



1 **Q. Are you the same Ryan Fuller who previously provided testimony in this**  
2 **docket?**

3 A. Yes.

4 **Purpose and Summary of Testimony**

5 **Q. What is the purpose of your rebuttal testimony?**

6 A. My rebuttal testimony addresses the proposed adjustments by Washington  
7 Utilities and Transportation Commission Staff (Staff) witness Ms. Kathryn H.  
8 Breda to the income tax component of the Washington-allocated revenue  
9 requirement in this case. More specifically:

- 10 • I explain why the reasons given by Staff do not provide a basis for the  
11 Commission to reject the Company's proposal to fully normalize income  
12 taxes.<sup>1</sup>
- 13 • I correct Staff's proposed flow-through adjustment by properly removing the  
14 impact of: 1) state income taxes; and 2) normalized non-property related  
15 temporary book-tax differences. On a corrected basis, the adjustment  
16 increases the Company's revenue requirement by \$25,891.<sup>2</sup>
- 17 • I explain that Staff's proposed restating adjustment to annualize the rate base  
18 reduction for the accumulated deferred income taxes generated by the repairs  
19 deduction is not consistent with the regulatory concept of a rate base reduction  
20 for accumulated deferred income taxes, and

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<sup>1</sup> In direct testimony, the Company's specific proposal is to normalize all temporary book-tax differences with the single exception of the temporary book-tax difference associated with the equity allowance for funds used during construction, for which flow-through accounting will continue.

<sup>2</sup> This amount is inclusive of Staff's proposed adjustment.

- 1           • I recommend an alternative to the Company’s request to establish a regulatory  
2           asset or liability for interest paid to or received from the Internal Revenue  
3           Service (the Service).

4   **The Company’s Proposal for Income Tax Normalization**

5   **Q.    What reasons does Staff provide the Commission as a basis for rejecting the**  
6   **Company’s proposal to normalize income taxes?**

7   A.    Staff provides three reasons.<sup>3</sup> First Staff contends that the Company did not fully  
8   address the transition to full normalization. Second, Staff contends that the  
9   Company did not provide evidence to determine the overall customer impact of its  
10   proposal. Third, Staff contends that normalizing income taxes is a “global policy  
11   issue,” and that the Company’s proposal cannot be adopted in a non-generic  
12   docket such as this.

13   **Q.    Did the Company fully address the transition to full normalization?**

14   A.    Yes. As specifically outlined in *Accounting for Public Utilities*, in making its  
15   proposal for normalized accounting, a company should address: 1) the timing of  
16   the change; 2) whether the change is made retrospectively or prospectively; and 3)  
17   the proper treatment of the flow-through effects from past periods.<sup>4</sup> The  
18   Company’s proposal addresses each of these issues. Specifically:

- 19           • The Company proposes to implement the change beginning January 1, 2011.<sup>5</sup>  
20           • The Company proposes to implement the change prospectively.

<sup>3</sup> Exhibit No. \_\_ (KHB-1T), Page 22, Lines 8-21, Page 23, Lines 1-3.

<sup>4</sup> Robert L. Hahne and Gregory E. Aliff, *Accounting for Public Utilities* §17.01[5] (Matthew Bender).

<sup>5</sup> Due to system limitations, the Company has requested approval to begin accounting for Washington-allocated temporary book-tax differences on January 1, 2011, which represents the beginning of the annual period closest to the rate-effective date.

- 1 • The Company proposes to allow flow-through effects from past periods for  
2 fixed asset related temporary book-tax differences to reverse over the same  
3 timing as would have occurred under flow-through accounting. This reversal  
4 is delineated and tracked on a jurisdictional basis by the Company's tax fixed  
5 asset system, PowerTax.
- 6 • The Company proposes to allow the flow-through effects from past periods  
7 for all other temporary book-tax differences to reverse over a fixed  
8 amortization period<sup>6</sup> to be approved by the Commission in the Company's  
9 next general rate case once the amount is finally quantified as of December  
10 31, 2010.<sup>7</sup>

11 **Q. Is this the proper process for a utility to adopt full normalization?**

12 A. Yes, despite Staff's assertion to the contrary, this is precisely the process that is  
13 required. In addressing the adoption of comprehensive income tax normalization,  
14 FERC Order No. 530 states that "Comprehensive [income tax normalization]  
15 should not be prescribed for accounting purposes prior to respective [temporary  
16 book-tax differences] being allowed in rates as resulting financial statements  
17 would be distorted."<sup>8</sup>

18 Requiring the Company to quantify the flow-through effects from past  
19 periods for the non-fixed asset temporary book-tax differences prior to the  
20 Commission approving the Company's proposal puts the Company in a regulatory

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<sup>6</sup> A reasonable proxy in the form of a fixed amortization period is necessary because the Company does not have a system that tracks the natural reversal of the flow-through on these temporary book-tax differences. The Company's intent, however, is that the amortization period will approximate a similar time period so as to have no net effect on customers with respect to these costs as compared to the continuation of flow-through accounting.

<sup>7</sup> Exhibit No.\_\_(RF-1T), Page 10, Lines 14-22, Page 11, Lines 1-2.

<sup>8</sup> Robert L. Hahne and Gregory E. Aliff, Accounting for Public Utilities §17.01[5] (Matthew Bender).

1 “Catch-22” since the Company could not possibly quantify this amount and  
2 propose an amortization period until the Company’s financial statements for the  
3 calendar year ending December 31, 2010, are finalized. The Commission’s  
4 authorization to use comprehensive income tax normalization is a necessary first  
5 step to “freeze and quantify” an otherwise moving target.

6 **Q. Did the Company provide evidence to determine the overall customer impact**  
7 **of its proposal?**

8 A. Yes, the financial impact is identified in my direct testimony and is supplemented  
9 by the detailed computation provided in Exhibit No.\_\_\_\_(RF-6). Revenue  
10 requirement for the 2009 test year is reduced by \$25,891 under the Company’s  
11 proposal as compared to flow-through accounting.<sup>9</sup> And, as proposed by the  
12 Company, the flow-through effects from past periods is intended to have no net  
13 effect on customers as compared to the continuation of flow-through accounting.

14 Because the impact of normalized accounting as compared to flow-  
15 through accounting is highly dependent on the test year, making the conversion in  
16 a test year that mitigates the impact to customers is an important consideration. In  
17 this respect, this rate case provides an excellent opportunity for the Commission  
18 to move to full normalization because conversion can be done at no cost to  
19 customers and even provides a small benefit.

20 **Q. Is the Company’s proposal a “global policy issue” that must be adopted for**  
21 **all companies regulated under the Commission’s jurisdiction?**

22 A. No. It is within the Commission’s discretion to specifically approve the  
23 Company’s proposal without making a policy decision that applies to all regulated

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<sup>9</sup> Exhibit No.\_\_\_\_(RF-1T), Page 6, Lines 7-11, Exhibit No.\_\_\_\_(RF-6).

1 utilities under the jurisdiction of the Commission. In fact, based on Staff's  
2 testimony and data request responses, the Commission already approves  
3 normalization to varying degrees for each regulated utility. For example, in its  
4 testimony Staff identifies three dockets in which normalized accounting for  
5 income taxes is approved.<sup>10</sup> Later in Staff's testimony it states that "the  
6 Commission has approved normalization for many single issues."<sup>11</sup>

7           Upon further inquiry by the Company as to the extent the Commission has  
8 approved normalized accounting, Staff provided a list of 14 additional dockets in  
9 its response to Company Data Request No. 1.27, provided as Exhibit No.\_\_(RF-  
10 9). Staff's data request response contains the caveat that the list is not  
11 comprehensive and further states that "In many cases, Commission orders do not  
12 state the Commission is 'authorizing normalized treatment', or words to that  
13 effect. However, many Commission orders on accounting petitions and in general  
14 rate cases may result in a form of normalization on specific issues, if a related  
15 book-tax difference is involved. In those situations, the most one could say is that  
16 normalization approval is implied. Even then, for some orders, it is difficult to  
17 discern what specific accounting is implied without examining the underlying  
18 record in the docket."

19 **Q. Is flow-through accounting consistent with generally accepted ratemaking**  
20 **principles in Washington?**

21 A. No. Flow-through accounting is not consistent with general ratemaking  
22 principles, primarily because it does not match costs to the customers using the

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<sup>10</sup> Exhibit No.\_\_(KHB-1T), Page 8, Lines 6-14.

<sup>11</sup> Exhibit No.\_\_(KHB-1T), Page 24, Line 21.

1 service. Accordingly, proponents of flow-through accounting are generally  
2 limited to using the argument of phantom taxes<sup>12</sup> to advocate their position  
3 (otherwise known as “continual tax deferral” or “permanent tax savings”). In  
4 fact, this is the single position in favor of flow-through accounting identified by  
5 Ms. Breda in her testimony, notwithstanding the fact that the phantom tax  
6 argument has been rejected for being an erroneous and misleading argument by  
7 both the Federal Energy Regulatory Commission (FERC) and the National  
8 Regulatory Research Institute (NRRI).<sup>13</sup>

9 **Q. Does an approach of selective determination for normalized or flow-through**  
10 **treatment of each temporary book-tax difference satisfy any practical or**  
11 **policy considerations?**

12 A. No. The same sound regulatory principles that make normalized accounting  
13 appropriate for the repairs deduction, such as the matching principle and  
14 intergenerational equity, apply to all temporary-book tax differences. An  
15 approach of selective determination creates unnecessary uncertainty for the  
16 Company as to the correct accounting treatment of the Company’s temporary  
17 book-tax differences for financial reporting purposes.

18 Furthermore, the Company already uses normalized accounting for more  
19 than 99 percent of its deferred income taxes,<sup>14</sup> leaving less than 1 percent of the  
20 Company’s temporary book-tax differences accounted for on a flow-through basis  
21 in the state of Washington.<sup>15</sup> Requiring flow-through accounting for this

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<sup>12</sup> Robert L. Hahne and Gregory E. Aliff, Accounting for Public Utilities §17.01[6][a] (Matthew Bender).

<sup>13</sup> Robert L. Hahne and Gregory E. Aliff, Accounting for Public Utilities §17.01[6][a] (Matthew Bender).

<sup>14</sup> This is primarily the result of the normalization requirement of the IRC.

<sup>15</sup> Exhibit No.\_\_\_\_(RF-6), Page 3 of 6.

1 proportionately small amount of remaining book-tax differences serves no  
2 practical purpose, particularly considering that flow-through accounting is not  
3 consistent with generally accepted ratemaking principles in Washington.

4 **Q. Do you agree with Staff that the Commission's long-standing policy is to use**  
5 **flow-through accounting when it is lawful to do so?**

6 A. No, I do not agree that the orders cited by Staff accurately describe the  
7 Commission's current policy on flow-through accounting. The key order cited by  
8 Staff dates from more than 25 years ago, and I am not aware of any more recent  
9 Commission orders affirming that the Commission's policy is to use flow-through  
10 accounting. Moreover, in the 1997 order cited by Staff, the Commission  
11 approved flow-through accounting upon request by the utility and did not  
12 reference any Commission policy in favor of flow-through accounting. Given  
13 that the orders Staff cites as establishing a general policy in favor of flow-through  
14 accounting are approximately 25 years old and, as I discuss above, the  
15 Commission has more recently authorized normalized accounting both explicitly  
16 and implicitly on many occasions, the Commission does not appear to have a  
17 uniform policy on flow-through versus normalized accounting.

18 From the Company's standpoint, the Commission's policy would most  
19 accurately be characterized as one that gives the Commission discretion to adopt  
20 full normalization for a particular utility if it is in the interests of customers to do  
21 so.



1 **Q. Did the Company take any steps to facilitate the review of its proposal prior**  
2 **to filing the rate case?**

3 A. Yes. At the Company's request, the Company held a meeting in Olympia on  
4 January 12, 2010, with Staff and Public Counsel. At this meeting, the Company  
5 presented its proposal to move to full normalization and specifically solicited  
6 feedback from the parties on what types of supporting analysis and data the  
7 Company should prepare for its filing. The Company also sought feedback from  
8 Staff on the proper procedural approach to seeking a Commission decision;  
9 Commission Staff expressed a clear preference that the issue be presented in a  
10 general rate case proceeding. The Company then held follow up meetings in  
11 Seattle with Public Counsel on February 12, 2010, and in Olympia with Staff on  
12 March 2, 2010. The Company has supported its proposal with all analysis  
13 directly or indirectly requested by the parties in these pre-filing meetings. Since  
14 the filing, the Company has provided all additional supporting analysis or data  
15 requested by the parties. The Company has demonstrated that its proposal is  
16 complete and fully developed.

17 **Q. If the Commission prefers to address this issue in a proceeding separate from**  
18 **this rate case, what is your recommendation?**

19 A. In the event that the Commission finds that additional analysis and discovery  
20 should be performed to address any remaining questions Staff may have, the  
21 Company respectfully requests that the Commission direct the Company to file an  
22 accounting application with the same proposal within 30 days from the date of the  
23 order and set a six-month review period for the filing. However, this path may

1 result in a lost opportunity considering the low impact of conversion to  
2 normalization in this general rate case.

3 **Staff's Adjustment to Remove the Impact of Normalized Accounting**

4 **Q. Does Staff properly quantify the necessary adjustment to remove the impact**  
5 **of normalized accounting?**

6 A. No. For two reasons Staff's adjustment is not correct. First, Staff's adjustment  
7 includes the impact of state income taxes which are not allowed for ratemaking  
8 purposes in the state of Washington. Second, and more materially, Staff does not  
9 make an adjustment to remove deferred income tax expense and accumulated  
10 deferred income taxes for non-property-related book-tax differences not required  
11 to be normalized by the Internal Revenue Code.

12 **Q. Please explain.**

13 A. If the Commission were to adopt Staff's adjustment, the Commission would, in  
14 effect, approve normalized accounting for the Company's non-property-related  
15 book-tax differences. This is not the intent of Staff based on its response to  
16 Company data request 1.29, provided as Exhibit No.\_\_(RF-10), which states: "In  
17 this case, Staff is not proposing normalization for any book/tax differences, other  
18 than with respect to the repairs deduction."

19 Company adjustment 7.9 removes the effects of flow-through related to  
20 the Company's fixed asset related book-tax differences only. The effect of state  
21 income taxes is separately removed in adjustment 7.8. No adjustment was made  
22 by the Company with respect to non-property related temporary book-tax  
23 differences because as a matter of process the Company's unadjusted results

1 report all non-property temporary book-tax differences on a normalized basis,  
2 which is the same basis on which the Company filed its case.

3 If the Company were to have filed this general rate case on a flow-through  
4 basis, a separate adjustment would have been necessary to remove from the  
5 unadjusted results deferred income tax expense and accumulated deferred income  
6 taxes for non-property related book-tax differences, as has been done in prior  
7 cases.

8 In detail, the Company carefully quantified the impact of these three  
9 components in Exhibit No.\_\_\_\_(RF-6). The correct adjustment, using the  
10 Company's filed pre-tax cost of capital, increases revenue requirement by  
11 \$25,891.

12 **Staff's Adjustment to Annualize the Rate Base Reduction for the Repairs Deduction**

13 **Q. Do you agree with Staff's testimony that under flow-through accounting the**  
14 **Internal Revenue Code (IRC) Section 481(a) adjustment for the repairs**  
15 **deduction and the 2008 repairs deduction are "in-period" for the 2009 test**  
16 **year?**

17 A. No. Although no party is proposing flow-through accounting for the repairs  
18 deduction, it is important to point out that under flow-through accounting, the  
19 level of income taxes provided for in the Company's cost-of-service is measured  
20 as the actual tax payable for the period.<sup>16</sup> In this case, the test year is the calendar  
21 year 2009. The IRC Section 481(a) adjustment and 2008 repairs deduction

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<sup>16</sup> Robert L. Hahne and Gregory E. Aliff, Accounting for Public Utilities §17.01[2][a](6) (Matthew Bender).

1 related to the calendar year 2008, were taken in the Company's 2008 federal  
2 income tax return, and impact taxes payable for 2008.

3 **Q. How is the adjustment to the 2008 taxes payable made during 2009 for the**  
4 **IRC Section 481(a) adjustment and the 2008 repairs deduction classified for**  
5 **ratemaking purposes?**

6 A. Under flow-through accounting, the adjustment is classified as an out-of-period or  
7 restating adjustment for ratemaking purposes. Out-of-period adjustments are  
8 required when an event is recorded in one period, but applies to another period.<sup>17</sup>  
9 In this case, an adjustment was made to the Company's income taxes payable  
10 during the calendar year 2009, but these events relate to the calendar year 2008.

11 **Q. Is this treatment consistent with other tax adjustments made during the test-**  
12 **year that relate to a prior period?**

13 A. Yes. Prior period tax assessments and provision-to-return adjustments are  
14 common out-of-period adjustments for ratemaking purposes,<sup>18</sup> and this practice is  
15 consistent with the Company's historic ratemaking in Washington. The IRC  
16 Section 481(a) adjustment and the 2008 repairs deduction were part of the  
17 Company's overall 2008 provision-to-return adjustment which was booked after  
18 filing the 2008 federal income tax return in 2009.

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<sup>17</sup> Robert L. Hahne and Gregory E. Aliff, Accounting for Public Utilities §7.05 (Matthew Bender).

<sup>18</sup> Robert L. Hahne and Gregory E. Aliff, Accounting for Public Utilities §7.05 (Matthew Bender).

1 **Q. If the Company's IRC Section 481(a) adjustment and 2008 repairs deduction**  
2 **are out-of-period for the 2009 test year and can lawfully be flowed-through,**  
3 **then why did the Company file these temporary book-tax differences on a**  
4 **normalized basis?**

5 A. The simple answer is because flow-through accounting for income taxes does not  
6 generate a balanced outcome between the Company and its customers. Had the  
7 Company recorded the repairs deduction on a flow-through basis, customers  
8 would have permanently lost Washington-allocated tax benefits of \$25.3 million  
9 related to the IRC Section 481(a) adjustment and 2008 repairs deduction because  
10 the tax benefits would have been out-of-period.<sup>19</sup> Regulatory results under flow-  
11 through accounting are highly dependent on the test year and it is widely  
12 understood that this method can have punitive results on both customers and  
13 regulated utilities.

14 **Q. Is Staff's adjustment to annualize the rate base reduction for the repairs**  
15 **deduction consistent with regulatory concept of a rate base reduction for**  
16 **accumulated deferred income taxes?**

17 A. No. Accumulated deferred income tax liabilities are viewed as a source of  
18 interest-free funds supplied by the taxing authorities that the utility is free to use  
19 in support of rate base investment.<sup>20</sup> Applying this concept, a utility cannot in  
20 fact use those funds to support rate base investment prior to realizing that benefit.

21 In the Company's case, the benefit of the repairs deduction was not  
22 realized by the Company until September 2009, when the Company's 2008

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<sup>19</sup> Exhibit No.\_\_(RF-1T), page 7, lines 7-18, Exhibit No.\_\_(RF-7).

<sup>20</sup> Robert L. Hahne and Gregory E. Aliff, Accounting for Public Utilities §4.04[9] (Matthew Bender).

1 federal income tax return was filed, at which time the accumulated deferred  
2 income tax liability was established.

3 Despite the adjustment being properly recorded in 2009, Staff's proposed  
4 adjustment attempts to characterize the Company's recording of the accumulated  
5 deferred income tax liability during 2009 as a "prior year adjustment." For this to  
6 be true, the Company would have needed to realize the cash benefit from the  
7 repairs deduction on or prior to December 31, 2008, which it did not.

8 Accordingly, no restating adjustment is justified.

9 **The Company's Request for a Regulatory Asset or Liability is Reasonable**

10 **Q. Should the Commission approve a regulatory asset or regulatory liability for**  
11 **interest paid to or received from the Service for adjustments made to the**  
12 **repairs deduction in the Company's 2008 and 2009 federal income tax**  
13 **returns?**

14 A. Yes. The Company does not broadly request the recovery of tax or interest paid  
15 to the Service, but has narrowly done so with respect to the repairs deduction due  
16 to its size and the uncertainty of the ultimate outcome. The deduction is new to  
17 companies and the Service alike and some amount of adjustment is likely to occur  
18 as the details are worked out on this initial round of federal tax examinations  
19 already underway for the Company's 2008 and 2009 federal income tax returns.  
20 The Company's proposal provides balance by 1) allowing for customers to benefit  
21 from the rate base reduction, while 2) holding both customers and the Company  
22 harmless for interest paid or received as a result of adjustments made to the  
23 repairs deductions reflected in this general rate case only.

1 **Q. If the Commission does not approve the Company's request, what do you**  
2 **recommend?**

3 A. The Company then recommends that the Commission offer the same regulatory  
4 treatment it afforded Puget Sound Energy (PSE) in its most recent general rate  
5 case<sup>21</sup>. Specifically with respect to PSE's repair deduction, the Commission  
6 determined that there is a demonstrated risk of recognizing IRS-allowed  
7 accounting changes before they are audited<sup>22</sup> and directed PSE to implement an  
8 increase to the rate base reduction for accumulated deferred income taxes in a  
9 future case if the IRS approves its methodology of repair costs following an  
10 audit.<sup>23</sup> The Company's facts and circumstances with respect to the uncertainty  
11 of the amount that will be sustained upon IRS examination are identical and  
12 justify the same treatment.

13 **Q. Does this conclude your rebuttal testimony?**

14 A. Yes.

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<sup>21</sup> Dockets UE-090704 and UG-090705 (*consolidated*).

<sup>22</sup> Dockets UE-090704 and UG-090705 (*consolidated*), Page 70, ¶195.

<sup>23</sup> Dockets UE-090704 and UG-090705 (*consolidated*), Page 70, ¶197.