

JOINT IOU PROPOSAL

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Division of Water and Audits
Utility, Audit, Finance & Compliance Branch

San Francisco, California
Date: January 13, 2011
Resolution No. W-4867

RESOLUTION

RESOLUTION ON THE COMMISSION'S OWN MOTION PLACING ALL COST-OF-SERVICE RATE-REGULATED UTILITIES ON NOTICE TO INCLUDE EVIDENCE TO REFLECT THE BENEFITS OF THE TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOB CREATION ACT OF 2010 IN THEIR NEXT GENERAL RATE CASE (GRC)

BACKGROUND

On December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 ("New Tax Law"). It has come to the attention of the Commission that this law may provide tax relief to the utilities regulated by this Commission. Among other provisions, this law provides for accelerated bonus depreciation on certain business property put into service after September 8, 2010 and before December 31, 2013.¹ The intent of the bonus depreciation provisions of the New Tax Law is to encourage businesses, such as utilities, to invest in their infrastructure, thereby creating jobs and spurring the economy.

Provisions in the New Tax Law may reduce the utilities' costs of providing service. Many of the utilities regulated by this Commission have their rates set on a cost-of-service basis that includes a determination of rate base. These utilities include, without limitation: water and sewer system corporations, small local exchange carrier telephone corporations, gas and electrical corporations, pipeline corporations, and heat corporations. However, the general rates of those utilities are typically reviewed only once every three to four years.

This resolution applies only to CPUC-jurisdictional rate base and the effects of the New Tax Law on CPUC-jurisdictional infrastructure.

¹ Generally, the New Tax Law allows for bonus depreciation of 100% of the cost of qualifying property put into service in 2011, and 50% of the cost of qualifying property put into service in 2012.

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DISCUSSION

The Commission believes it is in the best interest of California's utility customers and the general public for utilities to take advantage of the bonus depreciation provisions of the New Tax Law. However, because the various cost-of-service rate regulated utilities are at different points in their respective GRC cycles, the means to effectuate these ratepayer benefits will also vary.

We first observe that utilities will not realize any changes in their 2011 income tax payments as a result of the New Tax Law until their first estimated quarterly payment for 2011, which the energy utilities indicated in their comments on the draft resolution would be made no earlier than the September 2011 payment. We also note that the New Tax Law includes provisions that may reduce utilities' income taxes, such as the bonus depreciation provisions, and others that may increase them, such as possible loss of the Internal Revenue Code §199 Manufacturers' Deduction. Finally, we note that under cost-of-service ratemaking, we are effectively required to "normalize" the effects of accelerated depreciation, such as the bonus depreciation provisions of the New Tax Law, so the benefits of the bonus depreciation provisions will be passed through to ratepayers over the book life of the investments.²

Southern California Edison Company, San Diego Gas & Electric Company, and Southern California Gas Company have each filed applications for test year 2012 GRCs. We find that by updating each of those utility's 2012 GRCs to reflect the New Tax Law, ratepayers will be able to realize the benefits of that legislation. In response to our Draft Resolution, each of those three utilities committed to updating their test year 2012 cost-of-service estimates to reflect the New Tax Law. By this Resolution, we order them to do so at the earliest possible date.³

While existing ratemaking mechanisms likely will result in ratepayers benefiting from the tax benefits utilities receive under the New Tax Law in each utility's next GRC, it is not clear that all of the tax benefits resulting from this new law will benefit ratepayers unless utilities increase expenditures on infrastructure before their next GRC.⁴ Consistent with

² See D.93848, 1981 WL 165280 at *2 ("Of particular significance to ratemaking is that a normalization method of accounting must be used for ACRS and ITC applied to property placed in service after December 31, 1980"). These tax law requirements remain applicable to current property additions and specifically apply to the treatment of bonus depreciation.

³ We understand that the Internal Revenue Service is in the process of promulgating regulations interpreting the New Tax Law and that the utilities will need some time to review those regulations, when issued, before complying with this directive. We expect SCE, SDG&E, and SoCalGas to advise the Assigned Administrative Law Judges and Assigned Commissioners in their respective GRC dockets when such update submittals can be made. We put these utilities on notice, however, that the effect of the New Tax Law will be reflected in the final revenue requirement amounts we will adopt for these utilities' test year 2012 GRCs.

⁴ For example, many utilities have a deferred tax account that may capture, for ratepayers, benefits of the new tax law. However, if there is a lag in incorporating the actual amount of this account into rates, there may be some portion of the benefits that do not go to ratepayers. Meanwhile, utilities have previously included in rates

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our intent that utilities take advantage of the New Tax Law to benefit customers, improve their infrastructure, and help create jobs within California, we hereby place those cost-of-service rate-regulated utilities that do not have test year 2012 GRCs on notice that they will be required to include evidence in their next GRC demonstrating that they have made additional expenditures on infrastructure in 2011, 2012, or 2013 (as applicable, depending on the utility) that offset the net benefits of the New Tax Law. -

To the extent that those utilities that do not have a test year 2012 GRC do not make additional expenditures on infrastructure in 2011, 2012, or 2013 (as applicable, depending on the utility) that offset the net benefits of the New Tax Law, and have merely retained the net savings, if any, associated with the New Tax Law between GRC test years, the utilities are also on notice that they are subject to an adjustment of their revenues in their next GRC and that such prospective adjustments are not barred by the prohibition against retroactive ratemaking.

COMMENTS ON DRAFT RESOLUTION

Public Utilities Code section 311(g)(1) generally requires draft resolutions to be issued for comment at least 30 days before being voted on by the Commission. However, pursuant to Public Utilities Code section 311(g)(3), the Commission has adopted Rule 14.6(c)(9) of its Rules of Practice and Procedure which permits a reduction in the comment period here. More specifically, Rule 14.6(c)(9) permits the Commission to reduce the 30-day period for public review and comment in circumstances where the public interest in the Commission adopting a resolution before expiration of the 30-day review and comment period clearly outweighs the public interest in having the full 30-day period for review and comment. This resolution does not change utility rates, nor determine that utility rates ought to be changed. It only permits the Commission to consider those issues at a future date. On the other hand, delaying issuance of this resolution to allow for the full 30-day comment period might extend the period of time during which uncertainty about the Commission's treatment of the New Tax Law could be a concern. Accordingly, the public interest in adopting this resolution before expiration of a 30 day public comment period clearly outweighs the public interest in allowing for the full 30 day comment period. Accordingly, the draft resolution was issued for comment on December 30, 2010, served on all persons on the attached service list, and placed on the Commission's Agenda for January 13, 2011. Consistent with Rule 14.6(c)(9), there was a reduced comment period with comments due on January 7, 2011.

benefits that will be lost as a result of the New Tax Law. Both should be considered in determining the net savings of a utility as a result of the New Tax Law. Additional spending on infrastructure by utilities is also likely to result in unrecovered additional property tax expense and depreciation expense. These additional expenses will reduce the levels of additional spending that the utilities can accommodate.

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In comments on the Draft Resolution, PG&E, SDG&E, SoCalGas, and SCE made several legal, policy, and factual arguments opposing the Draft Resolution as originally drafted, and we have reflected those comments, where appropriate, in this resolution.

FINDINGS AND CONCLUSIONS

1. President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 (“New Tax Law”) on December 17, 2010.
2. The New Tax Law may provide tax relief to the utilities regulated by this Commission; among other provisions, this law provides for accelerated bonus depreciation on certain business property put into service after September 8, 2010 and before December 31, 2013.
3. The general rates of cost-of-service rate regulated utilities are typically reviewed only once every three to four years.
4. The Commission believes it is in the best interest of California’s utility customers and general public for utilities to elect to use the bonus depreciation provision of the New Tax Law.
5. Those utilities with test year 2012 GRCs are directed to update their 2012 revenue requirement estimates to reflect the effect of the New Tax Law. All other cost-of-service rate-regulated utilities are hereby placed on notice that they are required to include evidence in their next GRC demonstrating that they have made additional expenditures on infrastructure in 2011, 2012, or 2013 (as applicable, depending on the utility) that offset net benefits of the New Tax Law.
6. While existing ratemaking mechanisms likely will result in ratepayers benefiting from a portion of the tax benefits utilities receive under the New Tax Law, it is not clear that all of the tax benefits resulting from this new law will benefit ratepayers unless utilities increase expenditures on their infrastructure that offset the net benefits of the New Tax Law.
7. This resolution does not change utility rates, nor determine that utility rates ought to be changed. For those utilities with 2012 GRCs, it directs them to revise their test year 2012 estimates to reflect the New Tax Law. For utilities that do not have a test year 2012 GRC, this resolution only permits the Commission to consider, at a future date, the issue of whether utility rates should be changed in a future GRC if utilities do not make additional expenditures on infrastructure in 2011, 2012, or 2013 (as applicable, depending on the utility) that offset net benefits of the New Tax Law and instead retain any cost savings between GRC test years.
8. Delaying issuance of this resolution to allow for a full 30-day comment period might extend the time during which utilities may be uncertain about the Commission’s treatment of the New Tax Law.

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9. The public interest in adopting this resolution before expiration of a 30 day public comment period clearly outweighs the public interest in allowing for the full 30 day comment period.

ORDER

1. All cost-of-service rate-regulated utilities are hereby placed on notice that they shall be required to include evidence of the net benefits resulting from the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 (“The New Tax Law”) in their next GRC.
2. For those utilities that do not have a test year 2012 GRC, to the extent that the Commission determines in a utility’s next GRC that a utility has not made additional expenditures on infrastructure in 2011, 2012, or 2013 (as applicable, depending on the utility) that offset the net benefits of the New Tax Law and has merely retained the cost savings, if any, associated with the New Tax Law, utilities are also on notice that they are subject to an adjustment of their revenues in their next GRC.
3. Southern California Edison Company, San Diego Gas & Electric Company, and Southern California Gas Company shall update their test year 2012 cost-of-service estimates to reflect the New Tax Law at the earliest possible date.
4. The Division of Water and Audits shall serve a copy of this resolution, by mail or e-mail, on all cost-of-service rate-regulated utilities and any additional persons who submitted comments on the draft resolution.
5. The effective date of this order is today.

I certify that this Resolution was adopted by the California Public Utilities Commission at its regular meeting of [insert new date], 2011, and that the following Commissioners approved it:

PAUL CLANON
Executive Director