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CASE 28081 - Proceeding on motion of the Commission as to the proposed accounting and ratemaking procedures to implement requirements of the Economic Recovery Tax Act of 1981 as they affect public utilities.

STATEMENT OF POLICY ON ACCOUNTING AND  
RATEMAKING PROCEDURES TO IMPLEMENT  
REQUIREMENTS OF THE ECONOMIC RECOVERY  
TAX ACT OF 1981

(Issued January 13, 1982)

On October 9, 1981, we issued for comment a staff memorandum describing the provisions of the Economic Recovery Tax Act of 1981 (ERTA or the Act). The main feature of the Act is the Accelerated Cost Recovery System (ACRS), which allows a significant increase in tax deductions for depreciation, effective January 1, 1981, over those allowed in past years. However, in a major departure from past policy, the Act mandates "normalization" of tax savings

resulting from the new system. Further, as a direct consequence of the mandatory normalization for accelerated depreciation after 1980, Investment Tax Credits are also subject to the normalization requirements. The Act requires that regulatory commissions authorize the statutorily prescribed normalization in each company's first "rate order" following enactment of ERTA, or by January 1, 1983, whichever is sooner.

Eighteen parties filed comments on the staff memorandum.<sup>1/</sup> After reviewing the comments, we have decided to adopt the staff recommendation that we authorize normalization of these tax benefits rather than see them lost to the companies we regulate. But we have also decided to modify staff's proposal for implementing ERTA's required normalizations. In this Policy Statement, we review, briefly, the rationale for authorizing these normalizations and then discuss, in some detail, our plan for doing so.

#### COMPLIANCE WITH ERTA

The staff memorandum points out that the normalization mandated by ERTA will increase revenue requirements for those utilities that now flow through tax savings from accelerated tax depreciation. But the Act prohibits utilities

1/A list of the parties is appended to this Statement of Policy.

from using the ACRS in computing their taxes unless normalization is adopted. Therefore, in the absence of normalization, the only alternative would be to use the straight-line methods and longer service lives used on the regulated books. Potential tax savings would thus be lost. Under straight-line depreciation, federal income tax expense for ratemaking purposes would be essentially the same as if normalization were allowed, but ratepayers would be denied the benefit of the rate base deduction associated with the deferral of the tax savings.

Under these circumstances, there is little choice but to adopt the normalization procedures required by ERTA. While present ratepayers will not enjoy, under normalization, the savings resulting from the tax benefits at issue, the resulting rate base reduction will diminish present revenue requirements. Within a relatively short period, accumulation of the normalized tax savings (and their use to offset rate base) should reduce revenue requirements to the same extent as if the tax benefits had been flowed through. Moreover, the increased cash flow and interest coverage will enhance the utilities' financial condition, thus holding revenue requirements and rates still further below the level they would otherwise reach.

Among the points raised in the staff memorandum, the one that provoked the greatest concern on the part of the parties commenting was staff's suggestion that the impact of the ERTA-required normalizations could be eased by reversing discretionary normalizations already in place. Many utilities feared that any such action might be viewed by the Internal Revenue Service as a deliberate attempt to frustrate the ERTA normalization requirement, and might thus jeopardize the new tax benefits. But we intend to comply fully with the ERTA normalization requirements and will take no action to circumvent the intent of the Act. At the same time, discretionary normalizations have always been subject to ongoing review in light of a company's financial circumstances, and ERTA does not seem to require us to abandon that policy. Further, we expect the long-range implications of ERTA to be evaluated in the pending generic financing case.<sup>1/</sup>

#### IMPLEMENTATION OF ERTA NORMALIZATION

##### Implementation Procedures

In order to give regulatory agencies time to implement the new normalization requirements, the Act provides for a transition period. As already noted, action must be taken in each company's first rate order following enactment

1/Case 27679, Proceeding on Motion of the Commission to Investigate Financing Plans for major New York Combination Electric and Gas Utilities.

of ERTA or by January 1, 1983, whichever comes first. The staff memorandum made different recommendations for utilities that had rate cases in various stages and that had no pending cases. Its proposals will be considered in order.

Pending Rate Cases and Rate Cases Not Yet  
Filed But Having an Effective Date Before  
January 1, 1983

When ERTA took effect, some pending cases were so close to the end of their statutory suspension periods that it was impractical to reopen hearings to consider the effects of ERTA on revenue requirements. In those instances, staff recommended that we authorize the additional revenues apparently required by ERTA on a temporary basis, subject to refund after further review. We did so in each of the cases in which hearings could not be reopened.<sup>1/</sup>

In their comments on the staff memorandum, several utilities questioned this course of action. Brooklyn Union expressed concern that we contemplated adjusting the temporary rates not merely to reflect a more accurate analysis of ERTA's impact but also to provide "offsets" that could "ease the impact of ERTA on the customer." Other utilities suggested that the temporary rate increase procedure might not satisfy the Act's requirement that normalization be

<sup>1/</sup>E.g., Cases 27822, et al., New York State Electric & Gas Corporation, Opinion No. 81-18 (issued October 20, 1981), at mimeo pp. 34 and 35.

authorized in the "first rate order determining cost of service"; for the possibility of an "offset" might be construed by the IRS to mean we were giving mere "lip service" to normalization. Finally, the Consumer Protection Board contended that the temporary rate increase procedure is impermissible, illegal, and contrary to our past policy of authorizing temporary rates only in emergency situations.

Notwithstanding the CPB's contentions, we remain satisfied that the temporary rate procedure was a lawful, effective vehicle for implementing ERTA in those cases where only very limited time was available to examine the computations. We have employed a similar procedure for other items of expense where special circumstances precluded setting permanent rates.<sup>1/</sup> And we are confident, despite the utilities' concerns, that the procedure satisfied ERTA's requirements; for the only condition attached to making the rates permanent was a determination, based on further review, that the company's computations agreed with the guidelines contained in the Act, and we expect to issue soon an order making the temporary rates in all three cases permanent. We recognize that all regulations related to the Act have not yet been issued, but any final adjustments that may be required will be made prospectively, in subsequent rate proceedings.

<sup>1/</sup>See, e.g., Case 27936, Spring Valley Water Company Incorporated, Opinion No. 81-26 (issued December 23, 1981), at mimeo pp. 6-9.

In all other pending cases in which hearings had closed, there was time to reopen hearings to consider ERTA's impact.<sup>1/</sup> And in cases where hearings have not yet closed (and, of course, cases not yet filed), matters related to ERTA can readily be introduced and considered. In all such cases, accordingly, the ERTA-related revenues have been or will be allowed on a permanent basis. Prospective adjustments in light of the IRS' final regulations will be made, as necessary, in subsequent proceedings.

Utilities That Do Not File For Rate  
Increases To Be Effective Before  
January 1, 1983

For those utilities that would not otherwise have had rate orders by ERTA's January 1, 1983 deadline, staff proposed that we declare a normalization policy, as required by the Act, and authorize temporary increases solely to reflect the resulting increased tax expense. Refunds would be required if the actual return on equity for calendar year 1983 exceeded 16%. Staff's proposals were intended to discourage premature major rate filings by utilities that would not have filed but for the ERTA requirements, as well as to provide a simple procedure for affording rate relief where necessary.

<sup>1/</sup>In one such case, it was determined that there was no need to reopen hearings. Case 27936, supra, at mimeo pp. 36-37.

The parties' comments addressed the use of the temporary rate increase vehicle in general as well as the specific question of whether the criterion for requiring refunds should be a 16% return on equity during 1983. We consider the narrower issue first, and then turn to the broad question of whether temporary rates are the best means of proceeding.

The 16% Return on Equity Criterion

Use of this criterion was opposed by various parties for different reasons. Con Edison felt that the standard was too low, noting that it was below the 16.3% return on equity allowed in its recent steam rate case. And Long Island Lighting Company contended that refunds based on the company's rate of return would run afoul of ERTA's prohibition on indirect reductions to cost of service or rate base as a means of circumventing the effect of normalization.

On the other hand, Joseph Shill argues that suggesting now that a 16% return on equity is acceptable during 1983 would foreclose rate cases during that period unless a company chose to ask for more. He notes that ERTA's objectives include the reduction of interest and inflation rates, and argues that its revenue effect must be considered in that context. Finally, the Consumer Protection

Board contends that even if refunds were required, customers would not be compensated for the time value of the excess revenues they provided.<sup>1/</sup> Accordingly, the Consumer Protection Board prefers deferring the ERTA-related tax expense, rather than allowing it immediately.

We conclude we should not in effect now set an allowed rate of return for 1983; for required returns on equity can change dramatically over a short time, much more so over a long time. Moreover, it is important to keep in mind that the rate increases occasioned by ERTA's normalizations do not increase or decrease a company's realized rate of return. The higher rates paid by utility customers now are deferred for return to customers later, and do not result in increased earnings to the companies. Moreover, we have, in any event, jurisdiction to review companies' rates of return and reduce them in situations where we find them to be excessive. Accordingly, we decline to adopt the 16% standard. As discussed in the next section, however, the issue is really moot; for we are also declining to use the vehicle of allowing temporary rate increases.

#### Temporary Rate Increase Procedure

Several parties objected to the use of temporary rates to avoid accelerated rate filings. The Consumer

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<sup>1/</sup>As noted previously, customers will, in fact, receive a return on funds collected for the ERTA normalizations in the form of an offset to rate base.

Protection Board, as noted, considered temporary rate increases for this purpose to be impermissible and inconsistent with our policy of authorizing temporary rates only in emergency circumstances. It prefers deferring the impact of ERTA until it can be recognized in a regular rate case, and says it is "less worried" than staff that ERTA will precipitate rate filings that otherwise would not have been made. It also suggests that the impact of ERTA be examined in our pending Long-Range Financial Planning case.

Long Island Lighting Company and Con Edison also oppose the temporary rate procedure, albeit for reasons different from CPB's. They are concerned that a temporary rate order, subject to possible offsets and refunds, might not comply, in the eyes of the Internal Revenue Service, with ERTA's requirement that normalization be allowed in a rate order and that its effect not be offset by indirect reductions to the cost of service. Long Island Lighting Company suggests that we permanently approve rate requests designed solely to recognize the effect of normalization on a company's revenue requirement, and that the implications of ERTA be further considered in the Financial Planning case. Con Edison advocates the use of "mini" rate cases<sup>1/</sup> for this purpose, and suggests in some detail a procedure that could be followed in those cases.

<sup>1/</sup>I.e., cases not involving "major changes" as defined by the Public Service Law.

As we said above, we believe, notwithstanding CPB's comments, that allowance of temporary rates for the purpose of recovering the ERTA-related revenue requirement would be lawful. And, notwithstanding the utilities' comments, we believe allowance of temporary rates would satisfy the requirements of ERTA; for our order would authorize the implementation of normalization accounting and provide utilities a procedure for increasing their rates, if necessary, to reflect the normalization requirement by January 1, 1983. Nevertheless, we have decided that the use of temporary rates for this purpose would be unduly cumbersome. A rate filing, even if temporary, requires scrutiny before it can be allowed to go into effect, and as long as that scrutiny is to be applied, it makes better sense to examine the rates carefully enough to permit them to go into effect on a permanent basis. Accordingly, we have decided that ERTA-related revenue requirements for companies that would not otherwise file a major rate case should be authorized on a permanent basis by means of a mini rate case.

The procedure to be followed in the mini rate case will be similar, but not identical, to the one proposed by Con Edison. Under the company's proposal, we would allow a mini rate application providing for a rate increase limited to the additional revenues required as a result of normalizing

the tax effects of ACRS (and, where applicable, the Investment Tax Credits). The company proposed the following procedures:

1. All regulations, statements of policy, or Commission decisions requiring the filing of certain data and testimony in support of any proposed rate increase would be waived.
2. An application for such a mini rate increase would be accompanied by exhibits showing how the amount of additional revenues required by such normalization was computed.
3. If the Commission's staff required more than 30 days to check a company's computations, the company would, on request, delay the effective date of its filing to provide additional time for staff.
4. The Commission would issue a special permission order allowing such an application to become effective no later than December 31, 1982 so that the company would be able to exhibit to representatives of the Internal Revenue Service a Commission order authorizing a rate increase to reflect its normalization of the tax effect of ACRS.
5. The pendency of any such mini rate filing would in no way preclude a company from filing for a "major increase" in its rates.
6. To the extent possible, such mini rate increases would be applied on an across-the-board percentage basis to all rates and charges.

The procedure outlined by the company is reasonable, except that we see no need to waive outright the prohibition on simultaneous rate filings.<sup>1/</sup> Staff should be able to

1/16 NYCRR §61.10(a).

complete its examination of an ERTA filing within 30 days, so that a company's exposure to the effects of the prohibition would be limited. If, however, complications extended the processing time for the mini case beyond 90 days from the filing date, the prohibition on simultaneous filings would then be lifted. Except for that modification, we adopt the guidelines suggested by Con Edison.

It should be noted that the procedure contemplates that the mini case would normally proceed without hearings. We consider this a sound result, for the limited nature of these filings should make the time and expense of a hearing unnecessary. Parties wishing to raise general arguments concerning ERTA can do so in written comments to us, and staff will assist intervenors in reviewing the filings.

#### Tax Savings During Transition Periods

In the cases decided thus far under ERTA, we deferred, for the benefit of future ratepayers, the benefits attributable to ACRS arising between the effective date of ERTA and the time of our rate order. The staff memorandum proposed to continue this method of treating incremental benefits arising during the transition period.<sup>1/</sup> Five utilities challenged this aspect of staff's proposal.

<sup>1/</sup>The incremental tax savings would be measured by the difference between the ACRS depreciation allowable on property additions after 1980, and the non-deferred portion of the depreciation otherwise allowable under the Asset Depreciation Range System.

Long Island Lighting, National Fuel Gas Distribution Corporation and Orange and Rockland Utilities contend that the deferral violates our historical ratemaking procedures and is tantamount to retroactive ratemaking. We believe, however, that deferral is warranted in these circumstances, for the terms of the Act could not reasonably be predicted at any time before its enactment and because the increase in current tax savings under ACRS must eventually be repaid by ratepayers when tax depreciation declines in the future.

Brooklyn Union Gas Company and Rochester Telephone Corporation oppose the deferral on different grounds, arguing that it may jeopardize the availability of all ACRS reductions because it was the intent of Congress that the companies retain these transition period benefits. Orange and Rockland, however, notwithstanding its argument that ratemaking principles warranted allowing it to retain the transition period benefits, conceded that their deferral did not jeopardize the benefits under federal law. We are satisfied that Brooklyn Union and Rochester Telephone have construed ERTA unduly conservatively, and that staff's recommended procedure for handling transition period benefits in no way contradicts the intent of ERTA.

Several of the utilities were concerned about the possibility of a rapid amortization of the transition period deferral. They did not, however, object to a full normalization

procedure, in which the tax savings would be amortized over periods that paralleled the useful service lives of the plant to which they relate. We shall adopt this procedure, which is consistent with the requirements of the Act.

Finally, Niagara Mohawk and Con Edison argue that they should be permitted to retain the ACRS benefits realized during the transition period because those benefits will be more than offset by the loss of cash flow benefits resulting from ERTA's discontinuation of the repair allowance feature of the Asset Depreciation Range (ADR) System.<sup>1/</sup> But staff's proposal to defer transition period benefits was intended to deal primarily with the effect of present increases in tax depreciation and use them to offset increased tax liabilities in the future. Given this limited purpose, there is no need to offset the loss of other transition period tax savings against the deferral advocated by staff. Moreover, the effects of gains or losses in cash flow benefits are difficult to measure accurately; and there are, in any event, certain other tax benefits provided by ERTA that we do not intend to capture with respect to the transition period and that the utilities will therefore retain. For example, we will not require deferral of the new research and development credit during the transition period as proposed by staff.

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<sup>1/</sup>ADR is the depreciation system replaced by ACRS. We have authorized companies to normalize the repair allowance deduction it provides.

CONCLUSION

On the basis of our review of the parties' comments and our further consideration of staff's memorandum, we shall adopt the following procedures relating to implementation of ERTA:

1. In pending rate proceedings, and those that will be filed with an effective date before January 1, 1983, revenues related to the ERTA normalization requirements will be made effective on a permanent basis, without offsetting adjustments, subject only to determination of the accuracy of the data.
2. The incremental tax savings due to higher ACRS tax depreciation during the transition period (i.e., from the effective date of ERTA through the date of the rate order in question) should be deferred and amortized according to ERTA's criteria; i.e., the amortization period should be consistent with the economic and physical service lives of the plant, and not subject to accelerated amortization.
3. Utilities not filing for major rate increases to be effective before January 1, 1983 will be allowed to reflect the impact of ERTA through a "mini" rate case conducted in accordance with the guidelines specified in this Policy Statement.
4. The long-term impact of ERTA on the major utilities will be examined in our pending proceeding to investigate the utilities' financing plans.

LIST OF RESPONDENTS

Consumer Protection Board  
Joseph Shill  
West Branch Conservation Association  
The Brooklyn Union Gas Company  
Central Hudson Gas & Electric Corporation  
Consolidated Edison Company of New York, Inc.  
Continental Telephone Corporation subsidiaries in New York State  
Empire Telephone Corporation  
New York State subsidiaries of General Waterworks, Management and  
Service Company  
Highland Telephone Company  
Long Island Lighting Company  
National Fuel Gas Distribution Corporation - New York Division  
New York State Electric & Gas Corporation  
New York Telephone Company  
Niagara Mohawk Power Corporation  
**Orange** and Rockland Utilities, Inc.  
Rochester Gas and Electric Corporation  
Rochester Telephone Corporation

