



Oregon

Theodore R. Kulongoski, Governor

Public Utility Commission

550 Capitol St NE, Suite 215

Mailing Address: PO Box 2148

Salem, OR 97308-2148

Consumer Services

1-800-522-2404

Local: (503) 378-6600

Administrative Services

(503) 373-7394

December 23, 2010

Via Electronic Filing and U.S. Mail

OREGON PUBLIC UTILITY COMMISSION
ATTENTION: FILING CENTER
PO BOX 2148
SALEM OR 97308-2148

RE: Docket No. UG 171 (4) – In the Matter of AVISTA's, Senate Bill 408 Tax Filing for 2009 Tax Period.

Enclosed for electronic filing in the above-captioned docket is the Public Utility Commission's Staff Issues List.

/s/ Kay Barnes

Kay Barnes

Regulatory Operations Division

Filing on Behalf of Public Utility Commission Staff

(503) 378-5763

Email: kay.barnes@state.or.us

c: UG 171 Service List (parties)

**PUBLIC UTILITY COMMISSION
OF OREGON**

UG 171 (4)

STAFF ISSUES LIST

**Carla Owings
Dustin Ball
Deborah Garcia**

**In the Matter of
AVISTA's
Senate Bill 408 Tax Filing
for 2009 Tax Period**

December 23, 2010

**SENATE BILL 408, TAX FILINGS
STAFF'S INITIAL FINDINGS
FOR AVISTA CORPORATION – UG 171(4)**

TO: LEE SPARLING, MAURY GALBRAITH, JUDY JOHNSON AND
JASON JONES

**RE: AVISTA CORPORATION – UG 171(4)
SB 408 TAX FILINGS
2009 TAX PERIOD**

FROM: CARLA BIRD, 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, Avista Corporation (Avista) filed UG 171(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.

SUMMARY OF 2009 SB 408 IMPACT:

Avista reports the following for its Oregon Regulated Results of Operations for the 2009 Tax period:

Table 1-Original Filing

Federal and State Taxes Paid to units of Government	Taxes Collected	Surcharge or (Refund)	Interest¹ (7/1/09 through 6/1/2010)	Total Surcharge
\$4.6 million	\$3.7 million	\$0.9 million	\$160,000	\$1.0 million

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

Table 2-Staff’s Recommendation - AMENDED FILING 10/29/10

Federal and State Taxes Paid to units of Government	Taxes Collected	Surcharge or (Refund)	Interest² (7/1/09 through 6/1/2010)	Total Surcharge
\$5.0 million	\$3.7 million	\$1.3 million	\$230,000	\$1.5 million

The Staff recommended surcharge for the 2009 period is larger than the original request filed by Avista due to amendments that are explained below in the Staff Review. The final amendment filed by Avista is based upon the application of a refund the Company included in its original filing. Upon further review, the Company deemed the refund was not applicable to the Oregon jurisdiction and removed it in the amended filing. The result was an increase to the surcharge.

For the 2009 tax period, Avista proposes to surcharge approximately \$1.5 million. Interest of approximately \$230,000 will accrue during the deferral period. Avista estimates an additional amount of approximately \$17,000 will accrue during the amortization phase. The total impact including interest accruals is still approximately \$1.5 million.

¹ This is an estimate of all interest through deferral period.

² This is an estimate of all interest through deferral period.

The impact of a \$1.5 million surcharge on its own would represent an increase to Avista's retail revenues of approximately 1.5 percent without consideration of the 2008 SB 408 rate implementation currently in effect. Avista relied upon the 4(d) tax limitation for the outcome of its filing.

For the 2008 tax period, Avista refunded approximately \$1.0 million (including interest). This refund was implemented in June 1, 2010.

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.

At the conclusion of Staff's review and after some of the Parties³ 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 violation⁴ 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) would likely result in a significant change to Avista's 2009 SB408 filing, as currently proposed.

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 Utility companies as well as the Parties represented at the Settlement conference⁵ 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

³ The Parties to the Stipulated Agreements are defined in the section "Summary of Review" section on Page 4 below.

⁴ Discussed in section "Staff Review" on page 5 below.

⁵ Id.

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.

STAFF REVIEW:

Staff conducted face to face interviews on November 15, 2010 and November 22, 2010. Citizens' Utility Board (CUB) and Northwest Industrial Gas Users (NWIGU) (hereafter referred to collectively as the Parties) were present at both face-to-face meetings along with Staff and the Company. In addition, Staff sent Data Requests and conducted several informal phone discussions.

The Parties had agreed that Avista's Amended filing represented a just and reasonable outcome for the 2009 SB 408 filing. However, due to the magnitude of the potential adjustment related to Staff's investigation of normalization violations, Staff withdrew from the initial agreements discussed at the settlement conferences described above.

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, Avista falls under the 4(d) tax limitation. The outcome of the three "taxes paid" calculations (described above) results in taxes

paid that are lower than the deferred tax balance related to the depreciation of public utility property. Choosing the any of the “taxes paid” methods would result in a normalization violation. Therefore, Staff supports Avista’s use of the 4(d) tax limitation.

One of the driving forces for this result is the high level of accelerated depreciation associated with new assets placed in service during the tax period. As a result of our review, Staff discussed many issues related to Avista’s original filing, but for this memo Staff focuses on the issues identified as item (2) below.

Below is a summary of some of the topics reviewed by Staff in this filing:

(1) Amended Filing

(2) Taxes Collected – Net to Gross and Effective Tax Ratios.

(1) Amended Filing – On October 29, 2010, Avista amended its original filing to correct what it deemed was an error in the methodology employed to derive the balance for the 4(d) tax limitation. On page 8 of Staff’s template, Avista had reduced the balance of the amounts attributable to the tax benefit of deferred taxes related to public utility property by a refund Avista had received during the 2009 tax period. After further review, Avista had determined that no portion of the tax refund was properly allocable to the Oregon jurisdiction.

During the review process Staff requested further documentation of the refund and agrees that the refund is not allocable to the Oregon jurisdiction. Therefore, Staff supports Avista’s amendment to its original filing.

Avista amended its original filing by removing a refund that draws down the balance that relates to the 4(d) tax limitation. The result is an increase to Avista’s surcharge of approximately \$500,000.

(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 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 accurate 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.

In Avista's original filing, the Company had used the ratios set in its most recent rate proceeding, modified by the Purchased Gas Cost Mechanisms (PGA) that had been implemented that impact the tax period. To reflect the PGA modification, the Company had calculated the actual impact on revenues during the tax period, rather than to apply the proposed amounts of revenue to calculate the ratios. The Company would then apply those ratios (net to gross revenues and effective tax rates) to the gross revenues during the tax period.

Staff originally objected to this method believing that Avista was mixing the use of actual revenues with proposed revenues.

Avista pointed out that the PGA mechanisms [should] have a zero impact on taxable income (if done properly). This is true because every revenue of dollar associated with a strictly "gas cost" related mechanism is sheltered by the gas expense. Meaning, there is no margin or profit that should affect the taxable income. Using proposed levels of revenue rather than actual could create a tax impact due to the over- or under-collection of what actually occurs to what is forecast.

Staff agrees in principal that due to the true-up that takes place each year in Avista's PGA mechanism, the effects of over- or under-collection of gas costs are addressed and reconciled on an annual basis. Whatever slight differences that may exist during the tax period, would likely be related to the differences between a cash basis calculation for taxes and the accrual basis calculation for ratemaking. In principal, Staff agrees that the true-up will address some of these variances. However, Staff recommends that during the off-season; prior to the next SB 408 filing, Staff and Avista come to an agreement about the most consistent method to apply in order to accommodate the SB 408 true-up.

Staff and Avista agree to work together during the off-season to develop the most consistent method to accommodate the Annual PGA mechanism into the calculation of taxes collected for the SB 408 filing.

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Service List (Parties)

<p>AVISTA CORPORATION</p> <p>DAVID J MEYER (C) (HC) VICE PRESIDENT & CHIEF COUNSEL</p>	<p>PO BOX 3727 SPOKANE WA 99220-3727 david.meyer@avistacorp.com</p>
<p>AVISTA UTILITIES</p> <p>RON MCKENZIE (C) (HC) MANAGER - REGULATORY ACCOUNTING</p>	<p>PO BOX 3727 SPOKANE WA 99220-3727 ron.mckenzie@avistacorp.com</p>
<p>CABLE HUSTON BENEDICT HAAGENSEN & LLOYD LLP</p> <p>CHAD M STOKES (C) (W)</p>	<p>1001 SW 5TH - STE 2000 PORTLAND OR 97204-1136 cstokes@cablehuston.com</p>
<p>CITIZENS' UTILITY BOARD OF OREGON</p> <p>GORDON FEIGHNER (C) (HC) (W) ENERGY ANALYST</p>	<p>610 SW BROADWAY, STE 400 PORTLAND OR 97205 gordon@oregoncub.org</p>
<p>ROBERT JENKS (C) (HC) (W) EXECUTIVE DIRECTOR</p>	<p>610 SW BROADWAY, STE 400 PORTLAND OR 97205 bob@oregoncub.org</p>
<p>G. CATRIONA MCCrackEN (C) (HC) (W) LEGAL COUNSEL/STAFF ATTY</p>	<p>610 SW BROADWAY, STE 400 PORTLAND OR 97205 catriona@oregoncub.org</p>
<p>DANIEL W MEEK ATTORNEY AT LAW</p> <p>DANIEL W MEEK (C) (HC) ATTORNEY AT LAW</p>	<p>10949 SW 4TH AVE PORTLAND OR 97219 dan@meek.net</p>
<p>DAVISON VAN CLEVE</p> <p>IRION A SANGER (C) ASSOCIATE ATTORNEY</p>	<p>333 SW TAYLOR - STE 400 PORTLAND OR 97204 ias@dvclaw.com</p>
<p>DAVISON VAN CLEVE PC</p> <p>MELINDA J DAVISON (C)</p>	<p>333 SW TAYLOR - STE 400 PORTLAND OR 97204 mail@dvclaw.com</p>
<p>DEPARTMENT OF JUSTICE</p> <p>JASON W JONES (C) (HC) ASSISTANT ATTORNEY GENERAL</p>	<p>BUSINESS ACTIVITIES SECTION 1162 COURT ST NE SALEM OR 97301-4096 jason.w.jones@state.or.us</p>

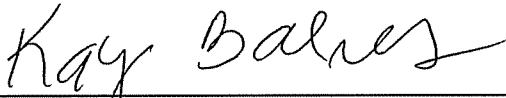
<p>ENERGY ACTION NORTHWEST</p> <p>EDWARD A FINKLEA (C) (W)</p>	<p>PO BOX 8308 PORTLAND OR 97207 efinklea@energyactionnw.org</p>
<p>KAFOURY & MCDUGAL</p> <p>LINDA K WILLIAMS (C) (HC) ATTORNEY AT LAW</p>	<p>10266 SW LANCASTER RD PORTLAND OR 97219-6305 linda@lindawilliams.net</p>
<p>MCDOWELL RACKNER & GIBSON PC</p> <p>PORTLAND SAFE ROOM</p>	<p>419 SW 11TH AVE STE 400 PORTLAND OR 97205 lisa@mcd-law.com</p>
<p>NORTHWEST INDUSTRIAL GAS USERS</p> <p>PAULA E PYRON (C) (W)</p>	<p>4113 WOLF BERRY CT LAKE OSWEGO OR 97035-1827 ppyron@nwigu.org</p>
<p>OREGON PUBLIC UTILITY COMMISSION</p> <p>CARLA BIRD (C) (HC)</p>	<p>PO BOX 2148 SALEM OR 97308-2148 carla.bird@state.or.us</p>
<p>PORTLAND GENERAL ELECTRIC</p> <p>RANDALL DAHLGREN (W)</p>	<p>121 SW SALMON ST - 1WTC0702 PORTLAND OR 97204 pge.opuc.filings@pgn.com</p>
<p>DOUGLAS C TINGEY (W)</p>	<p>121 SW SALMON 1WTC13 PORTLAND OR 97204 doug.tingey@pgn.com</p>
<p>PUBLIC UTILITY COMMISSION OF OREGON</p> <p>DEBORAH GARCIA (C) (HC)</p>	<p>PO BOX 2148 SALEM OR 97308-2148 deborah.garcia@state.or.us</p>
<p>TONKON TORP LLP</p> <p>DAVID F WHITE (W)</p>	<p>888 SW FIFTH AVE #1600 PORTLAND OR 97204 davidw@tonkon.com</p>

CERTIFICATE OF SERVICE

UG 171

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 860-001-0180, to the following parties or attorneys of parties.

Dated this 23rd day of December 2010, at Salem, Oregon.



Kay Barnes
Public Utility Commission
Regulatory Operations
550 Capitol St NE Ste 215
Salem, Oregon 97301-2551
Telephone: (503) 378-5763