PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

COMMISSION ADVISORY AND COMPLIANCE DIVISION

RESOLUTION E-3335
August 4, 1993

R E S O L U T I O N

RESOLUTION E-3335. RESOLUTION CORRECTING 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. Resolution E-3331 authorized 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, California Water Service Company, Apple Valley Ranchos 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 to establish a tax memorandum account (TMA), to be known as the 1993 Federal Tax Reform Legislation Memorandum Account, consistent with the findings in that resolution.

2. Discussion of nine documents (two advice letters, a limited protest filed by DRA, an opposition filed by the City of Carson, and five responses to DRA's limited protests) could not be included in Resolution E-3331. These documents are discussed in this resolution to complete the record, but their substance does not result in any change to the order in Resolution E-3331.

3. This resolution reaffirms Resolution E-3331.

BACKGROUND

1. Nine documents were inadvertently not discussed in Resolution E-3331. This resolution discusses the following documents that were not discussed in resolution E-3331:

A. California Water Service Company (Cal Water) Advice Letter (AL) 1282, filed on March 2, 1993.

B. Apple Valley Ranchos Water Company (Apple Valley Water) AL 89-W, filed on March 8, 1993.

C. The Division of Ratepayer Advocates's (DRA) limited protest to Apple Valley's AL 89-W, dated March 17, 1993.

D. The City of Carson's (Carson) opposition to Southern California Water Company's (SoCal Water) AL 915-W, dated March 22, 1993.

E. Apple Valley's response to DRA's limited protest of AL 89-W, dated March 26, 1993.

F. Park Water Company's (Park Water) response to DRA's limited protest of AL 154-W, dated March 26, 1993.

G. Santa Paula Water Works, Ltd. (Santa Paula Water) response to DRA's limited protest of AL 59-W, dated March 26, 1993.

H. SoCal Water's response to DRA's limited protest of AL 915-W, dated April 1, 1993.

I. Southern California Gas Company's (SoCal Gas) response to DRA's limited protest of AL 2165-G, dated April 6, 1993.

NOTICE

1. Public notification of ALs 1282 and 89-W 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.

DISCUSSION

Advice Letters 1282 and 89-W

1. ALs 1282 and 89-W request the Commission's approval to record in a TMA all of the utilities' revenue requirement associated with changes in Federal and State tax liability and Federal imposed fees resulting from President Clinton's proposed tax reform measure. The utilities will request rate recovery of the amounts recorded in the memorandum accounts in a future rate setting proceeding.

2. These requests are identical with requests that are discussed in Resolution E-3331. In that resolution, the Commission authorized all California water utilities under this Commission's jurisdiction to have 1993 Federal Tax Reform Legislation Memorandum Accounts, consistent with the findings in Resolution E-3331.

3. Cal Water and Apple Valley Water were authorized to have a 1993 Federal Tax Reform Legislation Memorandum Account in Resolution E-3331. Therefore no further action by the Commission is necessary.

DRA's Limited Protest to AL 89-W

4. DRA filed a limited protest to AL 89-W on March 17, 1993. DRA's limited protest is similar to the limited protests that were discussed in E-3331. Therefore, consideration of this document requires no change to the result reached in Resolution E-3331.

Carson's Opposition to AL 915-W

5. Carson filed its opposition to AL 915-W on March 22, 1993. During a meeting of the Carson City Council, on March 16, 1993, the council unanimously approved opposition to the TMA requested in Advice Letter 915-W. Carson's opposition is that "(C)hanges in federal and state tax liabilities which will impact the Southern California Water Company's operations through approval of Advice Letter No. 915-W will allow recovery of revenue associated with these liabilities. Approval of this action will pass along costs to community members who are already burdened with increasing utility rates."

6. Resolution E-3331 did not allow the recovery of any costs. It merely established a mechanism to enable the utilities to seek future 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 TMA should be recovered from ratepayers will be decided later in a future rate setting proceeding.

7. At that time, Carson will have the opportunity to raise any objection to SoCal Water's recovery of the costs included in its 1993 Federal Tax Reform Legislation Memorandum Account. Therefore, Carson's opposition requires no change to the result reached in Resolution E-3331.

Responses to DRA's Limited Protests

8. Apple Valley Water, Park Water, and Santa Paula Water filed responses to DRA's protest on March 29, 1993. All three responses are essentially identical. In their responses the water utilities stated that:

> In DRA's limited protests, DRA claims that the utilities' request needs to be revised to include several limitations necessary to ensure that the utility's ratepayers bear no

greater burden of Federal Income Tax (FIT) expense than is appropriate or expressly required when the actual changes are known.

DRA next proposes seven modifications and limitation, items which would not be includable in the TMAs, and offers two "solutions:"

1. The TMAs be limited to the tax effects of the Clinton Plan as currently proposed and that the utility file new advice letters to book additional effects into the TMAs as changes in the proposal become evident.

2. The TMAs be granted with DRA's suggested limitations but also leaving the advice letter filing "open" and subject to further limitations for items which DRA or other parties consider inappropriate, the further limitations to be accomplished by filing of additional limited protests.

The utilities believe that neither of these "solutions" are appropriate or necessary.

DRA notes that the details of the Clinton tax proposal are sketchy at this point and subject to substantial change prior to approval by Congress. Therefore, either of DRA's proposed "solutions" will result in numerous additional filing of advice letters and/or letters of protest by and concerning the utility and all the other companies who have requested TMAs. Given what the utilities have heard regarding the Commission Staff's current workload and staffing levels, this would impose an undesirable and non-productive additional workload on Staff and all parties.

DRA believes that it would be imprudent for the Commission to grant utilities a carte blanche to book in the TMAs the dollar impact of tax laws which have not yet been proposed and further believes that its proposed limitations on the TMAs are necessary to ensure that ratepayers do not bear a greater burden of FIT than is appropriate.

DRA's beliefs are apparently founded on the assumption that upon establishment of TMAs, the utilities could book expenses into the TMAs based only on proposed changes in the Internal Revenue Code (IRC) and that any expense booked into the TMAs would automatically be recoverable. Memorandum accounts do not work that way. Memorandum accounts track expenses for potential later recovery after the appropriate ratemaking treatment is determined. It is not necessary to determine the appropriate ratemaking treatment prior to establishing the memorandum account.

The utilities neither anticipate nor request recovery from the TMAs until after changes in the tax law are adopted by the Federal government and the ratemaking treatment of those changes has been established by the Commission. The TMAs requested by the utilities would not allow them to

recover FIT expense associated with tax law changes that are merely proposed or tax law changes which the Commission does not determine appropriate to reflect in rates. If necessary, the utilities would certainly stipulate to having language to this effect included in the resolution authorizing the TMAs.

It is the utilities' position that DRA's proposed "solutions" are not necessary because DRA's concerns are unfounded and because, if some assurance is required, it could more easily be provided by the stipulation proposed above by the utilities as to the language in the resolution. Furthermore, DRA's proposed limitations of the ability of the TMAs to track the impacts attributable to certain potential changes in the tax laws are not appropriate because they would effectively pre-empt the Commission's authority to determine the ratemaking treatment of the tax laws for the period that the TMAs are in effect.

When the Federal Tax law was last changed, in the Tax Reform Act of 1986 (TRA-86), the general result was a reduction in corporate tax expense. In that case, the Commission required that the utilities recalculate their adopted revenue requirement, retroactive to the effective date of TRA-86, to reflect the Commission's determination of the ratemaking treatment of the changes in the tax laws and refund the difference, with interest, to ratepayers. The only thing the utilities are requesting is the opportunity, limited by the effective date of the TMAs, to do the same thing now that it appears probable that there will be changes in the tax laws which will increase their FIT expense. Since there is no certainty of the effective date of any changes of the tax law or the Commission's determination of the appropriate ratemaking treatment of those changes, TMAs are necessary to ensure the utilities that opportunity.

9. SoCal Water filed its response to DRA's limited protest of AL 915-W on April 1, 1993. In its response, SoCal Water stated:

In its protest, DRA has recommended that the TMA not include any changes to the revenue requirement reflected in rates due to changes in the deductibility of entertainment expenses, for executive salaries in excess of $1,000,000, and other items. In addition, the DRA recommended that Advice Letter 915-W needs to remain "open" and subject to further limitations if other items come to light which they feel are inappropriate for inclusion in the TMA. SoCal Water disagrees with the DRA since the purpose of the TMA is to record the changes to the revenue requirement reflected in rates due to changes in the tax law which cannot be forecast at this time. SoCal Water will request rate recovery of the amounts recorded in the TMA in either: (1) a separate application specifically for that purpose, (2) a supply cost offset proceeding, or (3) another rate setting proceeding. SoCal Water will 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 adopted tax law changes in the TMA preserves SoCal Water's ability to seek rate recovery, it does not provide any assurance that such amounts will ultimately be recovered in rates. Thus, there is no need to limit what can be reflected in the TMA or leave Advice Letter 915-W "open". The DRA can litigate the appropriateness of recording specific amounts in the TMA.

SoCal Water agrees with the DRA that the TMA should reflect only changes to the tax 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 for changes associated with the proposed tax law change.

With respect to DRA's argument on the ratepayers being "forced to bear more costs associated with the lowering of tax deductibility for entertainment expenses", as well as the whole list of DRA modifications, SoCal Water contends that whatever tax liability is attributed to the incurrance of any expenses, it is not within the purview of DRA to determine whether the tax liability attributed to the expense is proper for ratemaking. Rather, it is DRA's obligation to review the prudency of the underlying expenses in relation to their necessity to the utility's obligation to provide service. Once the prudency of the expense is established, it becomes DRA's responsibility to ensure that the tax obligation so attributable is properly reflected in rates. To do otherwise assumes the utility has some choice on how expenses are taxed. SoCal Water is not claiming that whether or not a particular expense carries a tax burden is not relevant to the prudency of including the expense in the cost of service, but is claiming that once prudency of the expense is established the tax liability is merely a consequence of existing tax law.

The DRA also recommends that the TMA should reflect only the changes to the revenue requirement reflected in rates attributed to changes in the IRC from the date the TMA is authorized because the impact of changes to tax charges prior to the authorization of the TMA would be prohibited by the Commission's rules on retroactive ratemaking. SoCal Water disagrees with DRA assertions that there is a retroactive ratemaking concern because retroactive ratemaking only prohibits utilities from recording in the memorandum account expenses incurred before Commission authorization of the memorandum account. SoCal Water will not incur expense associated with changes in the IRC until the tax law changes are passed by Congress, become effective, and SoCal Water records a liability on its books. Even if the adopted tax law changes are applied back to January 1, 1993, or some other date, SoCal Water will not incur any additional tax liability until the tax

law changes are enacted by Congress later this year. It is inappropriate for SoCal Water to begin accruing taxes based upon any proposed tax law changes at this time. Frequently, tax law changes are proposed but never adopted. Until a tax law change is enacted, SoCal Water has no liability. Thus, the TMA should reflect the impact of all changes in the IRC for the effective date of the change, provided they are enacted after SoCal Water has received authorization to establish a TMA.

10. SoCal Gas filed its response to DRA's limited protest of AL 2165-G on April 4, 1993. In its response it stated that:

> The purpose of the TMA is to track gas revenue requirements associated with changes in SoCal Gas' federal and state tax liability resulting from proposed tax legislation. The DRA has questioned whether additional limitations need to be imposed concerning SoCal Gas' FIT liability. SoCal Gas submits that the limitations which DRA proposes to place on the proposed TMA are not necessary, as DRA has alleged, "[T]o ensure that SoCalGas' ratepayers do not bear any greater burden of FIT expense than is appropriate or expressly required when the actual changes are known." Moreover, since any substantial changes in the law cannot be determined until legislation is enacted, consideration of limitations such as those proposed by DRA is entirely premature at this time.
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> Recording in the TMA changes to the revenue requirement resulting from law changes merely preserves SoCal Gas' ability to seek rate recovery. It provides no assurance that such amounts will ultimately be recovered in rates. Rather, SoCal Gas intends to request rate recovery of the amounts recorded in the TMA through a subsequent application specifically designed for that purpose, a cost allocation proceeding, or another rate setting proceeding. SoCal Gas' supporting documentation will track monthly entries to the TMA back to the revenue requirement reflected in current rates. At that time, DRA, or any other party, will have an adequate opportunity to litigate the appropriateness of reflecting specific tax law changes in rates. For these reasons, none of the specific modifications recommended by DRA, nor the proposal that AL 2165-G remain open and subject to further limitations, should be adopted. Such limitations could act to the prejudice of SoCal Gas and are entirely unnecessary to accomplish the sole objective cited by DRA in support of its recommendations.
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> DRA has also recommended that the TMA only reflect the impact of changes of the IRC from the date that the TMA is authorized. SoCal Gas categorically disagrees with DRA's assertion that the rule against retroactive ratemaking prohibits utilities from booking expenses incurred prior to Commission authorization of a memorandum account. SoCal Gas submits that it will incur no expense resulting from changes made to the IRC until the new law becomes effective

and SoCal Gas has recorded such a liability on its books. Both will occur after the TMA has been established.

Even if the tax law changes are adopted retroactive to January 1, 1993, SoCal Gas will actually incur no additional tax liability until the proposed changes are enacted into law. It would be inappropriate for SoCal Gas to begin accruing taxes at this time to reflect changes which have not been adopted. Until and unless a change in the IRC is enacted, SoCal Gas has not incurred a tax liability. As a result, SoCal Gas submits that the TMA should reflect the impact of all changes in the IRC, even if retroactively applied to January 1, 1993, provided that they are enacted after SoCal Gas has received authorization to establish the TMA. Prior to final adoption of changes to the IRC, SoCal Gas simply cannot be viewed as having incurred liability for any such charges.

11. The responses of these five utilities essentially contain comments similar to those already made by San Diego Gas and Electric Company, Southern California Edison Company, and Pacific Gas and Electric Company that were considered in Resolution E-3331. In E-3331 the Commission agreed with the position of these utilities that TMAs should be authorized now, with a decision as to which amounts should be recovered from ratepayers deferred until later. Furthermore, E-3331 agreed with SoCal Gas' position on authorizing the utilities to record 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 Resolution E-3331. These amounts will be reviewed for retroactive ratemaking issues at the time the utilities seek recovery of their TMAs. Therefore, consideration of the responses of these five utilities requires no change to the decision reached in Resolution E-3331.

FINDINGS

1. Cal Water and Apple Valley Water were authorized to have 1993 Federal Tax Reform Memorandum Accounts in Resolution E-3331.

2. The documents that were not discussed in Resolution E-3331 do not change this Commission's position on authorizing the 1993 Federal Tax Reform Legislation Memorandum Accounts in Resolution E-3331.

THEREFORE, IT IS ORDERED that:

1. The findings and orders in Resolution E-3331 are reaffirmed.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on August 4, 1993. The following Commissioners approved it:

Executive Director

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