

## PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

COMMISSION ADVISORY  
AND COMPLIANCE DIVISION  
Energy Branch

RESOLUTION E-3374  
March 9, 1994

R E S O L U T I O N

RESOLUTION E-3374. SOUTHERN CALIFORNIA EDISON COMPANY REQUESTS AUTHORITY TO ESTABLISH A DEMAND-SIDE MANAGEMENT TAX CHANGE MEMORANDUM ACCOUNT.

BY ADVICE LETTER NO. 1030-E filed on November 23, 1993.

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SUMMARY

1. In this advice letter Southern California Edison Company (Edison) requests authority to establish a Demand-Side Management (DSM) Tax Change Memorandum Account. The advice letter, as filed, was unclear whether Edison was requesting memorandum account treatment for differences in taxes, interest, and penalties for prior periods or only prospective periods.
2. The Division of Ratepayer Advocates (DRA) protested this filing with concerns over retroactive ratemaking. Edison's response clarified that its request was for prospective periods only. The protest is denied.
3. This resolution authorizes Edison to establish the requested memorandum account to record potential future costs, as defined herein.

BACKGROUND

1. The purpose of this filing is to modify Edison's Preliminary Statement, Part N., Memorandum Accounts, to reflect the establishment of a DSM Tax Change Memorandum Account. Edison requests that the memorandum account reflect, on a monthly basis, the difference between Edison's total revenue requirement reflected in rates under the current tax method of expensing DSM costs and Edison's total revenue requirement reflected in rates adjusted to reflect the capitalization, for tax purposes, of certain DSM costs that are incurred after the establishment of the memorandum account. The change in revenue requirement, as proposed by Edison, would include (1) any penalties and interest assessed by tax agencies for tax periods after the effective date of the memorandum account if Edison's taxes are recalculated to reflect the capitalization of prospective DSM costs and (2) interest accrued after the effective date of the memorandum account (and paid to a tax agency) related to taxes and penalties for prior tax periods if

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Edison's taxes are recalculated to reflect the capitalization of prior DSM costs.

2. Edison's request follows an Internal Revenue Service (IRS) audit of Edison's 1983 through 1985 tax returns in which the IRS examining agent determined Edison's DSM program expenditures must be capitalized for tax purposes, rather than expensed as Edison and other utilities have treated such costs. Edison believes that if the IRS ruling changing the tax treatment of DSM expenditures is sustained, it will also impact future tax periods. Edison is not requesting that the memorandum account record any taxes or penalties for tax periods occurring prior to the effective date of the memorandum account. In addition, interest related to prior tax periods which accrued before establishment of the memorandum account would not be tracked in the memorandum account but would be borne by Edison's shareholders.

3. Edison states that its request for a memorandum account is consistent with Decision (D.) 90-01-016 because it is not seeking to record or recover tax liabilities or penalties for past tax periods. Edison states that it is responding to uncertainty relating to the proper tax treatment of DSM costs. Edison states that the creation of a tax memorandum account to address future tax periods permits the utility to pursue an aggressive tax return position for the benefit of the ratepayers.

4. The United States Supreme Court decision Indopco, Inc. v. Commissioner, (503 U.S. \_\_\_\_, 117 L.Ed. 2d 226, 112 S.Ct. 1039 (1992)) found that if a current cost to a company creates a substantial future benefit for the company, then that cost should be capitalized and not expensed for tax purposes. In D.93-12-043, the California Public Utilities Commission (Commission) allowed Southern California Gas Company to establish a memorandum account to track the interest and penalties, if any, imposed on the utility as a result of the Indopco decision.

5. By establishing a memorandum account, Edison preserves its opportunity to seek recovery of the potential changes in revenue requirement discussed above. Edison will request rate recovery of the amounts recorded in the memorandum account in a future proceeding if it is conclusively determined that DSM costs should be capitalized rather than expensed.

6. Edison filed Advice Letter 1030-E on November 23, 1993. On December 21, 1993, Edison filed a response to DRA's protest.

#### NOTICE

The original Advice Letter was noticed in accordance with section III of General Order 96-A by publication in the Commission Calendar and distribution to Edison's advice filing service list.

### PROTESTS

1. The Commission Advisory and Compliance Division (CACD) has received a protest from DRA for this Advice Letter filing.
2. DRA protests the retroactive nature of Edison's request and recommends that Edison's request for a memorandum account be rejected. DRA cites numerous California Public Utilities Commission (Commission) decisions in support of its position that the Commission has consistently denied establishment of memorandum accounts to record increases or decreases in expense levels which come to light years after the establishment of the original ratemaking levels of expense.
3. DRA cites D.88-01-061 as the Commission decision which sets forth the appropriate circumstances under which the Commission could authorize a tax memorandum account. That decision states that where there is uncertainty about the treatment of certain costs related to current or future tax periods, the Commission would authorize establishment of tax memorandum accounts. DRA does not believe Edison's request meets this criteria.

### DISCUSSION

1. Edison's initial advice letter filing left room for interpretation whether its request was for a memorandum account to record changes in revenue requirements associated with future tax periods (i.e., after establishment of a memorandum account) or for recovery of taxes, penalties, and interest associated with prior tax periods. This lack of clarity led to DRA's protest of the retroactive ratemaking nature of the filing. In its response to DRA's protest, Edison clarified that it was not seeking to record taxes and penalties associated with prior tax periods, but was seeking to record potential future costs for future tax periods. Edison does intend to record interest accrued after establishment of the memorandum account related to prior tax periods.
2. The Indopco decision, as well as the IRS examining agent's ruling, cause uncertainty about the appropriate treatment of DSM expenditures for tax purposes. Such IRS action was not anticipated in general rate cases for past years. D.92-08-007 states "if the [IRS] tax strategy developed for a past year is applicable to a future tax year, then the rule against retroactive ratemaking would not bar creation of a tax memorandum account to address only the future period." (p.4) Therefore, with respect to Edison's request to record the difference between Edison's total revenue requirement reflected in rates under the current tax method of expensing and Edison's total revenue requirement adjusted to capitalize certain DSM costs incurred after the establishment of the memorandum account for future tax periods, CACD recommends approval.
3. In addition, Edison requests the ability to record, from the date a memorandum account is established, the interest associated with prior tax liabilities and penalties. It is well

established at this Commission, that ratemaking is done on a prospective basis. The Commission's practice is not to authorize increased utility rates to account for previously 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. This practice is consistent with the rule against retroactive ratemaking. (See generally, D.92-09-055.) Edison's request for interest related to prior tax periods does not appear to violate the Commission's prohibition against retroactive ratemaking because the costs Edison wishes to record have not yet been incurred and the interest may only be accrued from the date of establishment of the memorandum account. Therefore, CACD recommends that Edison be allowed to record in the memorandum account, the interest associated with past tax periods which accrues from the date of establishment of the memorandum account.

4. CACD's recommendation that Edison be allowed to record certain potential future costs does not imply that Edison has the authority to recover any such costs in rates. Recording the changes in revenue requirement reflected in rates due to changes in federal and state tax liability resulting from the capitalization of DSM expenditures simply preserves Edison's ability to request rate recovery.

5. DRA's protest relates to retroactive ratemaking concerns. Based on the clarifications provided by Edison in its response to DRA's protest, these concerns have been adequately addressed and are now moot, CACD recommends DRA's protest be denied.

6. CACD recommends approval of Edison's proposed addition of the DSM Tax Change Memorandum Account to its Preliminary Statement in the tariffs.

#### FINDINGS

1. Edison filed Advice Letter 1030-E on November 23, 1993 to request Commission authorization to establish a DSM Tax Change Memorandum Account.

2. Edison is seeking authority to record the changes in revenue requirement reflected in rates due to changes in federal and state tax liability resulting from the capitalization of prospective DSM expenditures for future tax periods.

3. Edison requests the ability to record, from the date a memorandum account is established, the interest, associated with prior tax periods, which it has not yet incurred.

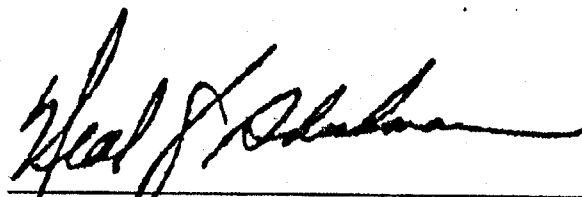
4. This request does not violate Commission rules against retroactive ratemaking.

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**THEREFORE, IT IS ORDERED that:**

1. Southern California Edison Company is authorized to establish a Demand-Side Management Tax Change Memorandum Account as proposed in Advice Letter 1030-E (and clarified in the December 21, 1993 response) to record potential future costs associated with changes in tax treatment of prospective demand-side management expenditures, and interest, associated with changes in tax treatment for prior demand-side management expenditures, that accrues after the establishment of the memorandum account.
2. Advice Letter 1030-E and the accompanying tariff sheets shall be marked to show that they were approved by Commission Resolution E-3374.
3. The protest of the Division of Ratepayer Advocates is moot.
4. This Resolution is effective today.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on March 9, 1994. The following Commissioners approved it:



NEAL J. SHULMAN  
Executive Director

DANIEL Wm. FESSLER  
President  
PATRICIA M. ECKERT  
NORMAN D. SHUMWAY  
P. GREGORY CONLON  
JESSIE J. KNIGHT, Jr.  
Commissioners