Exhibit No.___(RF-8T)
REVISED 12/10/10
Docket No. UE-100749
Witness: Ryan Fuller

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,	)	
	)	Docket No. UE-100749
Complainant,	)	
vs.	)	
PACIFICORP dba Pacific Power	)	
Respondent.	)	

PACIFICORP

REVISED REBUTTAL TESTIMONY OF RYAN FULLER

November 2010

REVISED 12/10/10

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

A. Yes.

Purpose and Summary of Testimony

Q. What is the purpose of your rebuttal testimony?

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

- I explain why the reasons given by Staff do not provide a basis for the Commission to reject the Company's proposal to fully normalize income taxes.[1]
- I correct Staff's proposed flow-through adjustment by properly removing the impact of: 1) state income taxes; and 2) normalized non-property related temporary book-tax differences. On a corrected basis, the adjustment increases the Company's revenue requirement by $~~25,891~~5,967.[2]
- I explain that Staff's proposed restating adjustment to annualize the rate base reduction for the accumulated deferred income taxes generated by the repairs deduction is not consistent with the regulatory concept of a rate base reduction for accumulated deferred income taxes, and

[1] 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.
[2] This amount is inclusive of Staff's proposed adjustment.

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

The Company's Proposal for Income Tax Normalization

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

A. Staff provides three reasons.[3] First Staff contends that the Company did not fully address the transition to full normalization. Second, Staff contends that the Company did not provide evidence to determine the overall customer impact of its proposal. Third, Staff contends that normalizing income taxes is a "global policy issue," and that the Company's proposal cannot be adopted in a non-generic docket such as this.

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

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

- The Company proposes to implement the change beginning January 1, 2011.[5]
- The Company proposes to implement the change prospectively.

[3] Exhibit No.__(KHB-1T), Page 22, Lines 8-21, Page 23, Lines 1-3.
[4] Robert L. Hahne and Gregory E. Aliff, Accounting for Public Utilities §17.01[5] (Matthew Bender).
[5] 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.

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

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

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

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

[6] 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.

[7] Exhibit No.___(RF-1T), Page 10, Lines 14-22, Page 11, Lines 1-2.

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

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

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

A. Yes, the financial impact is identified in my direct testimony and is supplemented by the detailed computation provided in Exhibit No.___(RF-6). Revenue requirement for the 2009 test year is reduced by $~~25,891~~5,967 under the Company's proposal as compared to flow-through accounting.[9] And, as proposed by the Company, the flow-through effects from past periods is intended to have no net effect on customers as compared to the continuation of flow-through accounting.

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

[9] Exhibit No.___(RF-1T), Page 6, Lines 7-11, Exhibit No.___(RF-6).

Q. Is the Company's proposal a "global policy issue" that must be adopted for all companies regulated under the Commission's jurisdiction?

A. No. It is within the Commission's discretion to specifically approve the Company's proposal without making a policy decision that applies to all regulated utilities under the jurisdiction of the Commission. In fact, based on Staff's testimony and data request responses, the Commission already approves normalization to varying degrees for each regulated utility. For example, in its testimony Staff identifies three dockets in which normalized accounting for income taxes is approved.[10] Later in Staff's testimony it states that "the Commission has approved normalization for many single issues."[11]

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

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[10] Exhibit No.__(KHB-1T), Page 8, Lines 6-14.
[11] Exhibit No.__(KHB-1T), Page 24, Line 21.

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

A. No. Flow-through accounting is not consistent with general ratemaking principles, primarily because it does not match costs to the customers using the service. Accordingly, proponents of flow-through accounting are generally limited to using the argument of phantom taxes[12] to advocate their position (otherwise known as "continual tax deferral" or "permanent tax savings"). In fact, this is the single position in favor of flow-through accounting identified by Ms. Breda in her testimony, notwithstanding the fact that the phantom tax argument has been rejected for being an erroneous and misleading argument by both the Federal Energy Regulatory Commission (FERC) and the National Regulatory Research Institute (NRRI). [13]

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

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

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

Furthermore, the Company already uses normalized accounting for more than 99 percent of its deferred income taxes,[14] leaving less than 1 percent of the Company’s temporary book-tax differences accounted for on a flow-through basis in the state of Washington.[15] Requiring flow-through accounting for this proportionately small amount of remaining book-tax differences serves no practical purpose, particularly considering that flow-through accounting is not consistent with generally accepted ratemaking principles in Washington.

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

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

[14] This is primarily the result of the normalization requirement of the IRC.
[15] Exhibit No.___(RF-6), Page 3 of 6.

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

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

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

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

A. In the event that the Commission finds that additional analysis and discovery should be performed to address any remaining questions Staff may have, the Company respectfully requests that the Commission direct the Company to file an accounting application with the same proposal within 30 days from the date of the order and set a six-month review period for the filing. However, this path may result in a lost opportunity considering the low impact of conversion to normalization in this general rate case.

Staff's Adjustment to Remove the Impact of Normalized Accounting

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

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

Q. Please explain.

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

Company adjustment 7.9 removes the effects of flow-through related to the Company's fixed asset related book-tax differences only. The effect of state income taxes is separately removed in adjustment 7.8. No adjustment was made by the Company with respect to non-property related temporary book-tax differences because as a matter of process the Company's unadjusted results report all non-property temporary book-tax differences on a normalized basis, which is the same basis on which the Company filed its case.

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

In detail, the Company carefully quantified the impact of these three components in Exhibit No.___(RF-6). The correct adjustment, using the Company's filed pre-tax cost of capital, increases revenue requirement by $~~25,891~~5,967.

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

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

A. No. Although no party is proposing flow-through accounting for the repairs deduction, it is important to point out that under flow-through accounting, the level of income taxes provided for in the Company's cost-of-service is measured as the actual tax payable for the period.[16] In this case, the test year is the calendar year 2009. The IRC Section 481(a) adjustment and 2008 repairs deduction related to the calendar year 2008, were taken in the Company's 2008 federal income tax return, and impact taxes payable for 2008.

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

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

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

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

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[16] Robert L. Hahne and Gregory E. Aliff, Accounting for Public Utilities §17.01[2][a](6) (Matthew Bender).
[17] Robert L. Hahne and Gregory E. Aliff, Accounting for Public Utilities §7.05 (Matthew Bender).
[18] Robert L. Hahne and Gregory E. Aliff, Accounting for Public Utilities §7.05 (Matthew Bender).

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

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

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

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

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

[19] Exhibit No.___(RF-1T), page 7, lines 7-18, Exhibit No.___(RF-7).
[20] Robert L. Hahne and Gregory E. Aliff, Accounting for Public Utilities §4.04[9] (Matthew Bender).

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

Despite the adjustment being properly recorded in 2009, Staff's proposed adjustment attempts to characterize the Company's recording of the accumulated deferred income tax liability during 2009 as a "prior year adjustment." For this to be true, the Company would have needed to realize the cash benefit from the repairs deduction on or prior to December 31, 2008, which it did not. Accordingly, no restating adjustment is justified.

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

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

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

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

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

Q. Does this conclude your rebuttal testimony?

A. Yes.

[21] Dockets UE-090704 and UG-090705 (*consolidated).*
[22] Dockets UE-090704 and UG-090705 *(consolidated),* Page 70, ¶195.
[23] Dockets UE-090704 and UG-090705 *(consolidated)*, Page 70, ¶197.