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ACTION REQUEST RESPONSE

To: Public Service Commission

From: Chris Parker, Director
Artie Powell, Energy Section Manager

Date: April 14, 2011

Re: Docket No. Docket No. 11-035-47, Utah Office of Consumer Services' Application for Deferred Accounting Order for 2010-2011 Bonus Depreciation; Docket Nos. 10-057-057-21 and 10-035-127, Investigative Docket to Explore the Issues Surrounding the Extension of Bonus Depreciation.

RECOMMENDATION

The Division concurs with the Office of Consumer Service's request for a scheduling conference in the matter of the extension of bonus depreciation under Docket No. 11-035-47. The Division also recommends that the Commission close the previously opened investigative dockets into the impacts of bonus depreciation, Docket Nos. 10-057-21 and 10-035-127.

ISSUE

On or about March 22, 2011, the Office of Consumer Services ("Office") filed an application for a deferred accounting order requesting that the Commission direct "Rocky Mountain Power to defer for later ratemaking treatment, the impacts of bonus depreciation on the accumulated deferred income tax offset to rate base which result from the [extension of bonus depreciation]." The Office also requested that the Commission set a scheduling conference to establish filing deadlines and a hearing if necessary in the matter. On March 24, 2011, the Commission issued

an Action Request to the Division requesting an explanation and statement of the issues to be addressed. This memo in part is the Division's response to the Commission's Action Request.

Additionally, the Division notes that two investigative dockets, Docket Nos. 10-057-21 and 10-035-127, were previously opened at the Division's request to explore the issues around the extension of bonus depreciation. A technical conference was held on February 1, 2011, under these dockets in which certain information was presented. On March 31, 2011, the Commission directed the Division to provide "an update . . . as to its recommendation for the process for the remainder of these proceedings." This memo is also intended to respond to the Commission's direction under these two dockets.

DISCUSSION

The Division concurs with the Office's request to set a scheduling conference in this matter (Docket No. 11-035-47) to establish filing deadlines and, if necessary, hearing dates. The issues surrounding the impacts of bonus depreciation are complex and deserve a procedure that will allow a full exploration and evaluation of those issues. As an example, if the Commission determines to allow deferred accounting treatment, the Commission will have to determine what it is that is being deferred—the impact that the Office seeks deferral of is not a simple expense (or revenue) but is a cash flow.

In a recent report, Moody's Investor Service stated, "Bonus depreciation deductions reduce a company's cash taxes because it allows firms to deduct capital expenditures more quickly, thereby reducing taxable income. . . . However, bonus depreciation is not incremental cash flow. Instead, we view bonus depreciation as a borrowing which pulls forward tax benefits that would normally be realized over the longer-term tax-life of the asset. As such, the cash received today will be repaid in the form of higher cash taxes in future years."¹ Thus, some might argue that the impact of the extension is already being deferred. Additionally, bringing forward future benefits without the associated costs raises questions of inter-generational equity, which will need to be addressed by the parties.

¹ Moody's Investor Service, Special Comment, "U.S. Investor-Owned Utilities: bonus Depreciation Provides Material Near-Term Benefit for the Sector But raises Longer-Term Questions," February 8, 2011.

While there seems to be a general acceptance of near-term cash flow benefits for the Company, Moody's expresses concern over the long-term implications. Addressing the impact of bonus depreciation on debt ratings, Moody's indicated that "It is possible that bonus depreciation, despite near-term benefits, could actually limit potential rating upgrades, largely due to decreased transparency and expected higher tax payments in the future."²

Additionally, Moody's indicates that passing to current ratepayers the benefits arising from the extension of bonus depreciation may not be consistent with tax normalization rules. In a 2007 case cited by Moody's, the Public Utility Commission of Texas ordered CenterPoint Energy to reduce its stranded costs due to its accumulated deferred income taxes and investment tax credits. A subsequent private letter ruling from the IRS indicated "that such a reduction would be a violation of normalization rules."³

Given the complexity of these issues, as well as others that may be subsequently raised by parties, the Division recommends that the Commission notice a scheduling conference in this matter, Docket No. 11-035-47. The issues to be discussed in this docket are likely to cover any issues that would be raised in the previously opened investigative docket, Docket No. 10-035-127. Therefore, the Division recommends that this investigative docket be closed.

The Division also recommends that Docket 10-057-21, the bonus depreciation investigative docket for Questar Gas Company, be closed. What issues may remain, are likely to be investigated under Docket No. 11-035-47, the Office's application for deferred accounting treatment. Additionally, the Division notes that for Questar Gas Company, the impact of the extension of bonus depreciation is already being passed to rate payers through a lower rate base captured in the Infrastructure Tracker. The Tracker was established in Docket No. 09-057-16; the first request for amortization of the account balance included an adjustment for bonus depreciation based on the then current understanding of the tax law change; future filings will include appropriate adjustments as well.

² Moody's Special Comment.

³ Moody's Special Comment.

CONCLUSION

Given the complexity of the issues surrounding the extension of bonus depreciation and any deferred accounting treatment of its impact, the Division concurs with the Office's request to set a scheduling conference in Docket No. 11-035-47. Additionally, given the likely near identical issues, the Division recommends that the Commission close the previously opened investigative dockets in this matter, Docket Nos. 10-057-21 and 10-035-127.

CC Dave Taylor, Rocky Mountain Power
Barrie McKay, Questar Gas Company
Michele Beck, Office of Consumer Services