

- SUBJECT:** Use federal income taxes in certain electric utility's rate making
- COMMITTEE:** State Affairs — favorable, without amendment
- VOTE:** 7 ayes — Cook, Giddings, Farrar, Frullo, Harless, Huberty, Sylvester Turner
- 2 nays — Geren, Smithee
- 4 absent — Craddick, Hilderbran, Menéndez, Oliveira
- SENATE VOTE:** On final passage, April 23 — 24-7 (Davis, Fraser, Garcia, Hegar, Hinojosa, Rodriguez, Watson)
- WITNESSES:** (*On companion bill, HB 711*)
- For — Patrick Cowlshaw, Texas-New Mexico Power Company; John W. Fainter Jr., Association of Electric Companies of Texas, Inc.; John Reed, Association of Electric Companies of Texas, Inc.; Scott Rozzell, CenterPoint Energy; (*Registered, but did not testify:* Brent Connett, Texas Conservative Coalition; Robert Gee, Texas-New Mexico Power Co.; Dale Peddy, Entergy; Patrick Reinhart, El Paso Electric Co.; Damon Withrow, Xcel Energy)
- Against — Chris Brewster, Oncor Cities Steering Committee; Connie Cannady, Oncor Steering Committee of Cities; Nikolaus Fehrenbach, City of Dallas; Randolph (Randy) Moravec, Texas Coalition for Affordable Power; Phillip Oldham, Texas Association of Manufacturers; Jack Pous, City of Houston; Tom “Smitty” Smith, Public Citizen; (*Registered, but did not testify:* Alfred (Freddie) Herrera, Alliance of Xcel Municipalities, Cities Advocating Reasonable Deregulation; Andrew Ryle, Public Citizen)
- On — Darryl Tietjen, Public Utility Commission; (*Registered, but did not testify:* Brian Lloyd, Public Utility Commission)
- BACKGROUND:** Utilities Code, ch. 36 gives the Public Utility Commission (PUC) the authority to consider electric utility rate cases and defines the elements that an electric utility can seek to recover costs as part of its rates. Cost elements include items such as operating and maintenance costs,

depreciation, and taxes, including federal income taxes, among many other elements.

Sec. 36.051 provides that the PUC in establishing an electric utility's rates, shall establish the utility's overall revenue at an amount that will permit the utility a reasonable opportunity to earn a reasonable return on invested capital used and useful in providing service to the public in excess of the utility's reasonable and necessary operating expenses.

Sec. 36.060 provides that the PUC compute an electric utility's federal income taxes, for ratemaking purposes, as though a consolidated tax return had been filed and the utility realized its fair share of the saving resulting from that return if the utility is a member of an affiliated group of companies eligible to file a consolidated federal tax return and it is advantageous for the utility to do so.

A consolidated federal tax return is generally defined as a unified tax filing by a corporation that owns 80 percent of the common stock of its affiliate companies.

In 1999, the Texas Legislature passed SB 7 to deregulate and open to competition the state's retail electricity market, effective 2002. This applies only to investor-owned utilities (IOUs) within the ERCOT (Electric Reliability Council of Texas) region. The rates charged by electricity transmission and distribution providers remain regulated throughout Texas, as do those of retail electric utilities operating in Texas outside of ERCOT. Retail electricity operations owned by municipalities and member-owned electric cooperatives are not subject to PUC regulation.

DIGEST:

SB 1364 would amend Utilities Code, sec. 36.060 (Consolidated Income Tax Returns) to provide that if an expense were allowed to be included in utility rates or an investment were included in the electric utility rate base, the related income tax benefit would have to be included in the computation of income tax expense to reduce the rates. If an expense were not allowed to be included in the utility rates or an investment not included in the utility rate base, the related income tax benefit could not be included in the computation of the income tax expense to reduce the rates. The income tax expense would be computed using the statutory income tax rates.

The bill would strike the following language from Utilities Code, sec. 36.060(a): “Unless it is shown to the satisfaction of the regulatory authority that it was reasonable to choose not to consolidate returns, an electric utility’s income taxes shall be computed as though a consolidated return had been filed and the utility had realized its fair share of the savings resulting from that return, if: the utility is a member of an affiliated group eligible to file a consolidated income tax return; and it is advantageous to the utility to do so.”

The bill would take effect September 1, 2013.

**SUPPORTERS
SAY:**

Fix the ratemaking system. SB 1364 would fix a simple problem. The PUC’s interpretation of current law allows the agency to set rates for electric transmission and distribution companies and investor-owned retail electric utilities operating in Texas outside of ERCOT partially based on the performance of utilities’ non-Texas businesses. The PUC considers the tax implications of a company’s affiliate corporations and the tax adjustments that corporation may make to minimize taxes. For example, a company filing a consolidated federal tax return can offset the profits from one its affiliates with the losses from another. The adjustment to rates is referred to as the consolidated tax saving adjustment, which results in the comingling of non-utility tax benefits to reduce utility rates.

Separate Texas utilities from other parts of a corporation. SB 1364 would “fence off” the utility’s revenues and expenses from other affiliates to limit the potential tax impacts from businesses that have nothing to do with the provision of electric service in Texas, much less electric rates.

Other states’ regulation. Texas is one of only five states that require a utility company to file for consolidated adjustment. While the law applies to electric utilities, it does not apply to other regulated entities in the state, such as natural gas utilities regulated by the Railroad Commission.

Effects on economic competition. The bill would ensure that true economic costs were reflected in a utility’s rates and end the confusion about what factors are included in Texas’ electric rates. Doing so would send a signal to Wall Street and the investment community that the PUC was not going to try to reach outside of Texas to an affiliated company to try to pull in a tax benefit earned by that affiliated company for the benefit of Texas ratepayers. Texas businesses want a level field and a stable regulatory environment, not subject to overreaching claims of the PUC

during its ratemaking processes. SB 1364 would make Texas utilities more attractive to investors by ensuring that a utility could retain the anticipated tax benefits.

Effects on ratepayers. The bill would not result in a rate increase just by being passed. It would only affect utilities that seek new rates. While it could increase rates, the effects would be minimal. For example, if SB 1364 had been in place in 2011 when CenterPoint Energy, an electric transmission and distribution utility serving the Houston metropolitan area, came in for a rate case, it would have increased the average residential electric bill by about 18 cents per month. It would not have affected the customers of Oncor Electric Delivery, a transmission company serving much of North Texas, during its last rate hearing in 2009. That's because the PUC ruled Oncor was not a member of an affiliated group and was ineligible to file a consolidated tax return.

The Legislative Budget Board's fiscal note states that the bill would have "no fiscal implication to units of local government."

Saving ratepayers money by removing consultants, attorneys, and accountants from tax deliberations. The legislation, by clarifying existing statutes, would remove one of the most contentious and complex issues from rate cases. Debating those issues involves attorneys, accountants, and experts witnesses. Under current statute, the cost of fighting over this arcane issue is passed back to ratepayers.

Phantom taxes. The bill would not affect taxes paid to the state or federal government. The bill merely would affect how federal income taxes were treated in ratemaking. There is no such thing as phantom taxes. While a company may not pay a federal tax in a particular year, due to accounting procedures such as accelerated depreciation for large investments that are available to businesses under the federal tax code, taxes are eventually paid. The federal government extends similar tax treatment to individuals, letting them defer taxes through accounts such as individual retirement accounts (IRAs). Electric utilities should not be penalized for using common and legal tax and accounting principles.

OPPONENTS
SAY:

Fix the rate-making system. Texas' electric utility rate-setting system is not broken. Consideration of the consolidated tax saving adjustment is extraordinarily complex, and the PUC rate-making system handles the adjustment through testimony presented to a State Office of

Administrative Hearings' (SOAH) administrative law judge who considers the evidence presented by all sides in a ratemaking. The PUC attributes the consolidated affiliated tax savings that can be apportioned to Texas in rate making. The state does not try to claim a corporation's entire tax savings, due to events like an affiliate's underperforming investment offsetting income, for the benefit of Texas ratepayers. The state does try to determine how that underperforming asset affects Texas ratepayers.

Separate Texas utilities from other parts of a corporation. It is impossible to entirely "fence off" a Texas electric utility from the tax consequences experienced by its corporate parents. For example, if the corporate parent makes a series of bad investments and those investments lead to higher borrowing costs, when the Texas utility seeks to borrow funds for its operations, it will do so at a higher cost. Thus, Texas ratepayers cannot be truly "fenced off" from poor or risky corporate decision-making.

Other states' regulation. Rate making is extraordinarily complex, and no two states set electric utility rates the same. While Texas happens to consider the tax implications of affiliates, other states may consider other factors in setting rates that Texas does not consider. Texas should not claim to be unique, then back away from that claim when it serves the limited purpose of a few corporate interests.

Effects on economic competition. The bill could potentially raise electric utility rates for Texas businesses for the sole benefit of electric utilities. The bill could make Texas unattractive to businesses considering locating in the state.

Effects on ratepayers. Supporters of the bill minimize the cost to residential ratepayers, but any resulting rates increases would be repeated year after year, taking money out of the pocket of average Texans and putting it into the ledgers of Wall Street firms and California trusts.

Finally, large users of electricity — such as cities, school districts, and manufacturing firms — could see a sizable increase in their electric rates if the bill were implemented.

Saving ratepayers money by removing consultants, attorneys, and accounts from tax deliberations. While nobody likes paying for consultants and attorneys to fight rate cases, they do serve a purpose,

presenting to an impartial SOAH judge evidence that should be considered during rate making, thus keeping rate increases to a minimum.

Phantom taxes. Current law allows some electric utilities to include taxes as part of their rate-making structure that may, in effect, never be paid to the federal government. For example, Oncor Electric Delivery, a transmission company serving much of North Texas, collected more than \$500 million from ratepayers for federal income taxes, but the taxes were never paid.

NOTES:

The House companion bill, HB 711, was reported favorably without amendment by the House State Affairs Committee on April 17.