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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of the Utah Office of Consumer Services for a Deferred Accounting Order Directing Rocky Mountain Power to Defer all Bonus Depreciation Allowed for 2010 through 2011 by the Small Business Jobs Act as amended	Docket No. 11-035-47 **ROCKY MOUNTAIN POWER'S MOTION TO DISMISS AND RESPONSE OPPOSING OFFICE'S APPLICATION**

Rocky Mountain Power, a division of PacifiCorp ("Rocky Mountain Power" or the "Company"), pursuant to Utah Code Ann. § 63G-4-204 and Utah Admin. Code R746-100-1.C.3 and 4, and Rule 12(b)(6) of the Utah Rules of Civil Procedure,[1] hereby moves the Commission to dismiss the Utah Office of Consumer Services' Application for a Deferred Accounting Order for 2010–2011 Bonus Depreciation ("Application") filed on March 22, 2011. The Application

[1] *See* Utah Admin. Code R746-100-1.C (stating when "there is no provision in these rules, the Utah Rules of Civil Procedure shall govern").

fails to state a claim upon which relief may be granted because (1) the Application is an improper attempt to establish a deferred account for a retroactive change in revenue requirement to account for regulatory lag rather than for a current revenue or expense, (2) the changes in tax depreciation referenced in the Application only result in tax timing differences and have *no impact* on the Company's total periodic income tax expense or the amount of income taxes the Company will ultimately pay, and (3) the Company is already properly accounting for accumulated deferred income taxes consistent with the changes in bonus depreciation cited in the Application, and customers will receive the benefit of those changes in future rates over the life of the assets to which they apply.

I. INTRODUCTION

Through its Application, the Office of Consumer Services ("Office") seeks "a deferred accounting order . . . directing Rocky Mountain Power to defer for later ratemaking treatment, the impacts of bonus depreciation on the accumulated deferred income tax offset to rate base." Application at 9. The essential premise for the request is that the Company was and is eligible for additional tax depreciation allowed under an extension of bonus depreciation previously available under the American Recovery and Reinvestment Act of 2009 ("ARRA")[2] through the Small Business Jobs and Credit Act of 2010 ("SBJA")[3] and the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 ("TRA")[4] (the SBJA and TRA will be referred to collectively as the "Acts") for 2010-2012. *Id.* at ¶¶ 6-7. The Office asserts that the

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[2] American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (2009). The Application refers to this act as the Recovery Act.

[3] Small Business Jobs and Credit Act of 2010, Pub. L. No. 111-240, 124 Stat. 2504 (2010). The Application refers to this act as The Small Business Jobs Act of 2010. Application at 1.

[4] Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296 (2010). The Application refers to this act as The Reid-McConnell Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010.

"rate and regulatory impacts of legislation extending and/or retroactively applying bonus depreciation to plant additions already in service or forecast through 2012 are unforeseeable, and extraordinary." *Id.* ¶ 9.

The Office is actually asking the Commission to establish a deferred account for the difference in revenue requirement in three prior cases that would have occurred had the Acts been in effect when the revenue requirement in those cases was determined. This is clearly not a request for deferred accounting, which applies to revenues or expenses; it is a request for retroactive ratemaking. The rule against retroactive ratemaking prohibits the relief the Office seeks and the exceptions to the rule do not apply in this circumstance. The Office is not entitled to seek a retroactive adjustment in rates to capture the effect of regulatory lag on decreases in rate base any more than the Company would be authorized to seek a retroactive adjustment in rates to capture the effect of regulatory lag on increases in rate base between rate cases.

Accordingly, the Company requests that the Application be dismissed or denied because the relief the Office seeks is not an appropriate use of deferred accounting and is inappropriate retroactive ratemaking. Furthermore, to the extent the Office seeks appropriate relief—deferred accounting for the impact of the Acts—it has already taken place.[5]

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[5] PacifiCorp's December 31, 2010 Form 10-K filed with the Securities and Exchange Commission states the following on page 34, "In September 2010, the President signed the Small Business Jobs Act into law, extending retroactively to January 1, 2010 the 50% bonus depreciation for qualifying property purchased and placed in service in 2010. In December 2010, the President signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 into law, which provided for 100% bonus depreciation for qualifying property purchased and placed in service after September 8, 2010. As a result of the new laws, PacifiCorp's December 31, 2010 tax provision reflected bonus depreciation on qualifying assets placed in service during 2010. Accordingly, PacifiCorp's receivable for income taxes increased to $345 million as of December 31, 2010."

II. STATEMENT OF FACTS

A. Accounting for Tax Depreciation, Including Bonus Depreciation

Bonus depreciation is a depreciation allowance for income tax purposes that is in addition to the normally provided accelerated rates of tax depreciation. In the case of the ARRA and the Acts, the purpose was to reduce income taxes currently due, thus increasing cash available for investments to stimulate economic recovery. Tax depreciation rates are not used as the depreciation rates applied to utility assets for the purpose of determining book depreciation expense or accumulated depreciation for utility plant in a general rate case ("GRC"). Those depreciation rates are determined by the Commission based on depreciation studies and are generally designed to depreciate the cost of an asset over its useful life. However, the difference between tax depreciation, including bonus depreciation, and book depreciation is not ignored in ratemaking.

The difference between book and tax depreciation is a temporary book-tax timing difference. Tax depreciation is more rapid than book depreciation because of differences in depreciation methods and depreciable lives. Over the life of the asset, however, the same amount of depreciation expense will be recorded for both book and tax purposes.

The temporary book-tax timing difference for depreciation has *no impact* on the Company's total periodic income tax expense or the amount of income taxes the company will ultimately pay. The difference only impacts the balance sheet classification of the periodic income tax expense as either currently due or as deferred. The deferred portion gives rise to an accumulating liability for income taxes that would otherwise be currently due if book depreciation were used for income tax purposes. This liability, known as an accumulated deferred income tax liability is recorded in Account 282 and applied as a reduction to the Company's rate base.

As compared to years when it is not enacted, bonus depreciation simply has the effect of deferring a larger portion of the same periodic income tax expense, and therefore, a larger accumulated deferred income tax liability is recorded. In any circumstance, as is implied by the name of the account, deferred accounting is already being employed for the related cost—income taxes.

The issue raised by the Application then is not one of deferred accounting for an unexpected item of revenue or expense recorded on the Company's books. For the reasons just explained, the Acts had no impact on Company's periodic income tax expense and certainly did not give rise to any revenue. The issue raised by the Application is whether the revenue requirement from past rate proceedings should be recalculated under different assumptions and the revenue requirement variance deferred; a clear-cut case of retroactive ratemaking.

B. 2009 General Rate Case

The Company's base rates on and after February 18, 2010 were determined in Docket No. 09-035-23 ("2009 GRC") filed by the Company on April 16, 2009. The rates were set in the Commission's Report and Order on Revenue Requirement, Cost of Service and Spread of Rates issued February 18, 2010. Thus, the Application purports to seek deferred accounting with regard to rates set in an order issued 13 months prior to the Application's filing. Application ¶ 14.a. As noted above, what the Application actually seeks is retroactive ratemaking.

The revenue requirement in the 2009 GRC was determined based on a test period commencing July 1, 2009 and ending June 30, 2010. When the Company filed its application in the 2009 GRC, it estimated accumulated deferred income taxes associated with assets placed in service during the last half of 2009 based on bonus depreciation of 50 percent because bonus depreciation was already in effect through that period under the ARRA. However, because the ARRA did not extend that bonus depreciation into 2010, accumulated deferred income taxes

associated with assets scheduled to be placed into service during the first half of 2010 were based on normal accelerated tax depreciation. Had the Company and the parties applied bonus depreciation to assets scheduled to be placed into service during the first half of 2010, the Company has estimated that the revenue requirement in the 2009 GRC as filed would have been approximately $1 million less.[6]

C. Major Plant Addition Cases

1. MPA I

The Company filed an application for cost recovery for the Ben Lomond to Terminal transmission line and the Dave Johnston Generation Unit 3 emissions control measure major plant additions under Utah Code Ann. § 54-7-13.4 in Docket No. 10-035-13 ("MPA I") on February 1, 2010. The case was partially resolved by a Report and Order issued June 15, 2010, approving a stipulation between the parties, including the Office. The order provided that the Company would receive an agreed rate increase of $30.8 million, but that the increase would be deferred. The order allowed the Company to defer $2.6 million per month with a monthly carrying charge of 0.695 percent for future ratemaking treatment. The Commission approved a rate increase for the principal and amortization of the deferred balance, fully resolving the issues in the docket, in an Order Approving Settlement Stipulation ("Order") issued December 21, 2010 in MPA I and Docket Nos. 10-035-14 and 10-035-89.

The accumulated deferred income taxes included in the revenue requirement determined in MPA I were based on normal accelerated tax depreciation because the SBJA was not enacted at that time. Had 50 percent bonus depreciation been used instead of normal accelerated tax

[6] This estimate is provided simply to indicate that the Office's suggestions in the Application that the rate impact of the reduction to rate base resulting from the Acts is significant, *id.* at ¶¶ 8-9, 12, is incorrect. However, the Application is defective as a matter of law, so establishing the rate impact of the Acts is not necessary to the Company's motion.

depreciation in computing the revenue requirement associated with the major plant additions in MPA I, the Company estimates the revenue requirement as filed would have been reduced by approximately $3 million.[7]

2. MPA II

The Company filed an application for cost recovery for the Populus to Ben Lomond transmission line and the Dunlap I wind project major plant additions under Utah Code Ann. § 54-7-13.4 in Docket No. 10-035-89 ("MPA II") on August 3, 2010. This case was resolved by the Order. The Order approved a revenue requirement increase of $33.29 million for the major plant additions in MPA II, rates to recover the previously-approved revenue requirement increase of $30.8 million for the major plant additions in MPA I, a rate increase to amortize the deferred balance in MPA I and a rate decrease to conditionally amortize the deferred balance of incremental renewable energy credit ("REC") revenues resulting from an accounting order in Docket No. 10-035-14.

The accumulated deferred income taxes included in determining the revenue requirement in MPA II were based on 50 percent bonus depreciation as provided by the SBJA. The Office assumes in the Application that 100 percent bonus depreciation should have been applied because of the TRA. Application at ¶ 7. However, the Internal Revenue Service ("IRS") issued clarification of the TRA in Revenue Procedure 2011-26 on March 29, 2011 ("IRS Guidance"), under which the 100 percent bonus depreciation provided by the TRA does not apply to the Populus to Ben Lomond transmission line and the Dunlap I wind project because they were more than ten percent completed before September 9, 2010.

[7] *See* footnote 5. The revenue requirement in this case was determined by stipulation. Therefore, the precise impact of the SBJA on the revenue requirement cannot be determined other than on an as filed basis.

Therefore, the correct bonus depreciation was used in computing accumulated deferred income taxes in determining the revenue requirement in MPA II—there is no incremental revenue requirement impact from the TRA. This fact materially affects the impact of bonus depreciation implied by the Office in its Application.

D. The Acts

The SBJA was signed on September 27, 2010. It allowed 50 percent bonus depreciation on certain assets, which was already in place for 2009 under the ARRA, through 2010. The TRA was signed on December 17, 2010, and extended 50 percent bonus depreciation through December 2012. Further, the TRA provided bonus depreciation of 100 percent for qualifying investments placed in service after September 8, 2010 through December 31, 2011. As noted above, under the IRS Guidance, the 100 percent bonus depreciation provided by the TRA does not apply to the assets that were the subject of MPA II.

E. 2011 General Rate Case

The Company filed its application for a rate increase in Docket No. 10-035-124 ("2011 GRC") on January 24, 2011. The Commission recently determined that the test period to be used in the case is July 1, 2011 to June 30, 2012 as proposed by the Company. The Company has computed its revenue requirement for the test period based on accumulated deferred income taxes for assets that went into service in 2010 and during the test period using the bonus depreciation provided by the Acts. In fact, in light of the IRS Guidance, the Company has overstated accumulated deferred income taxes during the test period because it applied 100 percent bonus depreciation provided by the TRA to all projects placed into service after September 8, 2010 through December 31, 2011. Based on the IRS Guidance, most of the assets placed in service during this time period do not qualify for 100 percent bonus depreciation. As a

result, the Company is updating its estimate of accumulated deferred income taxes and will provide the update as soon as it is available for proper reflection in the pending GRC.

F. Company Earnings

The Commission is well aware that the Company has not come close to earning the rate of return on equity ("ROE") authorized by the Commission for many years. The Commission set rates in the 2009 GRC based on an authorized ROE of 10.60 percent. During 2010, the Company earned an 8.57 percent ROE.[8] Thus, even including any amount by which rates were higher in the 2009 GRC and MPA I as a result of failure to foresee the extension of bonus depreciation in the Acts, the Company has under-earned during the period in question.

G. Amortization of Deferred Accounts

As stated previously, the Office's Application is simply a request to capture the revenue requirement impact of regulatory lag between rate cases. However, in the past even when deferred accounting has been properly applied and ordered by the Commission, the Commission has required the Company to begin amortization of the deferred items prior to inclusion and ratemaking treatment in a future GRC, and therefore subjected the Company to the impact of regulatory lag from the item. For example, in addressing deferred accounting for the closure costs of the Trail Mountain Mine, the Commission stated:

> 1. The Application, as amended, is approved, and PacifiCorp is authorized to defer the costs associated with the closure of the Trail Mountain Mine. The costs will be amortized over a five-year period beginning April 1, 2001.
>
> 2. The approval of the Application does not determine the rate-making treatment for the costs. Any determination of the prudence, calculation, and method of recovery will be made in a subsequent case.[9]

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[8] This is the Type 1 Normalized Earned ROE from the Company's December 31, 2010 Results of Operations.

[9] Report and Order, Docket No. 01-035-02 (Apr. 4, 2002) at 5.

In accordance with this order, the amortization was begun on April 1, 2001. The costs were then included in the next GRC, Docket No. 03-2035-02, with rates effective on April 1, 2004.

III. ARGUMENT

The Office argues that deferring the impacts of past tax depreciation for future ratemaking is necessary to ensure just and reasonable rates. *Id.* ¶ 14. The Office also argues that the Application should be granted because the Acts were "unforeseeable and extraordinary" and their impacts satisfy one of the exceptions to the rule against retroactive ratemaking recognized in Utah. Application ¶¶ 9, 12-13. Noticeably absent from the Office's argument is discussion of the additional factors identified by the Commission for consideration in deciding whether to grant deferred accounting.[10] The Application also fails to explain why: (1) it would be appropriate to establish a deferred account for a retroactive change in revenue requirement to account for regulatory lag where there is no change in any current revenue or expense; (2) retroactive ratemaking is appropriate where (a) the changes in tax depreciation referenced in the Application only result in tax timing differences and do not affect the total amount of tax expense the Company will ultimately pay or have an impact on the Company's total periodic income tax expense and (b) the exceptions to the rule against retroactive ratemaking do not apply based on the allegations in the Application and facts of which the Commission may take notice; and (3) any relief is necessary where the Company is already properly accounting for accumulated deferred income taxes consistent with the changes in bonus depreciation cited in the Application, and customers will receive the benefit of those changes in future rates over the life of the assets to which they apply. Therefore, the Application should be dismissed or denied.

[10] *See* Report and Order, Docket No. 06-035-163 (Jan. 3, 2008) ("*Deferred Accounting Order*").

A. Standard for Motion to Dismiss

In considering a motion to dismiss under Rule 12(b)(6), the Commission should accept the factual allegations in the Application as true and consider all reasonable inferences to be drawn from those facts in a light most favorable to the Office's claims.[11] The Commission should also review documents referenced in the Application and take notice of facts of record that have bearing on the claim.[12] Under the Rule 12(b)(6) standard, the Commission may also "look for plausibility in [the Application]."[13] More specifically, the Commission may "look to the specific allegations in the [Application] to determine whether they plausibly support a legal claim for relief."[14] Thus, in determining whether to dismiss the Application, the Commission is not required to accept allegations that are implausible or speculative or obviously inaccurate based on facts of which the Commission may take notice.

B. Standards for Deferred Accounting

The purpose of deferred accounting—the establishment of a regulatory asset or liability—is to defer recognition of expenses or revenues in a current period for possible ratemaking treatment in a subsequent period. It is apparent that this purpose is not applicable to the Application based on the foregoing statement of facts. A decision to grant deferred

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[11] *Barker v. Qwest Corp.*, Docket No. 02-049-46, 2002 Utah P.U.C. LEXIS 148, *3-*4 (Oct. 4, 2002). *See also In re McMillian*, Docket No. 09-019-01, 2011 Utah P.U.C. LEXIS 84, *2 & n.1 (Feb. 28, 2011) (quoting *Ho v. Jim's Enters.*, 2001 UT 63, ¶ 6, 29 P.3d 633); *Prows v. State*, 822 P.2d 764, 766 (Utah 1991) ("appears that the [petitioner] . . . would not be entitled to relief under the facts alleged or under any state of facts [it] could prove to support [its] claim"); *Hudgens v. Prosper, Inc.*, 2010 UT 68, ¶ 14, 243 P.3d 1275.

[12] *Lee v. Gaufin*, 867 P.2d 572, 585 n.19 (Utah 1993) ("Judicial notice may be taken of facts pursuant to Rule 201(b) of the Utah Rules of Evidence when the facts are capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned.") (internal quotations and citations omitted). *See also Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007); *Grynberg v. Koch Gateway Pipeline Co.*, 390 F.3d 1276, 1278 n.1 (10th Cir. 2004).

[13] *Kay v. Bemis*, 500 F.3d 1214, 1218 (10th Cir. 2007) (quotations and citations omitted).

[14] *Id.* (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007)) (other quotations and citation omitted).

accounting is simply a decision to allow a utility to capitalize expenses that would otherwise be required to be expensed in a current period or to defer recognition of revenues that would otherwise be required to be recognized in a current period. Therefore, although the Commission is not bound to follow financial accounting rules and guidelines regarding whether it is appropriate to defer an expense or revenue, the rules and guidelines have some relevance in considering a request for deferred accounting. *See, e.g.*, *Deferred Accounting Order* at 13. On the other hand, as the Commission concluded in its *Deferred Accounting Order*, allowing deferred accounting "is an indication, if but an early tentative one, that there is a likelihood that the particular expense can be included in a future revenue requirement determination." *Deferred Accounting Order* at 16-17. The Commission stated that this conclusion meant that "ratemaking rules and principles . . . may be given greater weight than accounting rules and principles in considering whether to issue an accounting order." *Id.* at 17.[15]

1. Accounting Standards

The accounting standards applicable to deferred accounting are found in the Uniform System of Accounts ("USOA") promulgated by the Federal Energy Regulatory Commission ("FERC"), 18 CFR Part 101, Definition 31 and Account 182.3, and adopted by the Commission, Utah Admin. Code R746-310-7.A, and in Statement of Financial Accounting Standards ("FAS") No. 71 ("FAS 71").[16]

USOA allows the creation of regulatory assets and liabilities.

[15] Contrary to this guidance, the Division of Public Utilities ("Division") focused almost entirely on an incorrect understanding of the application of accounting standards in its initial opposition to the Company's motion for deferred accounting for net power costs in the ECAM Docket. *See* Opposition of Division of Public Utilities to Rocky Mountain Power's Motion for a Deferred Accounting Order, Docket No. 09-035-15 (Feb. 24, 2010). On the other hand, the Office focuses solely on selected ratemaking principles in the Application. *See* Application at ¶¶ 11-13.

[16] FAS 71 is now known as Accounting Standards Codification Topic 980 Regulated Operations.

> 31. *Regulatory Assets and Liabilities* are assets and liabilities that result from rate actions of regulatory agencies. Regulatory assets and liabilities arise from specific revenues, expenses, gains, or losses that would have been included in net income determination in one period under the general requirements of the Uniform System of Accounts but for it being probable:
>
> A. that such items will be included in a different period(s) for purposes of developing the rates the utility is authorized to charge for its utility services; or
>
> B. in the case of regulatory liabilities, that refunds to customers, not provided for in other accounts, will be required.

18 C.F.R. Part 101, Definition 31. The USOA further provides that other regulatory assets should be recorded in Account 182.3:

> 182.3 Other regulatory assets.
>
> A. This account shall include the amounts of regulatory-created assets, not includible in other accounts, resulting from the ratemaking actions of regulatory agencies. (*See* Definition No. 30 [sic].)
>
> B. The amounts included in this account are to be established by those charges which would have been included in net income, or accumulated other comprehensive income, determinations in the current period under the general requirements of the Uniform System of Accounts but for it being probable that such items will be included in a different period(s) for purposes of developing rates that the utility is authorized to charge for its utility services. . . .
>
> C. If rate recovery of all or part of an amount included in this account is disallowed, the disallowed amount shall be charged to Account 426.5, Other Deductions, or Account 435, Extraordinary Deductions, in the year of the disallowance.

18 C.F.R. Part 1, Account 182.3.

FAS 71 provides in part:

> This Statement provides guidance in preparing general purpose financial statements for most public utilities. . . .
>
> In general, the type of regulation covered by this Statement permits rates (prices) to be set at levels intended to recover the estimated costs of providing regulated services or products, including the cost of capital (interest costs and a provision for earnings on shareholders' investments).

For a number of reasons, revenues intended to cover some costs are provided either before or after the costs are incurred. If regulation provides assurance that incurred costs will be recovered in the future, this Statement requires companies to capitalize those costs. If current recovery is provided for costs that are expected to be incurred in the future, this Statement requires companies to recognize those current receipts as liabilities.

. . . .

9. Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An enterprise shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:

a. It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.

b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.

FAS 71 (footnotes omitted). A footnote on the word "probable" in the foregoing states:

The term *probable* is used in this Statement with its usual general meaning, rather than in a specific technical sense, and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved (*Webster's New World Dictionary of the American Language,* 2d college ed. [New York and Cleveland: World Publishing Company, 1972], p. 1132).

Id. Finally, FAS 71 provides, "The provisions of this Statement need not be applied to *immaterial* items." (emphasis in original.) FAS 71 does not define material.

In applying these accounting standards, the purpose of the standards must be recognized. FAS 71 applies to general-purpose external financial statements of an enterprise that has regulated operations. FAS 71 provides guidance in the proper reporting and valuation of the enterprise for the economic impacts of regulated operations. It does not preclude the issuance of

accounting orders by the Commission, but instead sets the standard for the proper valuation related to the impact of such accounting orders and reporting to external investors and financial audiences. Once a company has received an order allowing the deferral of costs under FAS 71, it must make a determination of the probability of future recovery of those costs through a future revenue stream and a determination of materiality. To the extent a company does not believe a portion of the costs are probable of recovery, it will either need to not book those costs as an asset or will need to establish a provision against the deferred regulatory asset. Likewise, if a regulatory asset is not material, a company would not need to establish it. The probability and materiality determinations referenced in FAS 71 are management tests that are carried out based on facts and circumstances that would support the fair valuation of assets and fair reporting of financial condition on the financial statements of the company.

The granting of a deferred accounting order by the Commission is separate and apart from these management determinations. Thus, the Commission need not consider whether it is probable that it will ultimately consider the amounts deferred in setting rates in the future or whether an amount is material in the financial accounting sense of the term in deciding whether to grant an accounting order. Rather, as alluded to in the *Deferred Accounting Order*, the Commission must simply consider whether there is any reasonable chance that it might allow rate recovery of the amounts deferred and whether the amount is significant enough to receive consideration in setting rates. *See Deferred Accounting Order* at 16-17.

Based on the foregoing accounting standards and principles that are applicable to a Commission decision on whether to grant deferred accounting, a regulatory asset may be created if an expense is incurred in the current period that may appropriately be included in determining rates in a future period. Likewise, a regulatory liability may be created if revenue is received in

the current period that may appropriately be included in determining rates in a future period. The critical issue for purposes of this case is that expenses or revenues are the matters deferred, not the impact of a change in tax depreciation on revenue requirement. In addition, deferral of expenses or revenues is in a current period, not many months or years after they have already been expensed or recognized in accounting statements. Otherwise, the purpose of the accounting standards would be frustrated. If deferred accounting is sought after the fact, as in this case, the ability of investors and the financial community to rely on information provided to them will be compromised. In addition, the ability of the utility and other stakeholders to make decisions regarding whether a rate case is needed will be compromised.

2. Ratemaking Standards

As a general rule, rates are set following a general rate case in which all aspects of expenses, revenues and investments are considered to determine the level of rates that is designed to produce revenue sufficient to cover the costs incurred by a public utility in providing service to its customers during the period rates will be in effect. *Utah Dept. of Business Regulation v. Public Service Comm'n*, 720 P.2d 420 (Utah 1986) ("*EBA Case*"); *Utah Dept. of Business Regulation v. Public Service Comm'n*, 614 P.2d 1242, 1248 (Utah 1980) ("*Wage Case*"). Changes in one aspect of revenues, expenses or investments normally have not been a basis for a change in rates, and rates normally have not been allowed to be adjusted with retroactive application. *EBA Case* at 420. In addition, because rates are set for a future period, unusual costs or revenues are typically normalized to assure that rates are set to recover reasonably anticipated costs and not based on extreme events. R. Hahne and G. Aliff, *Accounting for Public Utilities* (LexisNexis 2008) at § 7.05.

As with all rules, there are exceptions. In an effort to assure that rates really do provide anticipated revenue sufficient to cover prudent cost of service, regulatory commissions have

approved various types of trackers, balancing accounts or cost adjustment mechanisms over the years.[17] These are typically approved where a material cost is quite volatile or difficult to predict and is largely outside the control of the utility.[18] They may also be approved in circumstances such as when there is a pattern of increased investment in replacement facilities that is beyond the normal course of operations.[19] In addition, rates have been allowed to be adjusted based on changes in a single item of expense, revenue or investment when doing so is more administratively efficient or fair, such as when a utility is making major plant additions. *See, e.g.*, Utah Code Ann. § 54-7-13.4. Deferred accounting is allowed for situations, such as the costs associated with an extraordinary storm, that would typically not be considered in setting rates as a result of normalization.[20] Finally, exceptions have been recognized for implementation of rate changes retroactively in limited circumstances.

The rule against retroactive ratemaking prohibits refunds or surcharges for rates previously paid pursuant to final Commission orders and the setting of rates higher or lower in the future based on past under- or over-earnings. *See MCI Telecommunications Corp. v. Public Service Comm'n*, 840 P.2d 765, 770 (Utah 1992); *EBA Case*, 720 P.2d at 421. Courts have held

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[17] *See, e.g.*, Hahne at § 8.10; M. Schmidt, *Automatic Adjustment Clauses: Theory and Application*, (MSU Press, East Lansing, MI. 1980). *See also* P. Joskow and R. Schmalensee, "Incentive Regulation for Electric Utilities," *4 Yale Journal on Regulation 1* (1986) at 1-50.

[18] *See* Corrected Report and Order, Docket No. 09-035-15 (Utah PSC Mar. 3, 2011) ("*EBA Order*") at 65-66; R. Burns, M. Eifert, and P. Nagler, "Current PGA and FAC Practices: Implications for Ratemaking in Competitive Markets," (National Regulatory Research Institute, 1991).

[19] Direct Testimony of Barrie L. McKay, Docket No. 09-057-16 (Dec. 3, 2009), Exhibit QGC 1.8 (listing states allowing infrastructure rate adjustment mechanisms for natural gas utilities).

[20] *See, e.g.*, *Office of Consumer Counsel v. Department of Public Utility Control*, 905 A.2d 1, 14-15 (Conn. 2006); *Re Missouri-American Water Company*, 237 P.U.R.4th 353, 2004 WL 2579639 (Mo. PSC Nov. 10, 2004); *Bus.and Prof'l People for the Pub. Interest v. Illinois Commerce Comm'n*, 563 N.E.2d 877, 881 (Ill. App. 1990); *Deferred Accounting Order* at 17.

that applications for deferred accounting do not amount to retroactive ratemaking.[21] The Commission, however, concluded in the *Deferred Accounting Order* that "[t]he rule against retroactive ratemaking, exceptions to the rule and their underlying rationales have application in considering whether an accounting order should be issued." *Deferred Accounting Order* at 16. For this reason and because the Application actually seeks retroactive ratemaking, the Company will address retroactive ratemaking principles in this response.

In the *Deferred Accounting Order*, the Commission first noted that "utilities . . . are generally not permitted to adjust their rates retroactively to compensate for unanticipated costs or unrealized revenues. This process places both the utility and the consumers at risk that the rate-making procedures have not accurately predicted costs and revenues." *Deferred Accounting Order* at 14-15 (quoting *EBA Case*, 720 P.2d at 420). The Commission then discussed the unforeseeable and extraordinary exception to the rule against retroactive ratemaking.

> An increase or decrease in expenses that is unforeseeable at the time of a rate-making proceeding cannot, by hypothesis, be taken into account in fixing just and reasonable rates. Furthermore, because the increase or decrease must have an extraordinary effect on the utility's earnings, the increase or decrease will necessarily be outside the normal ranges of variance that occurs in projecting future expenses.

Deferred Accounting Order at 15-16 (quoting *MCI*, 840 P.2d at 771). In further explaining this exception, the Commission concluded that

> The ratemaking principle that recognizes possible exceptions for unforeseen and extraordinary events also includes exception for events which may be known or foreseeable, but whose impact upon the revenues or expenses of the utility are unforeseeable and extraordinary or whose actual manifestations vary from their projections in an unforeseeable and extraordinary way.

Deferred Accounting Order at 19.

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[21] *See, e.g.*, *Bus. and Prof'l People*, 563 N.E.2d at 881 ("Nor does the order [for deferred accounting] constitute a backdoor approach to single-issue or retroactive ratemaking.").

The Commission then discussed issues related to timing of raising issues for deferred accounting related to a GRC. Where the subject of an expense was known at the time of a prior GRC, the Commission concluded that "[f]ailure to include costs or the inclusion of costs at different levels in a past rate case appears to draw closer to . . . missteps in the ratemaking process rather than unforeseen and extraordinary occurrences." *Id.* at 20. Noting that the revenue requirement in the prior GRC was resolved by stipulation, the Commission concluded:

> [I]t is reasonable to require any party who wishes to segregate a known expense or revenue from a pending ratemaking case and from the evaluations of a compromised revenue requirement, to specifically identify those expenses or revenues which have been or are intended to be taken off the table and are not part of the compromises in the current ratemaking proceeding, but intended to be reserved for future ratemaking consideration.

Id. at 21.

In addition to the foregoing principles enunciated by the Commission in the *Deferred Accounting Order*, the exceptions to the rule against retroactive ratemaking approved in *MCI* were approved in the context of a situation in which the utility was earning in excess of its authorized ROE and where the change in tax law was a permanent change that affected the utility's tax expense, not one affecting timing differences only. *MCI*, 840 P.2d at 768, 772.

With regard to the over-earning aspect of the exceptions, the court repeatedly focused on over-earnings in its discussion of the exceptions, *see, e.g., id.* at 772-73, and the remedy ordered was for a refund of earnings "to the extent they exceeded [the utility's] authorized rate of return." *Id.* at 776. Thus, retroactive ratemaking based on increased revenues or decreased expenses or a claim that rates were otherwise set too high in the past would only be justified if the utility were over-earning.

With regard to the change in tax law, the change in *MCI* was a reduction in the income tax rate for corporations from 46 percent to 34 percent. *Id.* at 767. Thus, the amount of taxes

paid by the utility for both book and tax purposes was reduced. Here the change in tax depreciation rates only affects the timing of tax payments. The Company will still pay the same amount of taxes over the life of the assets. As already discussed above, the temporary book-tax difference for depreciation has *no impact* on the Company's total periodic income tax expense. Thus, retroactive ratemaking based on a change in tax law would only be justified if the change had an impact on the total periodic income tax expense of the utility.

Based on the foregoing, the Commission may approve a request for deferred accounting or retroactive ratemaking if an expense or revenue is unforeseen and has an extraordinary impact on earnings or if it is foreseen, but the amount of the variance from that predicted in the prior rate case is unforeseeable and has an extraordinary impact on earnings. In addition, if the request is for deferred accounting for revenue or retroactive ratemaking associated with a claim that rates were too high, the utility must be over-earning. Finally, if the request is based on a change in tax law, the change must have an impact on the total periodic income tax expense of the utility.

C. Application of Standards to the Office's Application

The Application should not be granted because the Office is requesting an inappropriate use of deferred accounting and neither of the exceptions to the general prohibition against retroactive ratemaking apply.

First, through its Application, the Office seeks deferred accounting for an item that is already deferred, accumulated deferred income taxes, and to apply the deferral to periods before the Application was filed. The Application does not seek deferred accounting for a current revenue or expense for ratemaking in a future period. This is clearly inconsistent with the accounting standard that deferred accounting is granted to allow the deferral of current revenues or expenses for ratemaking treatment in a subsequent period and the general prohibition against retroactive ratemaking. The bonus depreciation tax benefits for which the Office seeks deferred

accounting in 2010 do not impact regulatory earnings because deferred income taxes are treated as an accounting deferral and capitalized.

Second, the Office is actually seeking retroactive ratemaking. It wishes to have the Commission recalculate the revenue requirement in prior rate proceedings to include bonus depreciation that was not included in calculating accumulated deferred income taxes in those proceedings. The effect of these recalculations would be to reduce rate base in those cases, thus reducing the revenue requirement on which rates were set. Thus, the Office seeks to recapture a rate benefit lost as a result of regulatory lag. This is no different than the Company asking the Commission to go back to the prior rate case and increase rate base by the amount of all investments not qualifying for major plant addition treatment added between rate cases and not considered in the rate base in the rate case. While the Office is trying to capture the regulatory lag on certain tax benefits between cases, the Company experienced the effects of regulatory lag on other costs and investments during that same period.

In support of its claim, the Office argues that the Acts are "unforeseen and extraordinary change[s]" that merit the application of an exception to the rule against retroactive ratemaking. Application ¶ 10. The Office cites an order from Docket No. 10-035-38 in support of an argument that an unforeseen and extraordinary change in tax expense justifies deferred accounting. *Id*. The Commission's reasoning in the order the Office cites, however, is easily distinguishable to the application of the Acts here.

In the order, the Commission decided that the exception for unforeseen and extraordinary retroactive ratemaking established by *MCI* applied.[22] In *MCI*, the change in tax law actually changed the utility's tax expense permanently and allowed the utility "to collect excessive rates

[22] Order, Docket No. 10-035-38 (Sep. 13, 2010) at 7.

and earnings." *MCI*, 840 P.2d at 774. In Docket No. 10-035-38, the Company sought deferred accounting for a one-time expense that resulted from a law eliminating a deduction associated with post-retirement benefits which required the Company to write-off an amount in the current period that would never be recovered in the future. Furthermore, the Commission required the deferred asset to begin amortization October 1, 2010 and no return on rate base was authorized for any portion of the asset.

Therefore, in the case cited by the Office, the Company is incurring regulatory lag because amortization began on October 1, 2010, but recovery in rates will not begin until the conclusion of the 2011 GRC. This treatment is identical to the treatment of deferred income taxes.

Here, although the Acts have extended bonus depreciation, they have not changed the utility's tax liability and have no impact on the Company's total periodic income tax expense for financial accounting or ratemaking purposes. As the court noted in *MCI*, "[o]rdinarily, changes in tax law are not a sufficient basis for invoking the exception to the general rule," and only justify the exception if the magnitude of the change is extreme and likely to continue. *See MCI*, 840 P.2d at 772. Here, the magnitude of the change is neither extreme nor likely to continue. Furthermore, as discussed above, the Company has been under-earning for years. Thus, the exception to the general rule prohibiting retroactive ratemaking that might provide a basis for deferred accounting or retroactive ratemaking does not apply here.

The Office does not suggest that retroactive ratemaking is justified by the second exception regarding utility misconduct. To the contrary, the Office's allegation that the Acts and their impact were unforeseen and extraordinary, *see, e.g.*, Application at ¶ 9, precludes any claim

that the Company withheld relevant information from the Commission or other parties. *See MCI*, 840 P.2d at 775.

Third, the Office acknowledges in the Application that the Company is already properly accounting for the impact of the Acts. Application at ¶¶ 8, 15. Thus, the Company has already deferred the impact of bonus depreciation on accumulated deferred income taxes, and customers will realize the ongoing level of benefit of that deferral in future rates over the life of the assets to which it applies without any action by the Commission. Accordingly, the relief sought by the Office is unnecessary.

Applying the standards for deferred accounting and retroactive ratemaking it is apparent that the Office's Application must be dismissed because the Office has not stated and cannot state a claim upon which relief may be granted.

IV. CONCLUSION

The Application is defective for several reasons. First, the Application is an improper attempt to establish a deferred account for regulatory lag associated with a change in revenue requirement rather than for a current revenue or expense. Second, the changes in tax depreciation reference in the Application only result in tax timing differences and do not affect the total amount of tax expense the Company will ultimately pay and have no impact on the Company's total periodic income tax expense for financial accounting or ratemaking purposes. Third, the Company is already properly accounting for accumulated deferred income taxes consistent with the changes in bonus depreciation cited in the Application, and customers will receive the benefit of those changes in future rates over the life of the assets to which they apply.

V. RELIEF SOUGHT

Based on the foregoing, Rocky Mountain Power respectfully requests that the Commission dismiss or deny the Application.

VI. NOTICES, FILINGS, COMMUNICATIONS AND DISCOVERY

Notices, filings and communications regarding the Application should be sent to the following:

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In addition, Rocky Mountain Power requests that all data requests regarding this application be sent in Microsoft Word or plain text format to the following:

By email (preferred): datarequest@pacificorp.com

By regular mail: Data Request Response Center
PacifiCorp
825 NE Multnomah, Suite 2000
Portland, Oregon 97232

Informal questions may be directed to David L. Taylor, Utah Regulatory Affairs Manager, at (801) 220-2923.

DATED: April 21, 2011.

Respectfully submitted,

ROCKY MOUNTAIN POWER

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CERTIFICATE OF SERVICE

I hereby certify that on April 21, 2011, I caused to be emailed, a true and correct copy of the foregoing **ROCKY MOUNTAIN POWER'S MOTION TO DISMISS AND RESPONSE OPPOSING OFFICE'S APPLICATION** to the following:

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