

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

WATER DIVISION
Large Water Branch

RESOLUTION W-4014*
December 20, 1996

R E S O L U T I O N

(RES. W-4014), SAN JOSE WATER COMPANY (SAN JOSE). ORDER AUTHORIZING THE ESTABLISHMENT OF A MEMORANDUM ACCOUNT FOR TRACKING REVENUE AND EXPENSE RELATED TO CHANGES IN FEDERAL AND STATE TAX LIABILITY FOR ALL CLASS A WATER UTILITIES, JESS RANCH SEWER UTILITIES, INC., SOUTHERN CALIFORNIA EDISON COMPANY, AND ALCO AND TORO WATER COMPANIES.

BY ADVICE LETTER 280, RECEIVED ON OCTOBER 24, 1996.

SUMMARY

This resolution authorizes all Class A water utilities, Jess Ranch Sewer Utilities, Inc., Southern California Edison Company, Alco and Toro Water Companies (the affected utilities) to establish a memorandum account for tracking revenues and expenses relating to changes in Federal and State tax liability resulting from funds received from owners or developers pursuant to Rule 15, Main Extensions.

BACKGROUND

In late October, 1986, the federal government passed the Tax Reform Act of 1986 (1986 TRA) which significantly affected all California public utilities, especially the state's privately-held public water companies. Until that enactment, when a real estate developer who applied to a public utility for extension of facilities to serve water to a new area paid the utility the amounts of money (or property) required to serve that area (Contributions-in-Aid-of-Construction (CIAC) and Advances-in-Aid-of-Construction (AIAC)), the utility did not treat such payments as "income" for income tax purposes. The 1986 TRA changed all that - by converting such payments into taxable income. As a consequence, beginning in 1987, in order to have available sufficient funds to pay the actual costs to construct a proposed extension of facilities, utilities had also to collect additional sums from each applicant: the amount of money that would enable them to pay the income tax liability arising from their receipt of the funds used to pay the hard-dollar cost of such projects. That additional amount of money which results from utilities' collecting contributions and advances "gross of federal income tax," is commonly referred to as a "tax gross-up."

After lengthy hearings, the Commission on September 10, 1987, issued Decision (D.) 87-09-026 which settled on two alternative methods to be adopted by utilities for determining how the tax gross-ups would be calculated: a so-called "Method Two" (to be used by smaller utilities) and a "Method Five" (to be employed by Class A utilities, Southern California Edison Company, and Alco and Toro Water Companies.

San Jose now requests authority to establish a memorandum account for tracking the total revenue requirement and expenses associated with recent changes in federal and state tax liability resulting from the "Small Business Jobs Protection Act" [Public Law (PL) # 104-188] and California Assembly Bill (AB) 3499. Both of these laws were passed earlier this year.

PL # 104-188 changes the federal Contributions-in-Aid-of-Construction (CIAC) tax liability by exempting certain contributions for water companies from federal taxation. The law also changes the depreciation life for water utility property from 20 to 25 years. It is undetermined, at this time, if California will also terminate the taxability of CIAC.

AB 3499 changes the California Corporation Franchise Tax (CCFT) rate from 9.3% to 8.84% effective January 1, 1997.

This situation is faced by all Method 5 companies.

In addition, San Jose requests to change the Income Tax component for the "gross-up" worksheet contained in Rule 15. This implication of PL # 104-188 is currently being reevaluated in another Commission proceeding (I.86-11-019). San Jose requests authority to apply the existing gross-up percentage to service connections only. Furthermore, San Jose requests authority to reduce the gross-up percentage on the remainder of CIACs and AICs such that the Method 5 gross-up percentage only reflects the requirement for CCFT, under the assumption that the collection of such taxes will itself be taxable for Federal Income Tax purposes.

Southern California Edison Co., California Water Service Co. (AL 1420, filed 10/15/96), Apple Valley Ranchos Water Co. (AL 102, 10/16/96), Park Water Co. (AL 171, 10/16/96), Jess Ranch Water Co. (AL 5-W, 10-16-96), and Jess Ranch Sewer Co. (AL 3-S, 10/16/96), have filed advice letters requesting the same treatment.

DISCUSSION

After discussion with the Class A utilities, Water Division agrees that this memorandum account is reasonable. This resolution would authorize the affected utilities to record these revenues and expenses that occur after its effective date. To allow these utilities to record revenues and expenses that it incurred before the effective date of this resolution would constitute retroactive ratemaking.

The recording of these revenues and expenses into the memorandum account does not constitute a prejudgment of the appropriateness of recovery of any expense included in the memorandum account. The purpose of authorizing this memorandum account is to insure that these utilities is not precluded from recovering these extraordinary revenues and expenses incurred as a result of PL # 104-188 and AB 3499.

In a future proceeding or general rate case, the Commission will reach a decision regarding the utility's recovery in rates of the memorandum account balance. In that proceeding, the staff will review the revenues and expenses and balance in the account and make a recommendation to the Commission about the amount to be included in rates.

Because rates are not affected by the creation of a memorandum account and parties will have an opportunity to review these costs in the future, no formal notice is required.

This memorandum account is to be used only to record revenue requirement and expenses related to changes in CIAC and IDC rates, changes in depreciation rates and CCFT rates. It is not designed to recover other amounts such as a developer being initially charged and paying a CIAC rate which later is determined to be too low and the extra fee charged to the developer can not be recovered from such developers. The rates that ratepayers are charged should not be raised to pay the deficit in this event, and the ratepayers should be specifically held harmless.

FINDINGS

1. All water utilities are required to comply with PL # 104-188 and AB 3499.
2. San Jose has requested the establishment of a memorandum account to record revenues and expenses associated with PL # 104-188 and AB 3499. This situation applies to all Method 5 water companies.

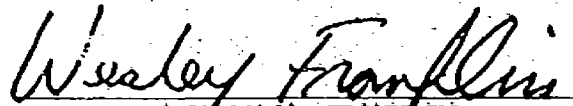
THEREFORE, IT IS ORDERED that:

1. All Class A water utilities, Jess Ranch Sewer Utilities, Inc., Southern California Edison Co., and Alco and Toro Water Companies are authorized to establish memorandum accounts by Advice Letter to record the revenues and expenses associated with PL # 104-188 and AB 3499 as described in this resolution. The revenues and expenses shall be reviewed by the staff in a future rate proceeding and, if found reasonable by the Commission will be allowed to be recovered in rates. The effective date of Advice Letter 280, and all other Advice Letters requesting the same treatment, shall be five days after the date of this resolution, or five days after filing, whichever is later.
2. No revenue or expense incurred prior to the effective date of this resolution shall be recorded in the memorandum account.

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3. Any deficiency created by gross-ups collected from the contributors that are less than the tax liability shall not be recovered from the ratepayers.
4. This resolution is effective today.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on December 20, 1996. The following Commissioners approved it:



WESLEY M. FRANKLIN
Executive Director

P. GREGORY CONLON
President
DANIEL Wm. FESSLER
JESSIE J. KNIGHT, Jr.
HENRY M. DUQUE
JOSIAH L. NEESPER
Commissioners