- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

In the Matter of the Application of Rocky Mountain Power for an Accounting Order Regarding Post-Retirement Prescription Drug Coverage Tax Benefits	))))))	DOCKET NO. 10-035-38 ORDER

ISSUED: September 13, 2010

SYNOPSIS

Due to a recent tax law change reducing the tax deductibility of accrued prescription drug coverage expenses for retirees, the Commission authorizes the Company to record a regulatory asset in the amount of $6.284 million. The asset shall be amortized over a four year period beginning October 1, 2010. No return on rate base is authorized for any unamortized portion of the asset. The Company shall remove the amortization from rates in its general or single item rate case anticipated to be filed in 2014.

By the Commission:

This matter is before the Commission on the application of PacifiCorp ("Company"), a public utility doing business in Utah as Rocky Mountain Power, for an accounting order authorizing the Company to record a regulatory asset associated with an unforeseen tax law change eliminating certain tax benefits previously reflected in rates. These tax benefits will no longer be available due to recent changes in the tax deductibility of post retirement prescription drug coverage expenses imposed by the Patient Protection and Affordable Care Act ("2010 Act"), signed into law on March 23, 2010.

PROCEDURAL HISTORY

The Company filed its application on April 1, 2010, seeking authority to establish a regulatory asset in the amount of approximately $4.7 million or $6.5 million after gross up for tax effects, to be amortized over four years beginning January 1, 2011. On May 6, 2010, the Commission held a scheduling conference setting a technical conference for June 1, 2010, and an evidentiary hearing for September 1, 2010.

Following the technical conference and the close of discovery, representatives of the Division of Public Utilities ("Division") and the Office of Consumer Services ("Office") met with Company personnel to discuss settlement on July 7, 2010. The parties did not reach settlement but agreed that the Division and the Office would file comments on July 28, 2010, followed by the Company's response on August 19, 2010. On July 27, 2010, the Company distributed proposed terms of settlement, slightly lowering the amount of the proposed regulatory asset. On July 28, 2010, the Office and Division filed comments. On August 19, 2010, both the Company and the Division filed comments informing the Commission of an alternative proposal to which both agree, and separately explaining their reasons for agreement.

On September 1, 2010, the Commission convened an evidentiary hearing. The Commission examined the Company's application, the alternative proposal supported by both the Company and the Division, and the different positions and outcomes advocated by the Office.

POSITIONS OF THE PARTIES

As described in the Company's application, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 ("2003 Act") provides a federal subsidy for employers that offer post-retirement prescription drug coverage to retirees.[1] Under tax rules

[1] The drug benefit must be at least as valuable as the Medicare Part D standard drug benefit.

effective until January 1, 2013, employers are permitted to deduct the entire cost of providing the drug coverage, even though some of the cost is offset by the subsidy.

For accounting purposes the Company records its future liability to provide post-retirement prescription drug coverage as a component of its other post-employment benefit ("OPEB") obligations.[2] The Company also records a deferred income tax asset representing the future tax benefit for the Company's entire accrued, but unpaid, OPEB obligation. Historically, this asset has included the part of the obligation that will be offset by the federal subsidy because prior to the 2010 Act, tax law allowed a deduction for the entire expense, as noted above.

For ratemaking purposes the Company has included the actuarially determined level of OPEB expense in the Company's annual revenue requirement.[3] Additionally, OPEB expense has been treated as deductible for income tax purposes, including the portion that is offset by the federal subsidy.

The Company brings this application because the 2010 Act repeals the current rule for taxable years beginning after December 31, 2012. As a result, the amount of drug coverage costs equal to the subsidy will no longer be a deductible expense for income tax purposes.[4] In other words, as a result of the 2010 Act, the Company's OPEB related deferred income tax asset, applicable to years after 2012, became overstated by the amount of the federal subsidy the Company will receive in those years.

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[2] The levels of future OPEB expenses, including for post-retirement prescription drug benefits are determined actuarially.
[3] The Company maintains it does not include the OPEB liability in rate base.
[4] The subsidy itself remains non-taxable.

The Company asserts the applicable accounting standard[5] required it to adjust its OPEB related deferred income tax asset when the 2010 Act became law. Specifically, the Company quantified the adjustment as the amount of federal retiree prescription drug subsidy accrued as of March 31, 2010, but not expected to be received until after December 31, 2012. The Company incurred a one-time charge for additional deferred income tax expense associated with the amount of the future subsidy. Absent the establishment of the requested regulatory asset, the Company contends it will have no opportunity to recover this expense in future rate proceedings.

The Company characterizes this situation as an unforeseen and extraordinary change in tax expense that merits the accounting order it requests. According to the Company the change is outside the Company's control and could not have been foreseen during any prior rate case. The tax law change is extraordinary both because of the amount of the increase in tax expense it generates and because of the infrequent nature of such changes.

In its application, the Company quantifies the post-2012 accrued drug coverage expense that is now non-deductible to be approximately $30 million, system-wide. The concomitant increase in income tax expense is about $11.4 million. When amortized and grossed up for tax effects, the system-wide revenue requirement impact is about $18.5 million, of which approximately $6.5 million would be allocated to Utah using the system overhead allocation factor.

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[5] Financial Accounting Standards Board Accounting Standards Codification Topic 740, *Income Taxes*, (formerly known as FASB Statement No. 109).

The Division asserts an event justifying deferred accounting treatment of the type the Company requests must be unforeseen, specific, unusual, and material. The Division opines the tax law change addressed in this order satisfies these criteria; it therefore recommends the Commission grant the request to establish an accounting order.

Notwithstanding this support for the requested relief, the Division disagrees with the Company's calculation of the amount of the regulatory asset. The Division's initial calculation placed the asset at about \$4.7 million (including the tax gross up), a \$1.8 million reduction to the amount the Company initially proposed.[6] In attempting to reconcile these differences in calculation methodology, the Company developed an alternative proposal which it and the Division now recommend as a reasonable calculation of the increased income tax expense. They assert adoption of the alternative proposal is in the public interest.

Under the alternative proposal, the Company would record a regulatory asset of \$6.284 million. This asset would be amortized over four years beginning October 1, 2010, three months prior to the starting date the Company requested in its application. Recovery of the asset would occur through including the amortization in future rate cases for the period the amortization is in effect. The Company would remove the amortization from rates in the Company's general or single item rate case anticipated to be filed in 2014. The Company would forego recovery of any unamortized balance as of September 30, 2014.

The Office does not specifically oppose the request for an accounting order, although it asserts the Commission would be justified in declining to authorize one. The Office also questions the amount of the regulatory asset as presented in both the Company's initial and

[6] The difference relates to the Division's capitalization of a portion of the OPEB accruals.

alternative proposals. The Office seeks to limit the quantification of the regulatory asset by the amount it concludes ratepayers have benefited historically from the tax deductibility of the subsidy. Applying this concept, the Office suggests there are options for determining the appropriate amount of the asset. The Office presents two such methods which would produce regulatory assets of $3,826,431 and $1,754,510, respectively. As discussed more fully below, in its attempt to incorporate in its analysis historical ratepayer benefits, the Office would retroactively change the past ratemaking treatment of a related but separate tax law provision that was not affected by the 2010 Act.

DISCUSSION, FINDINGS AND CONCLUSIONS

Ratemaking generally involves fixing prospective rates based on extensive examination of historical cost and revenue levels, and projections of future levels. In light of this evidence, rates are set at levels deemed adequate to cover expected utility costs and to provide shareholders a reasonable opportunity to earn a fair return on equity. In this case, the Company and Division ask the Commission to depart from this pattern and to issue an accounting order to address the exceptional circumstance of the change in tax law described above. The Commission has discussed in previous proceedings guidelines for implementing an accounting order to capture a change in utility expense for subsequent amortization in rates. *See Report and Order in Docket Nos. 06-035-163, 07-035-04, 07-035-14, issued, January 3, 2008, pp. 15-17*. Such an order can be justified when unforeseeable and extraordinary changes in expenses occur.

On the basis of the foregoing facts, we find the tax law change enacted by the 2010 Act warrants an accounting order in the amount identified in the Company's alternative proposal. The information provided to the Commission supports the position of the Company and Division: the 2010 Act created an unforeseen and extraordinary change in tax expense justifying an accounting order for deferred recovery of the increased expense. The Commission adopts as just and reasonable the Company's alternative proposal as summarized herein and presented in the Company's terms of settlement dated July 27, 2010, and the August 19, 2010 filings of the Company and the Division.

The Commission commends the Office for its contributions in analyzing and evaluating the Company's proposals. While not directly opposing an accounting order, the Office asserts the level of the regulatory asset should be limited to the amount by which ratepayers have historically benefited from the expiring tax advantages. In applying this principle the Office mixes two related, but distinct income tax attributes. The first of these is addressed above: the appropriate level of the deferred tax asset associated with expense accrued for future post-retirement prescription drug benefits. This tax attribute is at issue because the 2010 Act renders non-deductible the level of expense equal to the federal subsidy.

The second attribute is the income tax treatment of the federal subsidy itself. While the Company's books reflect an income accrual for the subsidy, it is not subject to income tax. This tax attribute has been in place since the 2003 Act. Importantly, it is not changed or affected by the 2010 Act. Hence there is no unforeseen or extraordinary event justifying examination of this income source now. Furthermore, although the Office presents data suggesting the tax benefits of this income source were not properly reflected in rates until August 2008, the Commission may not adjust future rates based on that alleged omission, as it pertains to historical rate periods and levels. In contrast, the Company's application addresses the impact of a current tax law change which generates an unforeseen and extraordinary one-time charge for additional deferred income tax expense.

ORDER

Based upon the above-described findings and conclusions, we issue an accounting order authorizing PacifiCorp to record a regulatory asset in the amount of $6.284 million. The asset shall be amortized over a four year period beginning October 1, 2010 and ending September 30, 2014. No return on rate base is authorized for any unamortized portion of the asset. PacifiCorp shall remove the amortization from rates in the Company's general or single item rate case anticipated to be filed in 2014, effective October 1, 2014.

Agency Review and Judicial Appeal

Pursuant to Utah Code 63-46b-12 and 54-7-15, agency review or rehearing of this order may be obtained by filing a request for review or rehearing with the Commission within 30 days after the issuance of the order. Responses to a request for agency review or rehearing must be filed within 15 days of the filing of the request for review or rehearing. If the Commission fails to grant a request for review or rehearing within 20 days after the filing of a request for review or rehearing, it is deemed denied. Judicial review of the Commission's final agency action may be obtained by filing a Petition for Review with the Utah Supreme Court within 30 days after final agency action. Any Petition for Review must comply with the requirements of Utah Code 63-46b-14, 63-46b-16 and the Utah Rules of Appellate Procedure.

DATED at Salt Lake City, Utah, this 13th day of September, 2010.

/s/ Ted Boyer, Chairman

/s/ Ric Campbell, Commissioner

/s/ Ron Allen, Commissioner

Attest:

/s/ Julie Orchard
Commission Secretary
G#68523