

Decision 88 04 038 APR 27 1988**ORIGINAL**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA
Mailed

Investigation on the Commission's)
 own motion for purposes of)
 adopting an order requiring)
 utilities to use a method of)
 calculating federal income)
 taxes for public utility)
 properties by imputing into)
 rates certain savings associated)
 with investment tax credit)
 ("interest synchronization").)

APR 27 1988

I.86-10-002
(Filed October 1, 1986)OPINIONBackground

On May 22, 1986, the Internal Revenue Service (IRS) issued final regulations relating to a limitation on the Investment Tax Credit (ITC) as used by certain regulated companies, including public utilities. (26 CFR Part 1, Fed. Reg. Vol. 51, No. 99, May 22, 1986, p. 18775 ff.) The regulation states that the utilization of "interest synchronization by a regulatory agency" for ratemaking purposes is consistent with the normalization requirements for ITC under Internal Revenue Code (IRC) § 46(f)(2). Under this ratemaking methodology a theoretical interest expense would be imputed in determining income tax expenses for ratemaking purposes for that portion of the ratebase which was financed through deferred investment tax credit. It assumes that the portion of a utility's ratebase financed through ITC was financed with a combination of debt and equity in the same ratios and with the same embedded debt cost as the remainder of the plant and such debt costs are used as a deduction in computing ratemaking income tax expense. The use of this ratemaking principle by the Commission would enable ratepapers to share more fully in the benefits utilities derive from ITC.

On October 1, 1986, this Commission instituted this investigation for the purposes of adopting an order requiring all utilities under the Commission's jurisdiction who treat ITC for ratemaking purposes under IRC § 46(f)(2) to adopt internal procedures utilizing interest synchronization in determining their revenue requirement for ratemaking purposes. The Order Instituting Investigation (OII) further required each affected utility to provide an original and two copies of the following within 20 days:

- a. The estimated adjustment to its revenue requirements which results from the use of interest synchronization for ratemaking purposes.
- b. A proposed advice letter to reflect the revenue requirement adjustment amount as either: a credit to its balancing account (gas and/or electric and large water utilities), or a change in its billing surcharge or surcredit percentage (telecommunications utilities).
- c. A proposed plan to establish a deferred account that recognizes the change in revenue requirement if no balancing account or billing surcharge is now in effect.

Each respondent utility was invited to provide comments on this OII and based on the filings and comments, the Commission indicated that it plans to issue a final decision in this OII. The adjustments used by each utility will be reviewed and modified by the Commission as necessary in each utility's next general rate case or attrition offset filing. No hearings were contemplated by the Order, unless a utility requests and sets forth adequate justifications for formal hearings. The filings received from respondents were placed in the formal files pursuant to an Administrative Law Judge's ruling dated March 4, 1988.

Responses by Respondents

Of the 31 respondents named in the OII, 20 companies listed in Appendix A had elected to use IRC § 46 (f)(1) for treatment of ITC rather than § 46 (f)(2) and therefore are not subject to the provisions of this OII.

Sierra Pacific Power Company (SPPC) and Southwest Gas Corporation (SWG) indicate in their responses that no further action was required in this proceeding since interest synchronization had been incorporated into their last general rate cases by Decision (D.) 86-02-030 and D.85-12-103, respectively. Similarly, Citizens Utilities Company of California (Citizens) commented that it had adopted the staff's calculation of interest expense which was based on an interest synchronization methodology in its last general rate case proceeding and adopted by the Commission in D.83-10-092; therefore, no further adjustment to Citizens' revenues was required. AT&T Communications (AT&T-C) commented that interest synchronization was proposed by the Division of Ratepayers Advocates (DRA) in its 1986 test year rate proceeding and that interest synchronization effects can most efficiently be incorporated into the rate order in Application (A.) 85-11-029. AT&T-C therefore requests a waiver of Ordering Paragraph 2(c) of the OII.

San Diego Gas & Electric Company (SDG&E), Southern California Edison Company (SCE), and Southern California Gas Company (SCG) proposed that the effects of interest synchronization on 1987 revenue requirements be implemented in their attrition rate adjustment filings thereby eliminating the need to file separate advice letters in this OII.

Pacific Bell in its comments noted that it has raised certain issues in the Phase 2 hearings in A.85-01-034 regarding proper calculation of an interest synchronization adjustment, if ordered, which were still unresolved at the time of the filing of comments. These issues related to plant utilization, remand and

modernization penalty issues. Pacific Bell stated that the first two issues were heard and briefed, but that the third issue will not be addressed until later in the proceeding which is scheduled to conclude in late 1987. Pacific Bell filed copies of its Opening and Reply Briefs and certain follow-up materials in A.85-01-034 to the Commission Advisory and Compliance Division (CACD) as its comments on interest synchronization. Pacific also filed a Motion to Dismiss itself from further participation in this OII since the issue of interest synchronization was heard and stands submitted in A.85-01-034 and further participation in this OII was unnecessary and duplicative of prior efforts.

General Telephone Company in its filing objected to any final decision in this proceeding which would require it to reduce its billing surcharge to reflect the impact of applying interest synchronization. General argues that: (a) such action is unjust, unreasonable, inconsistent with prior Commission decisions, and constitutes a confiscation of General's property without due process of law in violation of both the Constitutions of the United States and the State of California; (b) if the Commission intends to require a reduction in General's billing surcharge in this OII to reflect the application of interest synchronization, the Commission should also consider the expense increases General has experienced, but which have not been taken into consideration in developing General's revenue requirements; and (c) General opposes the application of interest synchronization because it is not based on sound rate-making principles. General contends that in order to avoid serious constitutional concerns, any consideration of interest synchronization with respect to General should take place in connection with the company's 1988 test year rate case. Furthermore, similar to Pacific Bell, General contends that any proposed reduction must be adjusted to exclude from the new interest calculation the ITC that appears on the company's books,

but which was lost as a result of General's settlement of the litigation commonly referred to as the Tax Remand Case.

Continental Telephone Company of California (Continental) in its response estimates the revenue requirement adjustment resulting from the adoption of interest synchronization as \$222,000 for the twelve months ended December 31, 1987. Rather than reflecting a reduction in its billing surcharge from 5.00% to 4.52%, Continental requests that it be authorized the use of a balancing account to track the effect of the interest synchronization rate-making adjustment. Continental makes this proposal because it appears likely that several offsetting, and somewhat interrelated, changes in Continental's 1987-88 revenue requirement will occur during this period which Continental believes can be best dealt with through a balancing account. Continental anticipates that all of the changes, both positive and negative, will be nearly offsetting.

West Coast Telephone Company of California (West Coast) commented that it does not have a surcharge or surcredit to adjust for the effects of interest synchronization. West Coast requests that it be allowed to establish a balancing account for the revenue requirement reduction of \$13,000 and to roll the revenue requirement reduction into a future rate case.

Discussion

The 20 respondents listed in Appendix A that had elected to use IRC § 46 (f)(1) for treatment of investment tax credit are not subject to the provisions of this OII. Of the remaining 11 respondents, SPPC, SWG, and Citizens have had interest synchronization incorporated into their last General Rate Cases and therefore require no further action in this proceeding. Similarly pursuant to AT&T-C's request for adjudication of this issue in its rate order in A.85-11-029, we adopted interest synchronization for AT&T-C in D.86-11-079. The 1987 attrition orders for SDG&E, SCE and SCG all adopted interest synchronization thereby eliminating

the need to file separate advice letters by these utilities to implement the effects of interest synchronization on 1987 revenue requirements.

Interest synchronization issues were heard in Pacific Bell's Phase 2 hearings in A.85-01-034 and resolution of such issues took place in D.87-12-067 in which the Commission ordered adoption of interest synchronization retroactive to March 5, 1986. The interim opinion (D.86-01-026) and the subsequent opinion modifying the interim opinion (D.86-03-049) provided that Pacific Bell's intrastate rates and charges would be collected subject to refund back to March 5, 1986 in view of the further reductions in revenue requirements which could result from consideration of Phase 2 issues, including interest synchronization. In view of these decisions there is nothing more to be done with Pacific Bell in this OII.

General's arguments are similar to those of Pacific Bell's and to the extent similar have been covered in D.87-12-067 in which the Commission ordered adoption of interest synchronization for Pacific. We further note that the Division of Ratepayers Advocates (DRA) has recommended the adoption of interest synchronization for General's 1988 test year rate case. Since it is our policy to use interest synchronization in computing ratemaking income tax expense because it results in a more equitable sharing of the benefits of ITC between ratepayers and shareholders, it is reasonable to use the forthcoming final order on General's 1988 test year rate case to implement interest synchronization in calculating ratemaking income tax expenses.

Continental's request to use a balancing account to track the effect of interest synchronization rather than reducing its billing surcharge is reasonable and should be granted. Such balancing account shall bear interest at the average three months commercial paper rate. Similarly West Coast's request to establish a balancing account to record the revenue requirement reduction

associated with interest synchronization is reasonable and should be granted subject to interest at the average three months commercial paper rate. Such balancing account totals shall be rolled into the next rate case.

Findings of Fact

1. On October 1, 1986 the Commission instituted this investigation for the purpose of adopting an order requiring all utilities under the Commission's jurisdiction who utilize ITC under IRC § 46(f)(2) to adopt internal procedures utilizing interest synchronization in determining their revenue requirement for ratemaking purposes.

2. Of the 31 respondents named in the OII, 20 companies had elected to use IRC § 46(f)(1) for treatment of ITC rather than § 46(f)(2) and therefore are not subject to this OII.

3. It is the Commission's policy to adopt interest synchronization in determining ratemaking income tax expenses for utilities which have opted to use IRC § 46(f)(2) for treatment of ITC because interest synchronization results in a more equitable sharing of the benefits of ITC between ratepayers and shareholders.

4. Interest synchronization had been incorporated into the last general rate cases for Citizens, Sierra Pacific Power Company and Southwest Gas Corporation therefore no further action is required in this proceeding.

5. Interest synchronization was adopted in AT&T-C's rate order in D.86-11-079.

6. The 1987 attrition rate orders adopted interest synchronization for SDG&E, SCE and SCG which eliminated the need to file separate advice letters.

7. The interest synchronization issue was heard in Pacific Bell's Phase 2 hearings in A.85-01-034 and the Commission by D.87-12-067 ordered adoption of interest synchronization retroactive to March 5, 1986.

8. DRA has recommended the adoption of interest synchronization in General's 1988 test year general rate case.

9. Continental has requested the use of a balancing account to track the effect of interest synchronization rather than reducing its billing surcharge because it believes that there are several offsetting, and somewhat interrelated changes in its revenue requirements in 1987-88 which can be best handled through use of a balancing account process.

10. West Coast does not have a surcharge or surcredit and requests that it be allowed to use a balancing account to record the reduction in revenue requirement resulting from interest synchronization. Such revenue requirement reduction effect will be rolled into a future rate case.

11. It is reasonable to grant West Coast and Continental's request to use a balancing account as long as such balancing account includes interest at the average three month commercial paper rate and is rolled into the next rate case.

Conclusions of Law

1. Interest synchronization has been adopted in the various general or attrition rate cases for all of the respondents using IRC § 46(f)(2) for treatment of ITC except for General, West Coast and Continental.

2. West Coast and Continental should be authorized to reflect the revenue requirement effects of interest synchronization in a balancing account to be rolled into the next rate case for each company.

3. Interest synchronization should be adopted in the final order in General's 1988 test year rate case.

4. The effective date of this order is the date of signature to permit West Coast and Continental to immediately commence recording the revenue reduction associated with interest synchronization into a balancing account.

5. The OII should be closed.

ORDER

IT IS ORDERED that:

1. West Coast Telephone Company of California and Continental Telephone Company of California are authorized to record the revenue requirement effect of interest synchronization in a balancing account. Such balancing account shall accrue interest at the three months commercial paper rate and be rolled into the next rate case for each company.

2. The OII is dismissed.

This order is effective today.

Dated APR 27 1988, of San Francisco, California.

STANLEY W. HULETT
President

DONALD VIAL
FREDERICK R. DUDA
G. MITCHELL WILK
JOHN B. OHANIAN
Commissioners

I CERTIFY THAT THIS DECISION
WAS APPROVED BY THE ABOVE
COMMISSIONERS TODAY.


Victor Weisser, Executive Director

APPENDIX A

UTILITIES WHICH PREVIOUSLY ELECTED OPTION 1,
SECTION 46 f(1), AND THEREFORE NOT SUBJECT
TO THE PROVISIONS OF OII 86-10-002

C. P. National (both energy and telecommunications)
Pacific Gas and Electric Company
Pacific Power and Light Company
Southern California Water Company
Calaveras Telephone Company
Capay Valley Telephone System, Inc.
California-Oregon Telephone Company
Ducor Telephone Company
Evans Telephone Company
Foresthill Telephone Company, Inc.
Hornitos Telephone Company
Happy Valley Telephone Company
Kerman Telephone Company
Pinnacles Telephone Company
The Ponderosa Telephone Company
Roseville Telephone Company
The Siskiyou Telephone Company
Tuolumne Telephone Company
The Volcano Telephone Company

(END OF APPENDIX A)