PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

COMMISSION ADVISORY AND
COMPLIANCE DIVISION

RESOLUTION E-3331
July 21, 1993

R E S O L U T I O N

RESOLUTION E-3331. SAN DIEGO GAS AND ELECTRIC COMPANY, SOUTHERN CALIFORNIA EDISON COMPANY, SOUTHERN CALIFORNIA GAS COMPANY, PACIFIC GAS AND ELECTRIC COMPANY, AND CERTAIN WATER COMPANIES REQUEST AUTHORITY TO RECORD IN A MEMORANDUM ACCOUNT THE INCREMENTAL REVENUE REQUIREMENT EFFECT ASSOCIATED WITH CHANGES IN THEIR FEDERAL AND STATE TAX LIABILITY RESULTING FROM THE 1993 TAX REFORM MEASURES.

BY ADVICE LETTERS 874-E, 854-G, AND 989-E, FILED ON FEBRUARY 19, 1993, AND BY ADVICE LETTERS 2165-G AND 1771-G, FILED ON MARCH 1, 1993 AND MAY 14, 1993 (RESPECTIVELY) AND VARIOUS ADVICE LETTERS BY WATER COMPANIES.

SUMMARY

1. San Diego Gas and Electric Company (SDG&E) filed Advice Letters (AL) 874-E and 854-G on February 19, 1993. Southern California Edison Company (Edison) filed AL 989-E on February 19, 1993. Southern California Gas Company (SoCalGas) filed AL 2165-G on March 1, 1993. Pacific Gas and Electric Company (PG&E) filed AL 1771-G on May 14, 1993. Southern California Water Company (SoCal Water) filed AL 151-E for its Bear Valley District on March 1, 1993, and AL 915-W for its sixteen water districts on March 2, 1993. Park Water Company (Park Water) filed AL 154-W on March 10, 1993. Santa Paula Water Works, Ltd. (Santa Paula Water) filed AL 59-W on March 10, 1993. Antelope Valley Water Corporation (Antelope Water) filed AL 89 on March 15, 1993. Arden Water Company (Arden Water) filed AL 44 on March 15, 1993. Dominguez Water Corporation (Dominguez Water) filed AL 151 on March 15, 1993. Kernville Domestic Water Corporation (Kernville Water) filed AL 36 on March 15, 1993. County Water Company (County Water) filed AL 48 on March 29, 1993. California-American Water Company (Cal-Am Water) filed AL 423 on April 1, 1993. The purpose of each of these advice letters is to seek Commission authorization to create a tax memorandum account (TMA) and for permission to record in it the incremental revenue requirement effect due to changes in tax liabilities resulting from 1993 federal tax reform measures. The Division of Ratepayer Advocates (DRA) filed limited protests to SDG&E's, Edison's, SoCalGas', SoCal Water's, Park Water's,

and Santa Paula Water's advice letters, and a protest to PG&E's advice letter.

2. This resolution grants SDG&E's, Edison's, SoCalGas', PG&E Gas Department's, SoCal Water's, Park Water's, Santa Paula Water's, Antelope Water's, Arden Water's, Dominguez Water's, Kernville Water's, County Water's, and Cal-Am Water's requests for creation of TMAs, with certain modifications. Each of these utilities, and all other water utilities subject to this Commission's jurisdiction, are granted permission to record in a TMA the incremental revenue requirement effect due to changes in federal and state tax liabilities and other expenses resulting from 1993 federal tax reform measures, in accordance with the specific findings of this resolution.

BACKGROUND

1. In his State of the Union address on February 17, 1993, President Clinton identified a number of proposed tax changes that would directly increase the utilities' federal tax liability. Examples are: (1) an increase in the corporate tax rate for businesses with taxable income greater than $10 million per year, (2) a reduction in the deductibility of business entertainment expenses, and (3) a broad-based tax on energy, such as one based on British thermal unit usage. At this time the precise timing and components of any tax reform package cannot be determined. For example, alternative energy taxes are being considered. Therefore an accurate forecast of the complete impact cannot be made. Accordingly, the utilities request the Commission to authorize a tax memorandum account to record these increased costs.

2. SDG&E, Edison, SoCalGas, SoCal Water, Park Water, Santa Paula Water, Antelope Water, Arden Water, Dominguez Water, Kernville Water, County Water, and Cal-Am Water request the authorization of a TMA to record the incremental revenue requirement effect associated with their utility operations. PG&E has only requested a TMA to collect the incremental revenue requirement effect associated with its gas department's operation, consistent with its April 13th announcement of its electric rate initiative which would freeze electric rates through the end of 1994.

NOTICE

1. Public notification of all advice letters was made by the utilities through mailing copies of the advice letters to other utilities, governmental agencies, and to all interested parties who requested such information. Notice of the advice letters was published in the Commission Calendar.

PROTESTS

1. DRA filed limited protests to SDG&E's, Edison's, SoCalGas', SoCal Water's, Park Water's, and Santa Paula Water's advice letters, and filed a protest to PG&E's advice letter.

2. DRA is concerned that the advice letters for the establishment of TMAs to track changes in federal income tax (FIT) which may occur due to changes to the Internal Revenue Code (IRC) proposed by President Clinton are not definitive enough and need to be modified to include several limitations. DRA feels these limitations are necessary to ensure that the ratepayers do not bear any greater burden than is required when the changes are known.

3. DRA believes that the following modifications should be made to the utilities' TMA proposals:

A. The TMA should not include nor track any adverse tax impact attributable to modification of the deduction for entertainment, including any associated meals. DRA believes that in this current climate of economic hardship and fiscal austerity, ratepayers should not be forced to bear more costs associated with the lowering of tax deductibility for entertainment expenses.

B. The TMA should not include nor track the adverse tax impact attributable to the limiting of the tax deduction for executive salaries in excess of a specified maximum amount. (The current proposal calls for capping the deduction for executive salaries at $1,000,000). DRA believes it would be unfair to ask ratepayers to make the utility whole for any increased taxes due to executives receiving more than $1,000,000 in pay per year.

C. All FIT impacts which are tracked in the proposed TMA should relate to ratemaking FIT deductions and credits used to set each utility's rates in its last general rate case (GRC) for its test and attrition years. Any and all attempts to true-up ratemaking tax levels authorized for collection in rates to actual FIT expense, for any reason other than the reflection of new federal tax legislation, should be prohibited.

D. The TMA should only reflect the impact of changes in the IRC from the date the TMA is authorized. The FIT impact on tax deductions prior to the authorization of a TMA by the Commission should be excluded due to the restrictions of retroactive ratemaking.

E. Even if items A. and B. are allowed in part, the TMA should not incorporate any of those costs which are being billed or allocated to the utilities from their subsidiaries. In addition, costs associated with items A. and B. should not be "capitalized" as part of overheads included in the cost of capital assets.

4. DRA notes that the details of the Clinton tax proposal are sketchy at this point and subject to substantial changes prior to approval by Congress. (DRA believes it would be imprudent for the Commission to grant the utilities carte blanche to book

in the TMA the dollar impact of tax laws which have not yet even been proposed).

5. DRA offers two solutions. The first would be to limit the TMA to recording the tax effects of the Clinton plan as currently proposed. As changes to the proposal become apparent, the utility could file a new advice letter for authority to book the related effects in the TMA. In the alternative, DRA offers the somewhat novel solution of granting the utility's request with DRA's limitations, but also leaving the advice letter filings "open" and subject to further limitations for clearly inappropriate items as they come to light. Modification to the "open" advice letters could be accomplished by DRA or other parties filing another protest (which would also be sent to the utility by DRA and noticed in the Daily Calendar). After 20 days, the Commission Advisory and Compliance Division (CACD) could choose whether to grant the new protest.

6. In a number of its protests, DRA recommended the following additional limitations for the proposed TMAs.

A. The TMA should not include nor track the adverse tax impact attributable to limiting the IRS Code Section 401(a)(17) tax deduction for executive pension and other benefits to a specified maximum amount. (The current proposal calls for lowering the deduction for executive benefits from $253,840 to $150,000 per year). DRA believes it would be unfair to ask ratepayers to make the utility whole for any increased taxes due to lower limits being imposed on deductable executive benefits.

B. The TMA should not include nor track any tax impact attributable to a reduction or elimination of the deduction for club dues and lobbying expense, as these costs have historically been denied recovery by the Commission in utility rates.

7. For PG&E, DRA stated that it "opposes PG&E's request to book to a memorandum account the 'Clinton' taxes associated with PG&E's gas utility operation .... DRA's opposition is twofold. First, the details of the Clinton tax proposal are subject to substantial changes prior to approval by Congress. DRA believes it would be imprudent for the Commission to grant the utility carte blanche to book in the [TMA] the dollar impact of tax laws which have yet not even been proposed. .... Second, PG&E's rates are among the highest in the nation and will only be made higher if PG&E's advice letter is granted."

8. SDG&E filed a response to DRA's limited protest on March 29, 1993. In its protest, DRA contended that SDG&E's advice letters were not definitive enough and recommended several modifications to exclude certain tax impacts from the TMAs. In addition, DRA recommended that the advice letters remain "open" and be subject to further limitations for items which it feels are inappropriate for inclusion in the TMAs. SDG&E disagrees with DRA's position in this matter, as follows: The advice

letters were necessarily non-definitive due to the uncertainty involved in the federal tax reform process. The details of President Clinton's tax proposal are sketchy and subject to substantial changes prior to approval by Congress. SDG&E filed advice letters as a proactive measure to preserve its opportunity to seek recovery of its revenue requirements associated with changes in Federal and State Tax liabilities. SDG&E feels that by granting approval of its advice letters, the Commission would not provide any assurance that such amounts will be recovered. SDG&E will still have to request rate recovery of these amounts in either: (1) a separate application specifically requested for that purpose, (2) an Energy Cost Adjustment Clause proceeding, or (3) another rate-setting proceeding. DRA can litigate the appropriateness of reflecting specific tax law changes in rates when SDG&E requests rate recovery of the amounts recorded in the TMAs. Thus, there seems to be no need to limit what can be reflected in the TMAs or to leave its advice letters open.

9. SDG&E agrees with DRA that the TMA should reflect only changes to the revenue requirement reflected in rates due to changes in the tax law. The TMA is not intended to "true-up" the revenue requirement reflected in rates for actual tax expenses other than the changes associated with the proposed tax reform.

10. SDG&E disagrees with DRA's recommendation that the TMAs only reflect the impact of tax law changes from the date the TMAs are authorized. SDG&E states that the Commission's rules on retroactive ratemaking prohibit utilities from booking expenses incurred before Commission authorization of a memorandum account. Accordingly SDG&E makes the following arguments: (i) It will not incur expenses associated with tax law changes until the new laws are enacted, become effective and SDG&E records a liability on its books. (ii) Even if the adopted tax law changes are applied back to January 1, 1993, SDG&E will not incur any additional tax liability until they are passed by Congress later this year. (iii) Thus, the TMA should reflect the impact of all tax law changes even if effective back to January 1, 1993, provided the legislation is enacted after SDG&E has received authorization to establish a TMA.

11. Edison filed its response to DRA's limited protest on March 8, 1993. Its comments were substantially the same as SDG&E's comments, except it stated that it would "maintain supporting documentation such that the monthly entries to the [TMA] can be traced back to the then current revenue requirement reflected in rates. Recording the changes to the revenue requirement reflected in rates due to the adopted tax law changes in the [TMA] preserves Edison's ability to seek rate recovery, it does not provide any assurance that such amounts will ultimately be recovered in rates." Therefore, Edison feels that there is no need to limit what can be reflected in the TMA or leave its advice letter "open". DRA can litigate the appropriateness of reflecting specific tax law changes in rates when Edison requests rate recovery of the amount recorded in the TMA.

12. SoCalGas, SoCal Water, Park Water, and Santa Paula Water did not respond to DRA's limited protests.

13. PG&E responded to DRA's protest on June 3, 1993. DRA contended that it would be imprudent for the Commission to grant PG&E "carte blanche" to book in the TMA the dollar impact of tax laws which have yet to be proposed. It is also DRA's belief that PG&E will have ample opportunity to file a new advice letter once a new tax law has been passed. PG&E's position is that:

> PG&E is merely requesting a tracking account at this time, not actual recovery of the costs in question. The establishment of a tracking account is only the first step in obtaining recovery and DRA will have another opportunity to object before any amount is recovered. Moreover, DRA's assertion that the tax has not been proposed is incorrect: the legislation has already passed the House of Representatives.

14. DRA stated that PG&E's filing should be rejected because Congress is likely to substantially modify the details of the President's proposal before it is enacted. In addition, according to DRA the memorandum account should only reflect costs from the date the account is first authorized by the CPUC. PG&E's response to these statements is that:

> These two DRA positions, when taken together, would leave the utility completely without recourse to recover tax costs associated with pending legislation with retroactive effect. Additionally, PG&E disagrees with DRA's views on retroactive ratemaking. In the legislative context, the rule against retroactive ratemaking should not be applicable to periods prior to enactment because the liability is not actually fixed until the law is enacted. In any event, any retroactive ratemaking issues may be resolved at the time the utility seeks recovery, rather than now, at the time the account is established.

15. DRA asserted that PG&E should not be allowed to recover the cost of potential tax law changes decreasing the deductibility of meals, entertainment, pension accrual, executive compensation and lobbying expenses. PG&E's response is that:

> PG&E is only requesting to establish a tracking account now. The merits of such costs booked into the account can be discussed at a later date.

16. In DRA's protest, DRA indicated that there is no language in PG&E's tariff to limit the TMA to tax impacts affecting only PG&E's gas department. DRA recommended that PG&E's Preliminary Statement be revised to reflect this limitation. PG&E's response is that:

> PG&E's gas and electric departments each have their own tariffs and thus two distinct Preliminary Statement sections. Advice 1771-G requested approval of an addition

to PG&E's gas Preliminary Statement only. Therefore, no language needs to be included to reflect such limitations.

17. In DRA's protest it stated that PG&E's rates are among the highest in the nation and noted that PG&E has volunteered to absorb the impacts of the new tax legislation on the electric side. DRA asks PG&E to additionally absorb the gas side impacts. PG&E's answer is that:

> Taxes are an appropriate cost of operations and recovery should not be barred because of high rates which may be caused by unrelated factors. Finally, PG&E's gas rates are in fact not among the highest in the nation and rank slightly above the U.S. average according to the American Gas Association monthly gas utilities statistical report.

DISCUSSION

1. The first question that has to be answered is -- should TMAs be approved. DRA and the utilities agree that it is impossible to determine the actual effect of the 1993 federal tax reform legislation before the final legislation is signed. This creates a level of uncertainty in the amount that could be recorded in memorandum accounts.

2. This uncertainty is the basis for the utilities filing their advice letters. When these utilities' rates were last set, the Commission used the then current tax laws in determining their revenue requirements. If the utilities are unable to recover any additional taxes imposed by the 1993 federal tax reform legislation this will likely affect the rates of return they earn.

3. Therefore, CACD recommends that the Commission authorize SDG&E, Edison, SoCalGas, PG&E' Gas Department, SoCal Water's Bear Valley District, and all water utilities under the Commission's jurisdiction to establish TMAs and record in these TMAs only the incremental revenue requirement effect due to changes in federal and state tax liabilities and other expenses resulting from the 1993 federal tax reform legislation.

4. By authorizing the utilities to establish these TMAs this Commission is not guaranteeing that the utilities will receive the incremental revenue requirements recorded in the TMAs. Each utility will have to support every dollar for which it will seek recovery.

5. The next question that has to be answered is what costs should be recorded in these TMAs. DRA suggested several limits in its protests.

6. The utilities' general response to DRA's proposed limits was that no limits are required now since all incremental revenue requirements in their TMAs will be reviewed prior to their recovery.

7. To a large extent, CACD agrees with the utilities' response. However, any and all attempts to true-up ratemaking tax levels authorized for collection in rates to actual tax expense, for any reason other than the reflection of the 1993 federal tax reform legislation, should be prohibited. The amounts to be recorded in the TMAs should be based on the ratemaking figures (e.g. revenues, profits, and tax deductions and credits) used to set each utility's rates in its most recent rate-setting proceedings, so long as such figures are available. More specifically, in calculating the federal and state income tax liability portion, each utility should record the incremental revenue requirement due to a change in its tax rate and changes to the tax deductions and credits last allowed in setting its rates.

8. In addition, these TMAs should not only include the cost increases due to the new federal legislation, but also all cost decreases caused by the 1993 federal tax reform legislation.

9. Each utility will be responsible for maintaining the supporting documents for all entries made into its TMA, and it will be the responsibility of each utility to support all incremental revenue requirements that it will seek recovery for in proceedings before this Commission. This includes showing that it is reasonable to recover any additional revenue requirement from the utility's ratepayers. Today's resolution simply establishes a mechanism to enable the utilities to seek recovery of the amounts they book in their TMAs.

10. SoCalGas and PG&E requested that their TMAs include interest on the balance in their TMAs. All requests for TMAs should be treated consistently, including whether they include interest. CACD feels that each utility should be responsible for the carrying costs associated with the balance recorded in its TMA. The risks of increased costs that may be caused by the 1993 federal tax reform legislation should be shared between the utilities' shareholders and their ratepayers. Therefore, CACD recommends that the utilities not be authorized to include interest on the outstanding balances recorded in their TMAs.

11. The last issue is what incremental revenue requirements should be booked into the TMAs in light of retroactive ratemaking issues.

12. The issue of retroactive ratemaking has been raised for two reasons: First, it is possible, although not likely, that the new tax legislation will be signed into law before the TMAs are authorized. Second, the new tax legislation may increase tax rates for periods prior to its passage.

13. In Decision (D.) 92-03-094 this Commission stated that:

> "It is a well established tenet of the Commission that ratemaking is done on a prospective basis. The Commission's practice is not to authorize increased utility rates to account for <u>previously</u> incurred expenses, unless, before the utility incurs those expenses, the Commission

has authorized the utility to book those expenses into a memorandum or balancing account for possible future recovery in rates."

14. The utilities' position is that these costs will not be incurred until the legislation is signed. But, DRA's position is that costs related to a period prior to the authorization of a memorandum account should not be allowed.

15. Because the legislation is not finalized at this time, CACD cannot determine what time period will be covered. In PG&E's response, it stated that "any retroactive ratemaking issues may be resolved at the time the utility seeks recovery, rather than now, at the time the account is established." CACD agrees with PG&E that retroactive ratemaking issues should be reviewed when the utilities seek recovery of these incremental revenue requirements.

16. Therefore, CACD recommends that the utilities be allowed to include in their TMAs all incremental revenue requirement effects that result from the new federal legislation, so long as the new legislation is signed into law after the effective date of this resolution. This will permit the utilities to present their arguments on the retroactive ratemaking issue when they seek recovery of the amounts recorded in their TMAs. However, if any 1993 federal tax reform legislation is signed into law prior to the effective date of this resolution, only the incremental revenue requirement effect of such legislation that relates to periods after the effective date of this resolution may be booked into the TMAs. Prior Commission decisions clearly require this limitation.

FINDINGS

1. By authorizing TMAs for SDG&E, Edison, SoCalGas, PG&E's Gas Department, SoCal Water's Bear Valley District, and all California water utilities under the Commission's jurisdiction, the Commission will enable them to seek future recovery of the incremental revenue requirement effects of pending 1993 federal tax reform legislation. Today's resolution simply establishes a mechanism to enable the utilities to seek recovery in the future and does not guarantee the utilities that they will be granted recovery of the incremental revenue requirement effect of 1993 federal tax reform legislation. The reasonableness of whether any or all of the amounts recorded in the TMAs should be recovered from ratepayers will be decided later.

2. Each utility will be allowed to record in its TMA the incremental revenue requirement effect due to changes in federal and state tax liabilities and other expenses that result from the 1993 federal tax reform legislation. Any and all attempts to true-up ratemaking tax levels authorized for collection in rates to actual tax expense, for any reason other than the reflection of the 1993 federal tax reform legislation, are prohibited. The amounts to be recorded in the TMAs shall be based on the ratemaking figures (e.g. revenues, profits, and tax deductions and credits) used to set each utility's rates in its

most recent rate-setting proceedings, so long as such figures are available. More specifically, in calculating the federal and state income tax liability portion, each utility will record the incremental revenue requirement due to a change in its tax rate and changes to the tax deductions and credits last allowed in setting its rates.

3. The utilities shall include in their TMAs not only their increases in costs, but also any decreases in costs as well.

4. SDG&E, Edison, SoCalGas, PG&E's Gas Department, SoCal Water's Bear Valley District, and every California water utility regulated by the Commission should be allowed to include in their TMAs all incremental revenue requirement effects due to changes in federal and state tax liabilities and other expenses that result from the 1993 federal tax reform legislation, so long as the new legislation is signed into law after the effective date of this resolution. These amounts will be reviewed for retroactive ratemaking issues at the time the utilities seek recovery of their TMAs. However, if 1993 federal tax reform legislation is signed into law prior to the effective date of this resolution, only the incremental revenue requirement effect of such legislation that relates to periods after the effective date of this resolution may be booked into the TMAs.

5. It will be the responsibility of the utilities to maintain support for each amount recorded in their TMAs.

6. The utilities will not be allowed to accrue interest on the balances recorded in the TMAs.

7. Prior to recovery of any cost included in the TMA, each utility will have to seek Commission authorization to recover these costs, and will have the burden of proof in showing that recovery of these costs is reasonable. Recovery of these costs may be requested in either:

A. A separate application specifically for that purpose;

B. An Energy Cost Adjustment Clause proceeding;

C. A Biennial or Triennial Cost Adjustment Clause proceeding; or,

D. Another rate-setting proceeding.

THEREFORE, IT IS ORDERED that:

1. San Diego Gas and Electric Company, Southern California Edison Company, Southern California Gas Company, Pacific Gas and Electric Company (Gas Department only), Southern California Water Company, Park Water Company, Santa Paula Water Works, Ltd., Antelope Valley Water Corporation, Arden Water Company, Dominguez Water Corporation, Kernville Domestic Water Corporation, County Water Company, California-American Water Company, and all other water utilities under this Commission's

jurisdiction are authorized to establish a tax memorandum account (TMA), to be known as the 1993 Federal Tax Reform Legislation Memorandum Account, consistent with the findings in this resolution.

2. The effective date of these 1993 Federal Tax Reform Legislation Memorandum Accounts shall be July 21, 1993.

3. San Diego Gas and Electric Company, Southern California Edison Company, Southern California Gas Company, Pacific Gas and Electric Company's Gas Department, and Southern California Water Company's Bear Valley District shall file revised tariff sheets, consistent with Ordering Paragraph 1 of this resolution, within five working days. These tariff sheets shall be marked with an effective date of July 21, 1993.

4. This resolution is effective today.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on July 21, 1993. The following Commissioners approved it:

Executive Director

DANIEL Wm. FESSLER
President
NORMAN D. SHUMWAY
P. GREGORY CONLON
Commissioners

Commissioner Patricia M. Eckert, being necessarily absent, did not participate.