From: Hughes, John (Reg Rel
Sent: 1/26/2011 9:18:18 AM
To: 'Galvin, Michael J.' (michael.galvin@cpuc.ca.gov)
Cc:
Bcc:
Subject: RE: Electric Utilities: Cash Flow Up In '11 Due To 100% Bonus Depreciation

Thanks.

From: Galvin, Michael J. [mailto:michael.galvin@cpuc.ca.gov]
Sent: Wednesday, January 26, 2011 9:17 AM
To: Hughes, John (Reg Rel)
Subject: FW: Electric Utilities: Cash Flow Up In '11 Due To 100% Bonus Depreciation

John
FYI
Please don't pass on the below comment. I deleted the name of the person who sent it.
Mike

Good Morning,

Here's free advice from Morgan Stanley, in case we're still thinking about paying a firm to tell us more about 100% bonus depreciation. Morgan Stanley agrees with our own internal expert, Mike Galvin, who has been saying this all along - that it is a cash flow issue and it lowers rate base in the next GRC.

I don't know where we are with the Resolution, but hopefully we can withdraw it.

JANUARY 26, 2011 GMT

Electric Utilities

Cash Flow Up In '11 Due To 100% Bonus Depreciation

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Morgan Stanley Research
North America

Greg

What's new: On 12/17/10, President Obama signed legislation that would extend and expand the bonus depreciation through 2012. The bill provides 100% depreciation bonus for capital investments placed in service after 9/8/10 through 12/31/11 and 50% bonus for equipment placed in service after 12/31/11 and through 12/31/12. Notably, 50% bonus depreciation, still applies to purchases made between 1/1/10 through 9/7/10.

Cash flow impact is material. For example, with a 20yr MACRS schedule, spending $1bn of capex would result in a $253MM after-tax cash flow benefit in the first year, assuming 75% of capex is eligible and a 35% tax rate. We provide details on our calculation in Exhibit 1.

For regulated utilities, the added inflow will ease financing overhang but slow rate base growth. The incremental cash flow is constructive from an operating standpoint and can mitigate near-term equity needs, with the trade-off being lower rate base growth. Utilities with large '11 financing needs that, we think, could benefit marginally from the incremental cash flow are SO, PGN, ED, and PCG. The extent of the current tax-shield benefit depends on individual company tax appetite. For instance the cash flow benefit could be delayed, in some cases beyond '12, for companies with already existing net operating losses (NOLs) or large deferred tax assets, such as NVE, CMS, TE and NEE. As we said above, the main drawback of bonus depreciation in a regulated environment lies with its effect on rate base growth trajectory. Higher tax depreciation slows down rate base expansion.

Cash flow impact positive for diversifieds. The additional cash flows provide a largely unplanned for benefit for the diversified utilities, especially in light of the depressed commodity price environment. Two main beneficiaries appear to be EXC and EIX.

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