Process

ALJ/ks *

7

ORIGINAL

Decision 93893 December 30, 1981

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SAN DIEGO GAS & ELECTRIC COMPANY for authority to increase its rates and charges for electric and gas service (NOI 21).	Application 59788 (Filed July 2, 1980; amended December 22, 1980, and February 23, 1981)

(Appearances listed in Appendix A of the main rate order issued today)

OPINION

On August 13, 1981 the Economic Recovery Tax Act of 1981 (ERTA) was signed into law. ERTA has significant immediate and long-term implications for ratemaking which are discussed in detail in Decision (D.) 93848 issued December 15, 1981 in OII 24. For clarity, some of that discussion is repeated in this decision in order to demonstrate and quantify the impact of ERTA on the rate increase granted today in San Diego Gas & Electric Company's (SDG&E) Application (A.) 59788.

We think it vital that California ratepayers understand the dramatic impact which ERTA has on utility rate increases. For SDG&E, $22.5 million, or 14%, of the general rate increase granted today is due exclusively to the new tax law. Today's increase is 16% larger than it would have been without the ERTA. As can be seen below, the provisions of ERTA related to utilities are extremely complex. But reduced to their essentials, they require ratepayers to pay in rates now the expense of taxes which are only later, and probably never, paid by the utilities to the federal government. This accounting technique is called "normalization." It is a means for utilities to obtain capital at no cost without resorting to the financial markets. In the past, the benefits of federal tax deductions and credits were "flowed through" by this Commission to ratepayers in the form of reductions in utility revenue requirement, in furtherance of state ratemaking policy to charge ratepayers only for costs actually incurred by the utilities. Now, however, ERTA requires such benefits to be "normalized" and retained by utilities. The result is a substantially higher utility rate increase today.

ERTA affects three areas most significantly: the accelerated cost recovery system (ACRS) for depreciation, modifications of investment tax credits (ITC), and repeal of the repair allowance deduction. In addition, a normalization method of accounting must be used for ACRS and ITC applied to property placed in service after December 31, 1980.

Repair Allowance

Under prior law, utility taxpayers had the option to elect the percentage repair allowance rule (PRA) which provided that all expenditures for repair, maintenance, rehabilitation, or improvement of the property which were not clearly capital expenditures were treated as currently deductible to the extent they did not exceed the PRA. If PRA was not used, a taxpayer used the generally applicable rules to determine whether to capitalize or deduct an expenditure for repair, maintenance rehabilitation or, improvement of property. It has been the experience of most utilities that the election of PRA provides greater amounts of current deductions, thereby lowering the amount of tax expense.

As a result of the elimination of the repair allowance, utilities will be reverting to the general rules with respect to repair expense which usually produces a lesser amount of current deductions and therefore leads to a greater tax expense. The effect of the loss of the repair allowance for SDG&E is $18,463,000.

ACRS

Prior law was designed to allocate depreciation deductions over the period the asset was used in the business so that deductions for the cost of an asset were matched with the income produced by the asset. Under ERTA the prior system is replaced with ACRS under which the cost of an asset is recovered over a period generally shorter than the useful life of the asset or the period the asset is used to produce income. The result is a faster depreciation and therefore a larger depreciation expense.

Normalization

Under ERTA, public utility property will not be eligible for accelerated depreciation unless the utility uses a normalization method of accounting. Unlike the law prior to ERTA, there is no provision with respect to ACRS property permitting the use of a flow-through method of accounting based on prior practice. Utilities, like SDG&E which previously used a flow-through method of accounting, are permitted to use the new ACRS method if the terms of the first rate order put into effect after August 13, 1981 determining cost of service with respect to post-1980 property uses normalization accounting. The order in SDG&E's general rate case is such an order and, accordingly, normalization accounting is used in that order to preserve the benefits of ACRS for SDG&E.

ITC

The amount of ITC that may be claimed has been liberalized under ERTA. The applicable percentages for recovery property placed in service after 1980 are 100% for otherwise qualifying 5-, 10-, or 15-year public utility property and 60% for 3-year property. The rules applicable to qualified progress expenditures are modified to eliminate the 7-year estimated useful life requirement but continues the 2-year construction period requirement. The current $100,000 ceiling on used property qualifying for ITC is raised to $125,000 in 1981 and $150,000 in 1985 and thereafter. ITC is subject to recapture on early dispositions under ERTA, however the amount subject to recapture has been reduced to reflect actual life on an annual basis.

Prior to ERTA the benefits of the 4% ITC could have been flowed through immediately to cost of service if the utility were on a flow-through method of accounting for depreciation purposes and if the flow-through option for the credit had been elected. SDG&E had elected flow-through accounting. A similar election was provided for the additional 6% credit and in addition those who had elected immediate flow-through relative to the 4% credit also could have elected cost of service normalization (ratable flow through) or opted for rate base normalization for the additional 6% credit. SDG&E elected cost of service normalization.

A similar election was not provided under ERTA for post-1980 property. As with ACRS, ITC on post-1980 property must be normalized and the utility must meet the new rules in the first rate order determining cost of service involving post-1980 property which becomes effective after August 13, 1981 and on or before January 1, 1983. The rate order on SDG&E's A.59788 is such an order and ITC was computed on a normalized basis.

This means that instead of flowing the benefits of the liberalized depreciation through to the ratepayer, the utility is allowed to retain the benefits. Had ERTA not been enacted, the rate increase for SDG&E would have been $143,802,400 instead of $166,302,300, a difference of $22,499,900. This difference is due solely to ERTA and should materially improve SDG&E's cash flow position, and ultimately its overall financial position.

Finding of Fact

ERTA was enacted August 13, 1981 making changes to the tax laws which affect rates set by this Commission for California public utilities.

Conclusion of Law

To preserve the benefits of ERTA for California utilities, rates should be calculated using full normalization for tax and depreciation expenses and reflecting all other provisions of ERTA.

O R D E R

IT IS ORDERED that the additional revenues in the amount of $22,499,900 required by the Economic Recovery Tax Act of 1981 are authorized and will be reflected in the main rate order signed today for San Diego Gas & Electric Company.

This order is effective today.

Dated December 30, 1981, at San Francisco, California.

JOHN E. BRYSON
President
RICHARD D. GRAVELLE
LEONARD M. GRIMES, JR.
VICTOR CALVO
PRISCILLA C. GREW
Commissioners

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

Joseph E. Bodovitz, Executive Director