

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

COMMISSION ADVISORY
AND COMPLIANCE DIVISION
Energy Branch

RESOLUTION E-3383
May 25, 1994

R E S O L U T I O N

RESOLUTION E-3383. PACIFIC GAS AND ELECTRIC COMPANY
REQUESTS AUTHORITY TO ESTABLISH A DEMAND-SIDE MANAGEMENT
TAX CHANGE MEMORANDUM ACCOUNT.

BY ADVICE LETTER NO. 1848-G/1470-E filed April 12, 1994.

SUMMARY

1. In this advice letter Pacific Gas and Electric Company (PG&E) requests authority to establish a Demand-Side Management (DSM) Tax Change Memorandum Account. The advice letter requests memorandum account treatment for differences in taxes, interest, and penalties for only prospective periods resulting from a potential change in tax treatment of DSM expenditures.
2. This resolution authorizes PG&E to establish the requested memorandum account to record potential future costs, as defined herein.

BACKGROUND

1. The purpose of this filing is to reflect the establishment of a DSM Tax Change Memorandum Account in PG&E's Preliminary Statement, for both its gas and electric operations. PG&E requests that the memorandum accounts reflect, on a monthly basis, the difference between PG&E's total revenue requirement reflected in rates under the current tax method of expensing DSM costs and PG&E's total revenue requirement reflected in rates adjusted to reflect alternate tax treatment (i.e., capitalization or nondeductibility) of certain DSM costs that are incurred after the establishment of the memorandum account. The change in revenue requirement, as proposed by PG&E, would include (1) any penalties and interest assessed by tax agencies for tax periods after the effective date of the memorandum account if PG&E's taxes are recalculated to reflect alternate tax treatment 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 PG&E's taxes are recalculated to reflect alternate tax treatment of prior DSM costs.
2. PG&E's request follows Internal Revenue Service (IRS) audits of other California utilities' tax returns in which the IRS examining agents have taken the position that DSM program

expenditures must be considered, for tax purposes, as capitalized costs or nondeductible items, rather than as expense items as California utilities have treated such costs. PG&E believes that if the IRS ruling changing the tax treatment of DSM expenditures is sustained in the case of other utilities, it will potentially impact future tax liability for PG&E as well. PG&E 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.

3. PG&E states that its request for a memorandum account is consistent with the treatment afforded Southern California Edison Company (Edison) in Resolution E-3374, dated March 9, 1994 and responds to uncertainty relating to the proper tax treatment of DSM costs.

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, PG&E preserves its opportunity to seek recovery of the potential changes in revenue requirement discussed above. PG&E 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 not be treated as expense items.

6. PG&E filed Advice Letter 1848-G/1470-E on April 12, 1994.

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 PG&E's advice filing service list.

PROTESTS

1. The Commission Advisory and Compliance Division (CACD) has received no protests for this Advice Letter filing.

DISCUSSION

1. PG&E's advice letter filing was clear 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. PG&E 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 in the Edison case, 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 PG&E's request to record the difference between PG&E's total revenue requirement reflected in rates under the current tax method of expensing and PG&E's total revenue requirement adjusted to reflect alternate tax treatment of certain DSM costs incurred after the establishment of the memorandum account for future tax periods, CACD recommends approval.

3. In addition, PG&E requests the ability to record the interest associated with prior tax liabilities and penalties which accrues after the date a memorandum account is established. 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 account for possible future recovery in rates. This practice is consistent with the rule against retroactive ratemaking. (See generally, D.92-09-055.) PG&E's request for interest which will accrue after the establishment of a memorandum account but relates to prior tax periods does not appear to violate the Commission's prohibition against retroactive ratemaking because the costs PG&E wishes to record have not yet been incurred. Therefore, CACD recommends that PG&E 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 PG&E be allowed to record certain potential future costs does not imply that PG&E has the authority to recover any such costs in rates or that such costs are reasonable. Recording the changes in revenue requirement reflected in rates due to changes in federal and state tax liability resulting from alternate tax treatment of DSM expenditures simply preserves PG&E's ability to request rate recovery.

5. CACD recommends approval of PG&E's proposed addition of the DSM Tax Change Memorandum Account to its Preliminary Statement in the tariffs.

FINDINGS

1. PG&E filed Advice Letter 1848-G/1470-E on April 12, 1994 to request Commission authorization to establish a DSM Tax Change Memorandum Account.

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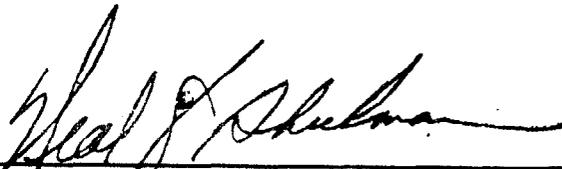
2. PG&E is seeking authority to record the changes in revenue requirement reflected in rates due to changes in federal and state tax liability resulting from alternate tax treatment of prospective DSM expenditures for future tax periods.
3. PG&E requests the ability to record, from the date a memorandum 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.
5. Approval of this request does not prejudge whether future recovery of such costs is reasonable.

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THEREFORE, IT IS ORDERED that:

1. Pacific Gas and Electric Company is authorized to establish a Demand-Side Management Tax Change Memorandum Account as proposed in Advice Letter 1848-G/1470-E to record potential future costs associated with changes in tax treatment of prospective demand-side management expenditures, and interest accrued after the establishment of the memorandum account but associated with changes in tax treatment for prior demand-side management expenditures.
2. Advice Letter 1848-G/1470-E and the accompanying tariff sheets shall be marked to show that they were approved by Commission Resolution E-3383.
3. This Resolution is effective today.

I hereby certify that this Resolution was adopted by the Public Utilities commission at its regular meeting on May 25, 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