarily codified at ORS 757.268, requires utilities to true-up any differences between income taxes authorized to be collected in rates from customers and income taxes actually paid to units of government that are "properly attributed" to utilities' regulated operations.[1] Utilities must make annual tax filings reporting these amounts on October 15 of each year. If amounts collected and amounts paid differ by $100,000 or more, then the Commission must order the utility to establish an automatic adjustment clause to account for the difference, with a rate adjustment effective June 1 of each year.[2]

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[1] ORS 757.268(4).
[2] *See* ORS 757.268(4), (6)(a); OAR 860-022-0041(8).

II. PROCEDURAL HISTORY

On October 15, 2009, Pacific Power filed its 2008 Tax Report as required by ORS 757.268.[3] On November 5, 2009, the Commission held a prehearing conference and adopted a procedural schedule. Commission Staff (Staff) held a workshop on November 13, 2009, and settlement conferences on November 23 and December 9, 2009. Staff, Pacific Power, the Citizens' Utility Board of Oregon (CUB), and the Industrial Customers of Northwest Utilities (ICNU) participated in settlement negotiations.

ICNU filed the direct testimony of Michael Early on January 14, 2010,[4] to preserve arguments that ICNU has previously appealed to the Oregon Court of Appeals regarding the rules implementing SB 408 and the safe room procedures adopted in the protective orders in SB 408 dockets. ICNU filed a motion to admit the testimony and the affidavit of Michael Early in support of the motion on February 25, 2010. ICNU's motion to admit the testimony of Michael Early is granted, and exhibits ICNU/100 and ICNU/101 are made part of the record in this docket.

Pacific Power, Staff, and CUB (collectively the "Stipulating Parties") submitted a Stipulation and Joint Explanatory Brief on January 19, 2010. The Stipulation and Joint Explanatory Brief are admitted into evidence under OAR 860-014-0085. ICNU did not sign the Stipulation, but indicates that it does not object to the Stipulation. The Stipulation is attached as Appendix A.

III. DISCUSSION

The Stipulation resolves all issues related to Pacific Power's 2008 Tax Report. In the 2008 Tax Report, Pacific Power states that it paid approximately $38.2 million more in federal, state, and local taxes than it was authorized to collect in rates. Staff raised two primary issues related to the 2008 Tax Report. First, Staff questioned the calculation of the deferred income taxes floor under OAR 860-022-0041(4)(d). Second, Staff questioned Pacific Power's method for deriving the cost of debt used to calculate interest expense under OAR 860-022-0041(2)(p).

Regarding Staff's first issue, Pacific Power tracked its deferred taxes in two categories: (1) deferred taxes related to tax depreciation on public utility property were reported on lines 5, 14, and 23 of the SB 408 Staff template; and (2) all other deferred taxes, including taxes related to book depreciation on public utility property, were recorded on lines 4, 13, and 22 of the SB 408 Staff template. Lines 5, 14, and 23 contain the amount that forms the basis for the deferred taxes floor, subject to further adjustment for tax refunds. This floor is designed to ensure compliance with normalization requirements by fully protecting deferred taxes related to depreciation on public utility property when the utility's current tax expense is negative. Pacific Power's approach was based on the fact that the

[3] The following documents are admitted into evidence and made part of the record in this docket: Pacific Power's 2008 Tax Report (Oct 15, 2009); Staff's Issues List (Dec 18, 2009); Pacific Power's Revised 2008 Tax Report (Jan 20, 2010).
[4] The testimony was re-filed to correct page numbering on January 20, 2010.

"taxes paid" calculation required by the rules implementing SB 408 consistently isolate and track tax depreciation separately from book depreciation as evidence of compliance with normalization. In the 2008 Tax Report, Pacific Power's deferred taxes reported on lines 5, 14, and 23 exceeded the stand-alone tax result, which was the lowest of the three "taxes paid" calculations, so the deferred taxes floor constituted the final "taxes paid" amount.

Staff interprets lines 5, 14, and 23 differently than Pacific Power. Staff believes that the deferred income taxes generated by the net difference between book and tax depreciation should be reported on lines 5, 14, and 23, not lines 4, 13, and 22. Staff believes that its method ensures that customers retain the benefits of book depreciation while still avoiding a normalization violation. If Staff's interpretation is used, and the deferred income taxes generated by the net difference between book and tax depreciation are reported on lines 5, 14, and 23, then the deferred income taxes floor would no longer exceed the stand-alone tax result. The stand-alone tax result would then constitute the final "taxes paid" amount. For the purposes of the 2008 Tax Report, the Stipulating Parties agreed that Staff's interpretation should be used. This change decreases Pacific Power's state and federal taxes paid, and therefore the total state and federal SB 408 surcharge for 2008, by $35.9 million.

The Stipulating Parties did not resolve the second issue raised by Staff. The Stipulating Parties agreed, however, to a compromise amount of interest expense for purposes of the 2008 Tax Report. Under this compromise, Pacific Power agreed to revise its 2008 Tax Report to include the interest expense for Pacific Power's taxes paid that is equal to a decrease of approximately $0.9 million to Pacific Power's state and federal taxes paid and to the 2008 SB 408 surcharge.

With both adjustments, the Stipulating Parties agree that the total SB 408 surcharge for state and federal taxes for 2008 should be $1,790,814, plus an estimated $285,872 in interest. The Stipulating Parties also agreed that Pacific Power would refund to customers $347,361, plus approximately $54,652 in interest, for local taxes. The Stipulating Parties state that the surcharge and the refund are consistent with applicable Commission rules, and that rates reflecting the surcharge and the refund are fair, just, and reasonable. No party objected to the Stipulation. Pacific Power filed its revised 2008 Tax Report on January 20, 2010, incorporating the changes in the Stipulation.

IV. CONCLUSION

The Commission encourages parties to a proceeding to voluntarily resolve issues to the extent that settlement is in the public interest. The active parties to this docket entered into a Stipulation that resolves all outstanding issues.

The Commission has examined the Stipulation, the Joint Explanatory Brief, and Pacific Power's revised 2008 Tax Report. We conclude that rates reflecting the surcharge and the refund authorized by the Stipulation are fair, just, and reasonable. We therefore adopt the Stipulation in its entirety.

V. ORDER

IT IS ORDERED that:

1. The Stipulation attached as Appendix A is adopted.

2. PacifiCorp, dba Pacific Power, must file compliance tariff sheets with a June 1, 2010 effective date as set forth in paragraph 15 of the Stipulation.

Made, entered, and effective APR 0 6 2010.

Ray Baum
Chairman

John Savage
Commissioner

Susan K. Ackerman
Commissioner

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements in OAR 860-014-0095. A copy of any such request must also be served on each party to the proceeding as provided by OAR 860-013-0070(2). A party may appeal this order by filing a petition for review with the Court of Appeals in compliance with ORS 183.480-183.484.

BEFORE THE PUBLIC UTILITY COMMISSION OF OREGON

UE 177(3)

In the Matter of: PACIFICORP, dba PACIFIC POWER & LIGHT COMPANY Filing of tariffs establishing automatic adjustment clauses under the terms of SB 408	**STIPULATION**

This Stipulation resolves all issues among the parties to this Stipulation related to PacifiCorp's 2008 Tax Report, filed in UE 177(3) pursuant to Senate Bill 408 ("SB 408"). SB 408 is codified in ORS 757.267, 757.268 and 757.210. Those statutes are implemented through OAR 860-022-0041.

PARTIES

1. The parties to this Stipulation are Staff of the Public Utility Commission of Oregon ("Staff"), PacifiCorp (or the "Company"), and the Citizens' Utility Board of Oregon ("CUB") (together, the "Parties").[1] This Stipulation will be made available to other parties to this docket, who may participate by signing and filing a copy of the Stipulation.

BACKGROUND

2. 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 affiliated groups 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

[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.

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. ORS 757.268(4); OAR 860-022-0041(7).

3. As required by SB 408, on October 15, 2009, PacifiCorp filed its tax report for calendar year 2008 ("2008 Tax Report"). PacifiCorp's 2008 Tax Report reflected approximately $38.2 million of federal, state, and local taxes paid above taxes authorized to be collected in rates. Cover Letter to 2008 Tax Report (October 15, 2009).

4. Under SB 408, this difference, plus interest, is to be collected as a surcharge through an AAC. ORS 757.268(6). PacifiCorp's AAC for state and federal taxes is contained in Schedule 102 and its AAC for local taxes is contained in Schedule 103. The Commission has discretion to set the amortization period for a refund or surcharge under the AAC. OAR 860-022-0041(8)(c).

5. The Commission held a prehearing conference on November 5, 2009, at which Administrative Law Judge Grant adopted a full procedural schedule for this docket, including testimony, a hearing, and briefing.

6. Staff served discovery and convened a workshop on November 13, 2009 to review issues raised by the 2008 Tax Report. All parties were invited to participate, and representatives from Staff, PacifiCorp, CUB, and ICNU attended.

7. The parties convened settlement conferences on November 23, 2009, and December 9, 2009, which the Company, Staff, CUB, and ICNU attended. The settlement conferences were noticed to all parties in the docket.

8. As described in more detail below and in Staff's Issues List attached hereto as Exhibit A, two primary issues surfaced during the parties' audit of the 2008 Tax Report: (1) the

calculation of the deferred income taxes floor under OAR 860-022-0041(4)(d); and (2) the calculation of interest expense under OAR 860-022-0041(2)(p).

a. Deferred income taxes floor. The deferred income taxes floor was added to the SB 408 rules in Order No. 07-401 (Docket AR 517) to provide additional protection against a normalization violation.[2] The floor is designed to ensure compliance with normalization requirements by fully protecting deferred taxes related to depreciation on public utility property when the utility's current tax expense is negative.[3]

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

The Company's approach was based on the fact that the "taxes paid" calculations required by the SB 408 rules consistently isolate and track tax depreciation separately from book depreciation as evidence of compliance with normalization. In the 2008 Tax Report, the Company's deferred taxes reported on lines 5, 14, and 23

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[2] See Order No. 06-532, pages 3-5, for a discussion of normalization requirements.

[3] PacifiCorp's current tax expense for 2008 was significantly reduced by a major tax deduction related to a change in application of tax regulations and bonus depreciation. Bonus depreciation also generated a significantly increased amount of deferred income taxes on public utility property.

exceeded the stand-alone tax result, which was the lowest of the three "taxes paid" calculations, so the deferred taxes floor constituted the final taxes paid amount.

Staff interpreted lines 5, 14, and 23 of the SB 408 Staff template differently from the Company. Under Staff's interpretation, the deferred income taxes generated by the net difference between book and tax depreciation are reported on lines 5, 14, and 23 of the SB 408 Staff template. Staff believes that its method ensures that customers retain the benefits of book depreciation while still avoiding a normalization violation. If Staff's interpretation is utilized and the deferred income taxes generated by the net difference between book and tax depreciation are reported on lines 5, 14, and 23 of the template, the deferred income taxes floor is no longer used because the amount of "taxes paid" is reduced to a level below the stand-alone tax result, which is the lowest of the three "taxes paid" calculations.[4] Based on the private letter ruling issued by the Internal Revenue Service on January 9, 2008 regarding SB 408 and its administrative rules, the Parties believe that the Company's use of the stand-alone method for determining taxes paid as agreed to in this Stipulation is consistent with the normalization requirements of the Internal Revenue Code.

The Commission has not previously interpreted the meaning of the template or opined upon this issue.

b. Calculation of interest expense. Staff and the Company have not agreed on the appropriate method for calculating interest expense pursuant to OAR 860-022-0041(2)(p). Staff has proposed the use of a five-quarter or 13-month average to calculate the weighted cost of debt for purposes of calculating interest expense, while PacifiCorp has proposed the use of 2008 year-end weighted cost of debt.[5] The Parties

[4] See Exhibit A to the Stipulation, pages 4-5, Issues 1-2 for Staff's additional discussion of deferred taxes.
[5] See Exhibit A to the Stipulation, page 5, Issue 3 for Staff's additional discussion of capital structure and cost of debt.

understand that this issue is expected to be resolved through a future rulemaking to be proposed by Staff. In this Stipulation, however, the Parties have agreed on a reasonable compromise level of interest expense for purposes of the 2008 SB 408 Tax Report.

As a result of the settlement conferences, the Parties have reached a comprehensive settlement in this case.

AGREEMENT

9. For purposes of the 2008 Tax Report, the Parties agree that the amount of deferred taxes reported on Lines 5, 14, and 23 of the template will reflect deferred taxes generated by the net difference between book and tax depreciation on public utility property. With this change, the deferred income taxes floor is no longer an issue for the 2008 Tax Report. Because the deferred taxes floor is reduced to a level below the stand-alone tax result, the taxes paid result is produced by the stand-alone method, which is the lowest of the three "taxes paid" calculations. This change decreases PacifiCorp's state and federal taxes paid, and the total 2008 state and federal SB 408 surcharge ("2008 Surcharge"), by approximately $35.9 million.

10. The Parties agree that PacifiCorp will revise its 2008 SB 408 Tax Report to include the interest expense for PacifiCorp's taxes paid that is equal to a decrease of approximately $0.9 million to PacifiCorp's state and federal taxes paid and the 2008 Surcharge.

11. The Parties agree to participate in a rulemaking commenced by the Commission at the request of Staff to address the appropriate method for calculating interest expense under OAR 860-022-0041(2)(p).

12. PacifiCorp will file a revised 2008 Tax Report incorporating these changes ("Revised 2008 Tax Report") concurrently with the filing of this Stipulation. The Parties agree

that the Revised 2008 Tax Report, filed pursuant to this Stipulation, complies with SB 408 and OAR 860-022-0041.

13. The Parties agree that the 2008 Surcharge should be $1,790,814, plus an estimated $285,872 in interest accruing from July 2008 through May 2010, as shown in Exhibit B to the Stipulation.[6] The Parties agree that this amount should be amortized over one year concurrently with the residual 2006 and 2007 SB 408 tax surcharge amounts for state and federal taxes ("Surcharge Residual") that is expected to be approximately $2,677,539.[7] The total amortization for the combined 2008 Surcharge and the Surcharge Residual will be $4,803,080 (including interest) to be recovered during the 12-month period beginning June 1, 2010 through May 31, 2011 in Schedule 102 PacifiCorp's Income Tax Adjustment tariff. The proposed surcharge will be allocated by customer rate schedule on an equal cents per kilowatt-hour basis, as required by OAR 860-022-0041(8)(d).

14. The 2008 refund for local taxes will be $342,361, plus approximately $54,652 in interest accruing from July 2008 through May 2011, as shown in Exhibit B to the Stipulation.[8] The local tax adjustment reflected in the Revised 2008 Tax Report will be implemented through Schedule 103, PacifiCorp's Multnomah County Business Income Tax tariff.

15. Upon approval of this Stipulation, PacifiCorp will make a compliance filing to reflect (1) the 2008 Surcharge of $1,790,814, plus interest, in Schedule 102; (2) the Residual Surcharge that is expected to be approximately $2,677,539, plus interest, in Schedule 102; and (3) the SB 408 local tax refund of $342,361, plus interest, in Schedule 103. The tariff schedules will reflect an effective date of June 1, 2010, and be updated if necessary to reflect the 2010 Blended Treasury Rate ("BTR")[9] that will apply to the amortization period. The net

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[6] Additional interest of approximately $21,340 will accrue during the amortization phase of this surcharge.
[7] Additional interest of approximately $27,514 will accrue during amortization of this residual between June 2010 and May 2011.
[8] Additional interest of approximately $4,080 will accrue during amortization of this refund.
[9] The 2009 BTR was used to estimate interest accruing during amortization as the 2010 BTR was not yet published.

change on June 1, 2010, will reflect the difference between the currently effective Schedule 102 surcharge of approximately $20.3 million implemented effective June 1, 2009, and the surcharge filed in the compliance filing in this docket. The resulting rate impact will be an overall decrease to net revenues of 1.5 percent.

16. The Parties agree to submit this Stipulation to the Commission and request that the Commission approve the Stipulation as presented. The Parties agree that the adjustments and the rates resulting from the Stipulation are fair, just, and reasonable.

17. This Stipulation will be offered into the record of this proceeding as evidence pursuant to OAR 860-014-0085. The Parties agree to support this Stipulation throughout this proceeding and any appeal, (if necessary) provide witnesses to sponsor this Stipulation at the hearing, and recommend that the Commission issue an order adopting the settlements contained herein.

18. If this Stipulation is challenged by any other party to this proceeding, the Parties agree that they will continue to support the Commission's adoption of the terms of this Stipulation. The Parties agree to cooperate in cross-examination and put on such a case as they deem appropriate to respond fully to the issues presented, which may include raising issues that are incorporated in the settlements embodied in this Stipulation.

19. The Parties have negotiated this Stipulation as an integrated document. If the Commission rejects all or any material portion of this Stipulation or imposes additional material conditions in approving this Stipulation any Party disadvantaged by such action shall have the rights provided in OAR 860-014-0085 and shall be entitled to seek reconsideration or appeal the Commission's Order.

20. By entering into this Stipulation, no Party shall be deemed to have approved, admitted, or consented to the facts, principles, methods, or theories employed by any other Party in arriving at the terms of this Stipulation, other than those specifically identified in the body of this Stipulation. No Party shall be deemed to have agreed that any provision of this

Stipulation is appropriate for resolving issues in any other proceeding, except as specifically identified in this Stipulation.

21. This Stipulation may be executed in counterparts and each signed counterpart shall constitute an original document.

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

Signature page follows.

STAFF

By: ______________________

Date: 1/19/10

PACIFICORP

By: ______________________

Date: ______________________

CUB

By: ______________________

Date: ______________________

STAFF

By: ______________________

Date: ______________________

PACIFICORP

By: Andrea Kelly

Date: 1/19/10

CUB

By: ______________________

Date: ______________________

STAFF

By: ______________________

Date: ______________________

PACIFICORP

By: ______________________

Date: ______________________

CUB

By: ______________________

Date: 1-19-10

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(3) Stipulation
Exhibit B

2008 Tax Period Multnomah County Business Tax Refund Interest & Amortization Summary
(estimated as of December 2009)

Line		Interest period		
1	Actual 2008 surcharge (tax report)			(342,361.00)
2	Interest at Cost of Capital (ROR) - 8.16%	July 2008 - January 31, 2010		(47,047.31)
3	Interest at Cost of Capital (ROR) - 8.08%	February 1 - April 15, 2010		(5,261.69)
4	Interest at 2010 Blended Treasury Rate 2.05%	April 16, 2010 - May 31, 2010		(2,342.91)
5	Total 2008 surcharge		$	(397,012.91)
6	**Beginning balance (Amortization) June 2010 - May 2011**		$	(397,012.91)
7	Projected Interest at 2010 B.T.Rate 2.05%	June 2010 - May 2011		(4,079.69)
8	Total projected 2008 tax period surcharge amortization, including interest		$	(401,092.60)
	Or:			
9	Total 2008 surcharge (per the tax report)		$	(342,361.00)
	Add:			
10	Total interest		$	(58,731.60)
11	Total		$	(401,092.60)

UE 177(3) Stipulation
Exhibit B

2007 Tax Period Amortization Summary (estimated as of December 2009)

Line		Interest Period		
1	Total 2007 surcharge inc interest as of May 31, 2009		$	5,057,334.00
2	Total amortized with Interest June 1, 2009 - May 31, 2010		$	2,379,794.63
3	**2007 Residual carried forward to 2008 tax year amortization period (June 2010 - May 2011)**		$	2,677,539.37
4	Interest at Blended Treasury Rate 2.05%	July 2010 - May 2011		27,514.30
5	**Total Projected 2nd year Amortization**		$	2,705,053.67

UE 177(3) Stipulation
Exhibit B

2008 Tax Period Surcharge Interest & Amortization Summary (estimated as of December 2009)

Line		Interest period		
1	Actual 2008 surcharge (tax report)			1,790,814.00
2	Interest at Cost of Capital (ROR) - 8.16%	July 2008 - January 31, 2010		246,094.00
3	Interest at Cost of Capital (ROR) - 8.08%	February 1 - April 15, 2010		27,522.71
4	Interest at 2010 Blended Treasury Rate 2.05%	April 16, 2010 - May 31, 2010		12,255.24
5	Total 2008 surcharge		$	2,076,685.95
6	**Beginning balance (Amortization) June 2010 - May 2011**		$	2,076,685.95
7	Projected Interest at 2010 B.T.Rate 2.05%	June 2010 - May 2011		21,339.95
8	Total projected 2008 tax period surcharge amortization, including interest		$	2,098,025.90
	Or:			
9	Total 2008 surcharge (per the tax report)		$	1,790,814.00
	Add:			
10	Total interest		$	307,211.90
11	Total		$	2,098,025.90

Rate Impacts

12	Proposed Price (cents/kWh)	0.036
13	Current Price (cents/kWh)	0.142
14	Price Change	(0.106)
15	Revenue Change	($14,191,480)
16	Est. Current Revenues	$980,803,000
17	Rate Impact	-1.5%