SW/dz

ORIGINAL

Decision No. 87828 SEP 7 1977

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the matter of the application of SOUTHERN CALIFORNIA EDISON COMPANY for authority to increase rates charged by it for electric service.	Application No. 54946 (Filed June 7, 1974)

Rollin E. Woodbury, Robert J. Cahall, William E. Marx, and Dennis G. Monge, by Rollin E. Woodbury and William E. Marx, Attorneys at Law, for applicant.
Jonel C. Hill and David B. Follett, by Robert M. Loch, Attorney at Law, for Southern California Gas Company; Burt Pines, City Attorney, by Leonard L. Snaider, Deputy City Attorney, for City of Los Angeles; Robert W. Russell, by Manuel Kroman, Attorney at Law, for Department of Public Utilities and Transportation, City of Los Angeles; Robert W. Schempp, for Metropolitan Water District of Southern California; and John W. Witt, City Attorney, by William S. Shaffran, Deputy City Attorney, for City of San Diego; interested parties.
Timothy E. Treacy, Attorney at Law, and Kenneth J. Kindblad, for the Commission staff.

OPINION ON REHEARING AND REOPENING

Decision No. 86794 dated December 21, 1976 was issued on the above subject application after 102 days of public hearing. It authorized rates intended to provide Southern California Edison Company (Edison) an increase of approximately $122.5 million for its California jurisdiction rates for the test year 1976 and provide a rate of return of 8.8 percent on the adopted California jurisdictional rate base and a return on common equity of 12.63 percent. On January 7, 1977 Edison petitioned for rehearing of D.86794 or for reconsideration and modification thereof. D.86986 dated February 15, 1977 granted a

rehearing limited to the issue of the manner in which certain items of replacement plant and plant installed by end of year 1976 to meet environmental requirements (designated "Special Items - Nonweighted" in this proceeding) should be included in rate base. On February 22, 1977 Edison filed a petition for rehearing and reconsideration of D.86794 and D.86986 and for reopening of the record to take additional evidence. D.87088 dated March 15, 1977 denied the petition to rehear and reconsider but based on the facts and argument set forth in the petition, granted the petition to reopen the proceeding to take further evidence on the issues relating to the investment tax credit (ITC) and rate of return pursuant to Section 1708 of the Public Utilities Code. Public hearings on these two matters were held before Administrative Law Judge Norman R. Johnson in Los Angeles on May 16, 17, 18, and 19, 1977 and June 8 and 9, 1977, and the matters were submitted on the receipt of concurrent opening briefs due July 11, 1977 and concurrent closing briefs due July 18, 1977.

Opening briefs were received from Edison, the Commission staff, and jointly from the city of Los Angeles and the city of San Diego (Cities), and reply briefs were received from Edison and the Commission staff. Proposed transcript corrections were forwarded by Edison by a letter dated June 16, 1977. These transcript corrections appear valid and are hereby accepted. Testimony was presented on behalf of Edison by a consulting attorney, by its assistant comptroller, by one of its senior plant appraisers, and by its manager of regulatory costs, and on behalf of the Commission staff by one of its engineers. Other parties to the proceeding participated by cross-examination of the various witnesses.

I - INVESTMENT TAX CREDIT

Background

As discussed in D.86794 the Tax Reduction Act of 1975 (TRA) signed into law by the President on March 29, 1975 provides, among other things, for an increase in the ITC rate from four percent to 10 percent for new qualified plant. TRA further provided that utilities, such as Edison that were using flow-through tax depreciation accounting, elect by June 25, 1975 one of the following three options:

Option 1: Reduction of rate base with a pro rata restoration each year.

Option 2: Immediate credit to income taxes which is flowed through on a pro rata basis over the life of the property (ratable flow-through).

Option 3: Immediate flow-through of the full amount of the credit (full flow-through).

Edison's election of Option 2, ratable flow-through, was discussed in detail on the record and was one of the myriad considerations in our deliberations on this matter as evidenced by the following quotes from D.86794:

> "Another factor for consideration in arriving at the proper rate of return level is the additional investment tax credit benefits accruing to Edison as a result of the Tax Reduction Act of 1975 (TRA). The record shows that Edison elected Option 2, ratable flow-through, for the additional 6 percent investment tax credit provided for by TRA. In Decision No. 85627 dated March 30, 1976 on Southern California Gas Company's Applications Nos. 55676 and 55544 and San Diego Gas & Electric Company's Applications Nos. 55677 and 55543 in a similar situation, we found as follows: '5. A rate of return adjustment downward of 0.25 percent on an $824.5 million rate base will best recognize the reduction in risk claimed by SoCal in its choice of Option 2.' Similarly in Re SoCal Gas Co., Decision No. 86595 dated November 2,

> 1976 in Application No. 55345 at page 96, we recognized 'that because of SoCal's election of Option II, cash flow would be maximized, interest coverage increased, and the financial requirements in constructing facilities and acquiring gas supplies relieved.' The corresponding reduction in risk redounding to Edison from its election of Option 2 was included in our considerations in arriving at our adopted rate of return." (Mimeo. page 22.)
>
> * * *
>
> "3. The 12.63 percent return on common equity included in the computations deriving the above 8.8 percent rate of return is reasonable and includes consideration of the election of Option 2, ratable flow-through, for the additional investment tax credit allowances permitted by the Tax Reduction Act of 1975." (Mimeo. page 103.)
>
> * * *
>
> "i. Edison's selection of Option 2, ratable flow-through, for the increased ITC allowances provided in the TRA of 1975 reduces external financing requirements and thereby reduces investor risk and should be included in our consideration of a proper rate of return." (Mimeo. page 105.)

TRA provides limitations in the case of regulated companies that have selected ratable flow-through as set forth in the Internal Revenue Code Section 46(f) as follows:

> "(2) Special rules for ratable flow-through.- If the taxpayer makes an election under this paragraph within 90 days after the date of enactment of this paragraph in the manner prescribed by the Secretary or his delegate, paragraph (1) shall not apply, but no credit shall be allowed by section 38 with respect to any property described in section 50 which is public utility property (as defined in paragraph (5)) of the taxpayer-

> "(A) Cost of service reduction.-If the taxpayer's cost of service for rate-making purposes or in its regulated books of account is reduced by more than a ratable portion of the credit allowable by section 38 (determined without regard to this subsection), or
>
> "(B) Rate base reduction.-If the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the credit allowable by section 38 (determined without regard to this subsection)."

Edison interpreted the above quoted D.86794 excerpts as an indication that possibly increased ITC benefits were to be faster than ratably flowed through to the ratepayer and sought the advice of independent outside legal counsel with special expertise in this area to evaluate whether the availability of the additional ITC benefits was jeopardized by our treatment of this issue in D.86794. It was this counsel's opinion that our treatment of the ITC issue will seriously jeopardize Edison's ability to avail itself of these increased ITC benefits for all open tax years as well as for the future and formed the basis for Edison's petition for reopening of the record to take additional evidence.

Edison's Position

Edison's position, presented into evidence by an outside legal counsel, K. William Kolbe, and by Edison's assistant comptroller, C. S. Reenders, is that our consideration of the reduction in risk redounding to Edison from its election of Option 2 in arriving at a reasonable rate of return might possibly be construed by IRS as an impermissible indirect reduction in rate base resulting in Edison's loss of eligibility for the additional ITC benefits provided by TRA of 1975; that unless this Commission treated the unamortized investment credit as

common equity, Edison's eligibility for the additional ITC benefits is in jeopardy; and that for Edison to retain its eligibility it is necessary for this Commission to restore any reduction in rate of return made as a result of Edison's election of Option 2 and to either indicate that we treated the unamortized investment tax credit as shareholder capital in arriving at the adopted capital structure or change the capital structure to reflect unamortized tax credit as shareholder capital. Mr. Kolbe's testimony encompassed the concept that loss of eligibility of the additional ITC benefits would result from any accounting treatment that could directly or indirectly reduce the cost of service for ratemaking purposes by more than a ratable portion of the allowable credit or directly or indirectly apply the credit to reduce the base to which the taxpayer's rate of return is applied for ratemaking purposes. The testimony indicated then any adjustment to rate of return will constitute such an indirect rate base adjustment. In support of this position he quoted from Senate Report No. 92-437, 92nd Cong., 1st Sess., 1972-1 C.B. 559, 580, as follows:

> "'In determining whether or to what extent a credit has been used to reduce the rate base, reference is to be made to any accounting treatment that can affect the Company's permitted profit on investment by treating the credit in any way other than as though it had been contributed by the company's common shareholders. For example, if the "cost of capital" rate assigned to the credit is less than that assigned to common shareholders' investment, that would be treated as, in effect, a rate base adjustment.'"

According to the testimony, the above-quoted language also requires that a commission which applies a rate of return based on embedded average cost of capital must include the unamortized investment credits as a component of equity capital and assign

to such capital the same rate of return assignable to other equity capital in deriving the rate of return applied to total rate base.

In addition, Mr. Kolbe sponsored as exhibits one IRS ruling and two IRS information letters which he believes fully support his position on this matter.

The IRS ruling relates to our D.85627 dated November 2, 1976 in Southern California Gas Company's (SoCal) A.55345 in which we recognize the reduced risk associated with SoCal's election of Option 2 by a downward rate of return adjustment of 0.25 percent on an $824.5 million rate base. The IRS ruling states that should D.85627 stand as the final determination[1/] within the meaning of the term in Section 46(f)(4)(c) of the Internal Revenue Code, the decision would contravene the provisions of Section 46(f)(2) with the resultant loss of eligibility for the increased ITC benefits because such a rate of return adjustment would have placed SoCal in a position similar to its position had it elected full flow-through and, further, there is no support in the decision that the adjustment bears any reasonable relationship to SoCal's more favorable position for attracting debt and equity financing.

The two information letters sponsored as exhibits by Mr. Kolbe relate to regulatory action by the Department of Public Utilities, city of Dallas, Texas, in one case and the Public Service Commission of New Mexico in the second case. The city of Dallas information letter inquired as to the effect on the additional ITC availability were a ratemaking order issued requiring one-half of the authorized rate of return applied to the unamortized investment tax credit be flowed through to income for the benefit of the company's ratepayers.

1/ Section 46(f)(4)(c)(i): "...a determination is final if all rights to appeal or to request a review, a rehearing, or a redetermination have been exhausted or have lapsed."

The IRS information letter to the Public Service Commission of New Mexico relates to the utility's proposed ratemaking procedure of including the reserve for accumulated deferred ITC with the common stock for the derivation of the company's composite capital structure for use by that Commission in the determination of an overall rate of return to be applied to the utility rate base. The letter writer concluded that in determining the overall cost of capital of a utility for ratemaking purposes, deferred ITC's are properly to be included and assigned a return not less than that considered applicable to common equity.

Commission Staff's Position

It is the staff's position that the appropriate ratemaking treatment of accelerated tax depreciation and ITC, where taxes far in excess of taxes actually paid are used for ratemaking purposes has been heretofore presented to the California Supreme Court which stated "Alternatively the commission could choose to mitigate the windfall accruing to real parties in interest in consequence of their failure to elect accelerated depreciation prior to 1969 by setting more modest rates of return in recognition of the additional source of capital available to the utilities by virtue of the federal tax laws." (City of Los Angeles v Public Utilities Commission (1975) 15 C 3d 680, 704, fn 42); that our consideration of risk as affected by the election of Option 2 or use of accelerated depreciation in the fixing of rate of return was not challenged by either Southern California Gas Company in connection with D.85627 on A.55677 and A.55544 or Pacific Telephone and Telegraph Company in connection with D.53540 in A.53887; that our treatment of ITC will not imperil Edison's eligibility because Congress clearly knew the distinction between rate base and rate of return and incorporated no restriction on rate of return in Section 46(f)(2)(A) or (B); that a private letter ruling

involving a different utility, such as the gas company, cannot be used by the IRS as an authority to challenge Edison's eligibility for the additional ITC; and that the inclusion of unamortized ITC with the resulting increased cost of capital would place an added burden upon ratepayers contrary to the Congressional intention to share the tax savings between the utility and its customers.

Cities' Position

Cities' position on ITC as set forth in the jointly filed brief is that guidance from the California Supreme Court in City of Los Angeles v Public Utilities Commission (1975) 15 C 3d 680 indicates that efforts of regulatory bodies to pass the benefits of reduced tax expenses on to the utilities' ratepayers are mandatory for a state agency charged with insuring that no public utility shall receive any unjustified rate increases; that this Commission's rate of return adjustment is not inconsistent with current tax law; that similar ratemaking treatment set forth in D.83540 on Pacific Telephone and Telegraph Company (PT&T) was not challenged by either PT&T or IRS; and that the Tax Code precludes the use of cost-of-service and/or rate base adjustments to negate the benefits of ITC, but imposes no such constraints on adjustments to the rate of return.

Discussion

The issues involving ITC in this reopened proceeding that require resolution are as follows:

1. Did this Commission, after determining that Edison's overall risk position supports a certain rate of return, make a downward adjustment to that rate of return to reflect Edison's election of Option 2?

2. Does a downward adjustment in the rate of return constitute an indirect adjustment in rate base rendering a utility ineligible for the additional ITC benefits provided by the TRA of 1975?

3. Is it Congressional intent that unamortized ITC be treated as equity capital available to utilities such as those subject to this Commission's jurisdiction where rate base consists of original cost depreciated plant rather than its capital investment?

4. What weight, if any, should be given the private IRS ruling to Southern California Gas Company and the two information letters to the city of Dallas and the Public Service Commission of New Mexico in this matter?

5. Does the ratemaking guidance set forth by the California Supreme Court in City of Los Angeles v Public Utilities Commission mandate the establishment of a more modest rate of return in recognition of the additional source of capital available to Edison because of its election of Option 2?

D.86794 states in part: "After careful consideration of all the previously discussed relevant factors in the development of a reasonable return on common equity we adopt as reasonable a return on equity of 12.63 percent which, applied to our adopted capital structure and costs, translates to a rate of return of 8.8 percent..." (Mimeo. page 23.) These previously discussed relevant factors include the cost of money, Edison's capital structure as compared to other similar utilities, interest coverage ratios, price/earnings ratios, price/book ratios, future financing requirements, the level of earnings required to restore common stock sale price to at least book cost, and, of course, the effect of the additional investment tax benefits accruing to Edison as a result of its election of Option 2. In other words, all the relevant factors, including Option 2 benefits, were considered as a whole. We did not, contrary to Edison's construction of the language of the decision, arrive at a reasonable return on equity exclusive of Option 2 benefits and then adjust the figure downward to reflect

the Option 2 benefits. Option 2 benefits were specifically mentioned as being included in our considerations because the effect of Edison's election of Option 2 was a major issue in the proceeding and not because, as Edison believes, a specific downward adjustment was made to our derived reasonable rate of return.

In any event, we are not persuaded that a downward adjustment in rate of return of utilities subject to our jurisdiction is an indirect adjustment to rate base as contended by Edison's witnesses. Section 46(f)(2) is quite specific in the constraints on eligibility for those ratepayers electing Option 2, ratable flow-through. Loss of eligibility occurs if the taxpayer's cost-of-service for ratemaking purposes is reduced by more than a ratable portion of the allowable credit or "If the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the credit allowable by section 38 (determined without regard to this subsection)." Congressional committee reports and proposed regulations[2/] explain the use of the credit to reduce cost-of-service as any accounting treatment that can affect cost-of-service and cite as examples the use of the investment credit to reduce ratemaking federal income tax and the reduction, by the amount of the credit, of the depreciable basis of the property on the regulated books of account. It is clear from the record that neither such adjustment is contemplated in this proceeding.

With respect to rate base reductions, the committee reports make reference to any accounting treatment that can affect the company's permitted profit on investment by treating

---

2/ House Report No. 92-533, 92nd Cong., 1st Sess., 1972-1 C.B. 498,511; Senate Report No. 92-437, 92nd Cong., 1st Sess., 1972-1 C.B. 559, 580; Proposed Regulations Section 1.46-5(A).

the credit in any way other than as though it had been contributed by the company's common shareholders and cite as an example of such an impermissible adjustment the assignment of a lesser cost of capital to the credit as being the equivalent of a rate base adjustment. Inasmuch as treating unamortized investment tax credit as though it had been contributed by the common shareholder is in direct conflict with the Uniform System of Accounts[3/] prescribed by the Federal Power Commission and adopted by numerous utility regulatory agencies, it is obvious that the congressional committees were concerned only with ratemaking accounting treatment. Furthermore, constrictions on regulatory agency actions of necessity are broad-based to encompass all of the varying practices and concepts of the numerous regulatory agencies throughout the country. There are several so-called fair value oriented regulatory agencies who use as rate base[4/] either the utility's actual capitalization or a fair value rate base derived from a weighting process based on the percentage of common equity in the capital structure. In either case the inclusion of unamortized ITC in common equity at a return on equity less than that applied to the common shareholder's equity rate would dilute the indicated revenue requirement relative to such a requirement exclusive of the unamortized ITC. It is just such an effect the restrictions were intended to contravene. Such restrictions, however, are

---

3/ Common stock transactions are recorded under proprietary capital accounts whereas accumulated deferred investment tax credits are in Account 255 under Deferred Credits.

4/ Proposed Regulations Section 1.40-5(b)(3) - Rate Base - For purposes of this section, the term "rate base" means the base to which the taxpayer's rate of return for ratemaking purposes is applied.

completely inapplicable for the regulation of utilities subject to this Commission's jurisdiction because rate base is neither adjusted by unamortized ITC nor affected by the utility's capital structure. The unamortized ITC does, however, serve as a source of internal financing and will, therefore, eventually find its way into rate base in the form of capital additions.

The 1976 Tax Reform Act made private IRS rulings, such as the one relating to SoCal introduced into evidence in this proceeding, available for inspection and copying by the public beginning with rulings requested after October 31, 1976. However, the act bars the use of such letter rulings as a precedent unless Treasury regulations otherwise specify that a particular ruling or rulings may be used as a precedent. This bar to precedential value of private rulings applies to the IRS as well as taxpayers. Under these circumstances, this letter would be of limited use in the resolution of the instant proceeding even if, as Edison erroneously believes, it is possible to interpret the language in our decision as stating that a downward adjustment was made to our derived reasonable rate of return to negate the effect of Edison's election of Option 2.

IRS information letters are provided in the interest of sound tax administration in answer to inquiries by individuals and organizations. Such letters purportedly do no more than call attention to a well-established interpretation or principle of tax law without applying it to a specific set of facts.

The IRS information letter sent to the city of Dallas Department of Public Utilities relates to the jeopardizing of the availability of the additional ITC benefits of TRA if a ratemaking order issued requiring that one-half of the authorized rate of return on the utility rate base attributable to ITC were to be flowed through to income for the benefit of the ratepayers. From the information letter it would appear that the physical means of effecting the proposed ratemaking treatment

would be to flow through as income an amount equal to 3.5 percent of the unamortized ITC in addition to the ratable flow-through amount or, alternately, to deduct one-half of the unamortized ITC from rate base. It is obvious that the former is cost-of-service reduction as contemplated in Section 46(f)(2)(A) and the latter is a rate base reduction as contemplated in Section 46(f)(2)(B) with the result that the utility would lose its eligibility for the additional ITC. It is equally obvious that either the contemplated cost-of-service reduction or direct rate base reduction is completely dissimilar to the ratemaking considerations being contemplated herein.

The second IRS information letter relates to the inclusion of unamortized ITC in common stock for the derivation of the composite capital structure for a rate proceeding before the Public Service Commission of New Mexico. New Mexico is classified as a fair value state (see 54 Public Utilities Fortnightly 563, October 28, 1954). Under these circumstances it is possible that the dollar amount of the rate base of the utility in question could be affected by the inclusion or exclusion of unamortized ITC in equity capital and the revenue requirement could be affected by the return applied to such unamortized ITC. Neither circumstance would be applicable to utilities subject to this Commission's jurisdiction.

Both the Commission staff and Cities quoted in their briefs the following from a California Supreme Court decision:

> "Alternatively, the commission could choose to mitigate the 'windfall' accruing to real parties in interest in consequence of their failure to elect accelerated depreciation prior to 1969 by setting more modest rates of return in recognition of the additional source of capital available to utilities by virtue of the federal tax laws." (City of Los Angeles v Public Utilities Commission (1975) 15 C 3d 680, 704, fn 42.)

The establishment of a more modest rate of return was one of several alternatives listed by the California Supreme Court as available to remedy a serious problem perceived by the Commission. The first sentence of footnote 42 states: "In this connection we emphasize that nothing in the course of this opinion should be construed as binding the Public Utilities Commission either now or in the future to any particular method of rate-setting which it decides is not useful." It is obvious that the Supreme Court neither mandates nor prohibits the establishment of a lesser rate of return to reflect additional capital available through federal tax laws.

II - RATE BASE ISSUE

Background

D.86986 dated February 15, 1977 was an order granting rehearing of D.86794 limited to reconsideration of the issue of the manner in which certain items of replacement plant and plant installed by end of year 1976 to meet environmental requirements (denominated "Special Items - Nonweighted" in this proceeding) should be included in rate base. These items have historically been included in rate base on a weighted average basis. D.86794 stated in part:

> "These replacement items, consisting generally of deteriorated distribution plant, storm damaged items, and overhead-to-underground conversion projects, appear to have relatively short construction periods and, therefore, no departure from past practices appears justified. Also lacking in this record is convincing evidence that justifies special treatment of environmental items as contrasted with other NOCWIP. Consequently, the special items will be included in the ADC base until completed and placed in service when they will be included in rate base on a weighted average basis as has been done historically." (Mimeo. page 79.)

In its petition for rehearing Edison noted that this plant which does not contribute to the increased capacity was, according to the uncontradicted record, to be in service by the end of the test year and suggested that it be more appropriate to reflect the revenue requirements associated with such plant in the base rate increase authorized by D.86794 rather than require Edison to file a new and separate application.

Edison's Position

Edison's position, presented into evidence by a senior plant appraiser, is that environmental and replacement plant do not contribute to increased system capacity, nor are they associated with increased load or kilowatt-hour sales or revenues and, therefore, should be included in rate base at full value as nearly as possible to the time the plant comes on line. According to this witness' testimony, the weighted average calculation for rate base traditionally matches investment with associated revenues and revenue requirements, but this theory does not apply to replacement and environmental plant which does not provide increased revenues to cover carrying costs associated with such investment. The replacement items related to distribution line plant and the environmental items consist of air and water pollution control facilities, solid waste disposal costs, noise abatement equipment, and aesthetic costs. The record shows that the nonweighted amount for these items is $37.2 million which translates to a California jurisdictional revenue requirement of $6,935,000.

Commission Staff's Position

The Commission staff's position, as presented into evidence by one of its utilities engineers, is that there is no basis to treating "Special Items" differently than any other additions to rate base. He testified that it is very difficult to draw a line between environmental and nonenvironmental

portions of a project being constructed and, in any event, environmental costs associated with a project are part of the costs of the project and should not be treated any differently than the other project costs in the determination of the rate base.

Discussion

The record discloses that the three largest items totaling $32.8 million out of the $37.2 million consist of replacement of deteriorated or damaged equipment, $5.7 million; undergrounding under Rule No. 20, $4.4 million; and the difference between overhead and underground distribution facilities, $22.7 million. Such items are included in the weighted average balances for CWIP for the application of ADC. When placed into service they are removed from the ADC base and included in the weighted average plant balances. They are essential for the maintenance and/or increase of system capacity and warrant the same treatment as other plant. In addition, treating this plant as requested by Edison would result in its inclusion in both the ADC base and rate base for a portion of the year to the detriment of the ratepayer.

In both its petition for rehearing and brief on the rehearing, Edison noted our reference to our recent decision concerning Pacific Gas & Electric Company (PG&E) (D.86281 dated August 24, 1976 in A.55509) suggesting possible alternatives, especially one that would expedite the inclusion in rate base of plant as it comes on line, and suggested that the inclusion of "Special Items - Nonweighted" in rate base at this time would be such an alternative. The early inclusion in rate base of plant as it comes on line referred to in D.86281 and D.86794 relates to the exclusion of nonoperative construction work in progress (NOCWIP) of approximately $400 million. Needless to

say, the effect on utility rates of excluding or including such an amount in rate base is far greater than the effect of the "Special Items" under consideration in this proceeding.

Findings

1. Relevant factors such as the cost of money, Edison's comparative capital structure, interest coverage ratios, price/earnings ratios, price/book ratios, future financing requirements, the level of earnings required to restore common stock sale price to book value, and the effect of additional investment tax benefits accruing to Edison as a result of its election of Option 2 were considered as a whole in arriving at a reasonable return on equity and rate of return to allow Edison.

2. Edison's cost-of-service for ratemaking purposes was not directly or indirectly reduced by more than a ratable portion of the credit allowable by section 38 (determined without regard to IRC subsection 46(f)(2)(A)).

3. Edison's rate base for ratemaking purposes is not directly or indirectly reduced by reason of any portion of the credit allowable by section 38 (determined without regard to IRC subsection 46(f)(2)(B)).

4. The California Supreme Court in City of Los Angeles v Public Utilities Commission (1975) 15 C 3d 680, fn 42, neither mandated nor prohibited the establishment of a more modest rate of return in recognition of the additional source of capital available to Edison by virtue of the additional ITC provided by the TRA of 1975.

5. The inclusion of unamortized ITC as equity capital is required only for regulatory agencies that utilize capital structure in deriving rate base and not for regulatory agencies, such as this Commission, that derive rate base from the weighted average depreciated plant balances.

6. The 1976 Tax Reform Act prohibits the use of private IRS rulings as a precedent unless Treasury regulations otherwise specify that a particular ruling or rulings may be used as a precedent.

7. The IRS information letters sent to the city of Dallas Department of Public Utilities and the Public Service Commission of New Mexico describe the application of Sections 46(f)(2)(A) and (B) of the Internal Revenue Code to situations that are not paralleled in the instant proceeding.

8. Replacement plant or plant installed for environmental purposes, designated in this proceeding as "Special Items - Nonweighted", should be included in rate base on a weighted average balance basis.

Conclusions

1. The inclusion of the effects of Edison's election of Option 2 as one of the many factors considered in our determination of a reasonable rate of return will not adversely affect Edison's eligibility for the additional ITC provided for in the TRA of 1975.

2. The inclusion of unamortized ITC as equity capital is required only for regulatory agencies that utilize capital structures in deriving rate base and not for regulatory agencies, such as this Commission, that derive rate base from the weighted average depreciated plant balances.

3. Replacement plant or plant installed for environmental purposes designated in this proceeding as "Special Items - Nonweighted" should be included in rate base on a weighted average balance basis.

4. The relief requested should be denied.

O R D E R

IT IS ORDERED that Decision No. 86794 is affirmed.

The effective date of this order shall be twenty days after the date hereof.

Dated at San Francisco, California, this 7th day of SEPTEMBER, 1977.

Robert Batinovich
President

I will file a dissent.
William Symons, Jr.

Commissioners

Commissioner Vernon L. Sturgeon, being necessarily absent, did not participate in the disposition of this proceeding.

A. 54946 - D.

COMMISSIONER WILLIAM SYMONS, JR., DISSENTING

I have reviewed the language in the above case on rehearing. The majority uses quibbling language in this new document called an Opinion.

There is no question about it and it is absolutely clear that Decision No. 86794 in Application No. 54946 adjusted the rate of return downward because of the Option 2 Benefits of I.T.C. (See page 3 and 4 of Opinion). In Decision No. 86794, we cited Southern California Gas Company where we adjusted rates downward. Then we said or spoke of a "corresponding" drop for Southern California Edison Company. This clearly implies a corresponding treatment. Yet the Opinion before us goes on and on to say that we didn't determine a rate of return for Edison and then drop or lower rates. Instead it says we considered the effects of the I.T.C. during our rate of return determination rather than after. I feel certain this is contrary to the facts and I believe it to be untruthful.

The consequences of the Commission majority's actions must be allowed to surface or come home to roost. The sad part is the extra money that will be unnecessarily paid by the ratepayers.

The citizenry needs to be alerted as to who the commissioners are that will be responsible for unnecessary future costs. This may be stiff medicine, but now is the time to administer it while the patients still have some pulse and can realize their plight.

The effect of other cases must be weighed also, including the Pacific Telephone and Telegraph Company case. I stick by my original concurring and dissenting opinion, dated December 21, 1976 (attached)

and I again dissent for the following reasons:

1. There must be honesty and integrity in accepting a Commission appointment. Because of the Oath of Office I swore to in the high position I hold as a Public Utilities Commissioner, I must uphold and enforce the law to the best of my ability;
2. Because of the impact this will have on future cases before the Public Utilities Commission;
3. Because of the impact it will have on the PT&T case that has been on the Commission Agenda since April 1977;
4. The majority of this Commission must face reality and realize we are not a nation of men, but a nation of laws. Our actions ought not to be directed by what our duly appointed officials think, but by what our laws mandate. When government officials attempt to interline our government laws with paternalistic dicta, no matter how benevolent or well-meaning, they vitiate the contractual obligations between the American people and their government, as ordained by the Constitution of the United States of America.

San Francisco, California
September 7, 1977

William Symons, Jr.
WILLIAM SYMONS, JR.
Commissioner

Attachment

A. 54946 - D. 86794

COMMISSIONER WILLIAM SYMONS, JR., Concurring in Part and Dissenting in Part

I concur with the increase approved in the single ordering paragraph insofar as it provides a portion of the financial relief which the facts show is needed and justified; however, I take issue with five major points in the body of discussion: (1) rate of return, (2) construction work in progress, (3) budget for public information, (4) method of cost allocation and rate design and (5) write-off of Vidal Plant. Overall, I judge the resulting level of earnings to be seriously deficient.

1. Rate of Return

While not granting Edison's requested 9.6% rate of return, I find the hearing Examiner's proposed 9.2% rate of return more appropriate than the punitive 8.8% adopted here today. The utility's external financing requirements through 1978 are substantially greater than it has experienced in the recent past. With a 9.2% rate of return, the resulting return on capital should meet that minimum needed to attract capital at a reasonable cost and not impair the credit of Edison. Even at the 9.2% rate of return level, we note that the "times interest coverage" of 2.91 which resulted in Edison's last general rate case decision in 1973 (Decision No. 81919) will slip to 2.83.

Insufficient earnings also are signalled by the degree to which the purchase price of common stock has fallen below book value. The probable outcome of today's order with its 8.8% rate of return and a resulting 12.63% return on equity has been known to the investment community for several weeks. That this return is inadequate may be discerned from the results of the recent sale of Edison common stock. On December 8, 1976, Edison sold 5,000,000 shares of common stock. The price received was about $22/share. This occurred at a time when current book value was over $30/share.

Investment Tax Credit. The reason which really determines this low 8.8% rate of return is not discernible in this decision. Perhaps it is caused by a desire by the majority to rechannel the effects of the Federal Investment Tax Credit. I have dissented from such attempts in the past because they are dangerous and contrary to the policy of Congress. (See Dissenting Opinion to D. 85627, March 30, 1976) I consider it foolhardy for state regulators to run such a risk where the state's utilities and their customers stand to be the ultimate fall guys. I can understand the terrorized state of the major utilities who fear (1) not just "docking" of millions of dollars in earnings by the California Commission because of the utulity's free selection ITC Option 2, but (2) having to pay a second time because the bullying conduct of the California Commission causes the Internal Revenue Service to disallow California companies the 6% investment tax credit. The Commission majority may consider itself safe because it has been imprecise as to the quantitative impact of this consideration (today's Opinion, page 22, also Finding #3, page 103). But if this "enigmatic" approach fails before the IRS, I suspect we will be treated to a further shameful episode in this ITC affair, as the responsible regulators try to push the blame off onto the utility companies.

2. Nonoperative Construction Work In Progress (NOCWIP)

Current sizeable increases in (1) construction time, (2) cost of capital, and (3) size of capital projects argue for some inclusion of NOCWIP in rate base. When consideration is given to the tax deductibility of the debt component of return, we have a method of increasing cash flow at the rate of approximately one dollar for every dollar and a half of revenue, a superior method of increasing cash flow. The NOCWIP in rate base also eliminates the discrepancy of the allowance for funds used during construction (ADC) which is currently at the 8% level, where the cost of capital runs in excess of 9%.

Partial inclusion at this time of NOCWIP in rate base would be appropriate and beneficial. It would be a transition from the present future cost payment method to this pay-as-you-go basis, and should be limited initially. For the case at hand and for consideration in later cases, we would do well to follow the policy example of Federal Power Commission Order No. 555 dated November 8, 1976. In that case, NOCWIP related to pollution abatement plant modification was allowed. Rather than the Examiner's proposed $300 million NOCWIP inclusion, pollution-abatement-related NOCWIP per Exhibit 47 in this proceeding would provide a $45 million rate base allowance equivalent to a $7.4 million revenue requirement at a 9.2% rate of return.

3. Budget for Public Information

A "smaller ticket" but vital item in this decision is the slashing of the Public Relations/Public Information budget of the utility from approximately $3,800,000 down to $800,000. In the public discussion by the Commissioners urging this course, lack of sufficient documentation was the given explanation. Yet, we see emerging from the newly inserted language a thrust not just for documentation, but a blatant attempt to control the content of the information the utility may give to the public in the ordinary course of business. Proceeding in an Orwellian manner, communication of thoughts not specifically permitted is forbidden. On page 51, only informational advertising expense of $10,000 for kite safety messages and $40,000 in notices of financial offerings are allowed. Conservation messages are also allowed. But specifically excluded, even though neither the P.U.C. staff nor hearing Examiner recommended it, were $400,000 for plant safety and siting advertising or $150,000 for a discussion of viable future energy sources.

Why should the public be cut off from discussion of viable future energy sources by the energy utilities? It doesn't make sense. However, if we recall that special political interest groups have sought to silence the utilities, and that certain Commissioners have expressed ire at utility discussions of Nuclear Power, we can see that what may not be good government may be "good" politics. This whole area is too important to allow government power to be used to stifle full public discussion. Further attention will have to be paid to exactly what is in the "guidelines" the government is imposing.

4. Method of Cost Allocation and Rate Design

Greater care must be given to cost allocation and rate design. I agree with the Examiner's recommendation that we maintain the use of the Monthly Peak Responsibility method for jurisdictional allocations and the Load Factor Diversity Factor method for California jurisdictional allocations. The decision on rate spread is made less crucial by the fact it is balanced by a simultaneous rate reduction due to the operation of the energy cost adjustment clause. Yet, simply hiking rates on a uniform cent-per-kilowatt hour ignores relating prices to actual costs. Testimony, such as Mr. Reed for the California Manufacturers' Association, that present domestic rates in the Edison system as authorized by Decision No. 85294 are insufficient to meet the out-of-pocket cost to serve for usages under 1,500 Kwhr a month which includes 98.8% of the bills rendered by the utility, should ring an alarm bell. We must have rates where each class--residential, commercial, industrial or other--pulls their own weight as to costs. "Lifeline", "welfare" or "income redistribution" rates can spell doom for the economic future of California with farm products too expensive to market, and business and jobs driven from California.

5. Write-off of Vidal Plant

The amortization of the Vidal nuclear generating station is another victim of alleged insufficient documentation, though the hearing Examiner did not so find. On this point it should be noted that the staff did not testify against the propriety of the write-off, assuming cost savings information was available. Today's decision is too terse concerning the future course the Commission intends to take regarding this expense. I would have added to the discussion by noting that the Commission does not intend to preclude subsequent relief on this point in a special proceeding where further documentation and evaluation will be possible.

San Francisco, California
December 21, 1976

/s/ William Symons, Jr.

WILLIAM SYMONS, JR.
Commissioner