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VIA EMAIL
January 7, 2011

Marzia Zafar
California Public Utilities Commission
505 Van Ness Avenue
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Dear Ms. Zafar:

Re: Comments of Pacific Gas and Electric Company on Proposed Resolution W-4867 To Make Rates Subject to Refund to Reflect New Tax Law

Pursuant to Sections 14.5 and 14.6 of the Rules of Practice and Procedure of the California Public Utilities Commission, Pacific Gas and Electric Company (PG&E) hereby files comments on Proposed Resolution W-4867 ("Proposed Resolution"), which would make utility rates in 2011 subject to refund to reflect impacts of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010, signed by President Obama on December 17, 2010 (the "New Tax Law").

I. EXECUTIVE SUMMARY

The Commission should not adopt the Proposed Resolution as drafted because 1) making utilities' rates subject to refund ("Refund Order") in this manner is inconsistent with longstanding and well-founded Commission practice; 2) utility customers would be better served by allowing utilities to maximize the benefits for customers of the New Tax Law by accelerating replacement of aging infrastructure rather than providing rate refunds; and 3) imposing a generic Refund Order (or undertaking any other extended analysis of the impact of

the New Tax Law) would have the inevitable result of delaying or discouraging utilities from making the infrastructure investments that the New Tax Law was intended to promote, thereby harming customers by limiting tax benefits that otherwise could be made available to them.

1) The Refund Order Is Inconsistent With Past Practice. To PG&E's knowledge, the Commission has never before issued a generic Refund Order in response to a law change deferring tax liabilities, even though such changes have occurred several times over the last decade alone. There are a great many changes in law that increase (or decrease) expenses and other costs resolved during a utility's rate cycle. Just last year, there were changes in law that increased utilities' expenses (including taxes) associated with the landmark Health Care Legislation. However, with exceptions that certainly would not apply to this situation (see discussion in II(A), below, regarding tax rate changes, as distinguished from the present change in deferred taxes), the Commission has never made such a general order providing for adjusting rates. The very nature of deferred tax adjustments, including the fact that rate base is trued up to reflect both additional capital spending and additional deferred taxes in the utilities' next general rate case (GRC), justifies PG&E's request that the Commission reject making utility rates subject to refund.

2) Utility Customers Would Benefit Most From The New Tax Law By Allowing Utilities To Make Additional Investments In Infrastructure. The New Tax Law allows utilities and other businesses to defer tax liabilities when they make investments in long-term assets before 2013. As such, the New Tax Law provides an incentive for businesses to raise capital and make investments to stimulate the economy. Encouraging utilities to use the cash flow benefits of the New Tax Law to increase replacement of aging infrastructure during the period of the

Federal tax incentive (i.e., 2011-2012) is a far more beneficial way to use these incentives, and more consistent with the objectives of the New Tax Law, than to attempt to quantify those incentives (which may prove extremely difficult to do) and refund rates accordingly. For this reason, PG&E recommends that, instead of making rates subject to refund (Proposed Resolution, Ordering Paragraph #1), the Commission should encourage utilities to take full advantage of the New Tax Law and accelerate spending on infrastructure improvements to the greatest extent possible.

3) The Proposed Resolution Creates Significant Uncertainty That May Delay Necessary Utility Investment And Undermine The Intended Benefits Of The New Tax Law. Having an extended period where rates are subject to refund, which will inevitably occur if the Proposed Resolution is adopted, will undermine the utilities' ability to take advantage of tax incentives on the customers' behalf and will thereby defeat the purpose of the New Tax Law. Therefore, PG&E urges the Commission to not adopt the Refund Order. In addition, PG&E asks that the Commission withdraw the Proposed Resolution in its entirety or, alternatively, resolve any remaining issues raised in the Proposed Resolution as expeditiously as possible, but no later than 60 days from January 13, 2011 (the date the Commission will consider the Proposed Resolution), so as to give the utilities the necessary certainty to start implementing the accelerated investments envisioned by the New Tax Law.

II. THE COMMISSION SHOULD DELETE LANGUAGE IN THE PROPOSED RESOLUTION MAKING RATES SUBJECT TO REFUND.

As explained in the Executive Summary, the Commission should not adopt the Proposed Resolution because 1) the "Refund Order" is contrary to past Commission practice (which is

grounded on sound policy considerations); 2) the cash flow benefits associated with the New Tax Law are best used on behalf of customers to accelerate needed investments during the period set forth in the law (2011-2012); and 3) issuance of the "Refund Order" would create significant uncertainty and thereby fatally undermine the utilities' ability to undertake that accelerated investment. These points are discussed further below.

A. Making Utilities' Rates Subject To Refund Is Inconsistent With Longstanding And Well-Founded Commission Practice.

The Proposed Resolution's "subject to refund" language would deviate from past Commission practice. While the Commission has adjusted rates retroactively in the case of tax rate changes (see OII 86-11-019, addressing the reduction in Federal tax rates from 48% to 34% as a result of the Tax Reform Act of 1986t), it has never to PG&E's knowledge adjusted rates within a rate case cycle to reflect changes in deferred taxes. This is true even though bonus depreciation in various forms has been enacted on numerous occasions throughout the last decade.

When rates are established in a GRC, they are generally set (subject to adjustments which differ among utilities) for a three-year period. There are sound policy reasons why the Commission limits the adjustments that may be made in between rate cases and why, in this particular case, it should not make any generic adjustments within the rate cycle on account of this law change. Foremost among these reasons is the fact that changes go in both directions, and even within a change in law, there may be other factors that are offsetting either directly or indirectly.

As a generic matter, the Commission should not change its long-standing practice to not reflect deferred tax changes in between rate cases for the following reasons:

- Changes in deferred taxes (even without considering offsetting effects) are worth far less to customers than a tax rate change and do not warrant making rates subject to refund.
- Changes in deferred taxes are trued up in the utilities' next GRC.
- Because a deferred tax is an offset to rate base, any adjustment may be offset by associated increases in capital spending and depreciation.
- In any event, trying to compute a "fair" deferred tax ratemaking adjustment will require the Commission to resolve complex computational and offset issues --- issues that are best avoided without compelling reasons to the contrary. Utilities may well have been subject to other uncontrollable expenses in between rate cases that have increased their costs of service.

1. Changes in deferred taxes are worth far less to customers within a rate cycle than a tax rate change.

The New Tax Law represents a change in deferred taxes, not a tax rate change. Rate adjustments that would result from this tax-timing benefit (deferred taxes) are worth far less proportionately than rate reductions that previously resulted from reductions in tax rates. In this respect, the Proposed Resolution properly recognizes (at p.1) that the benefits are treated as a deferred tax for ratemaking purposes. This means that the tax savings realized cannot be flowed through to customers as a reduction in tax expense, but may only be reflected as an offset to financing costs (i.e., return on rate base) for the period of the deferral. In addition, prior to the

new tax law, PG&E did not forecast making 2011 Federal income tax payments until September 15, 2011. Consequently, any offsets to financing costs from a 2011 tax return deferral would only begin on that date and, as a result, any 2011 theoretical revenue requirement adjustment could only reflect an offset (i.e., financing cost reduction) for a fraction of a year.

2. Changes in deferred taxes are trued up in the utilities' next rate case.

The Proposed Resolution appears to recognize (at p. 1) that in the utilities' next rate case deferred taxes (along with other elements of rate base) are trued up. This is not the case with changes in tax *rates* that result in permanent benefits (or burdens). Because the benefit of deferred taxes such as these can last for at least twenty years, ratepayers already are assured of receiving most, if not substantially all, of the deferred tax benefit. This is another reason why changes in deferred taxes of the type involved here have not been subject to adjustment in the past.

3. Changes in deferred taxes are often offset by increased capital spending, which together with increased depreciation expense, can offset changes in deferred taxes in whole or in part.

The Commission's Generic Investigation into Taxes and Ratemaking (the "Tax OII") rejected arguments for a routine re-opening of tax computations in the case of tax law changes in between rate cases. While stating that the Commission retained the authority to reflect changes in the tax laws in between rate cases, the Commission also observed that it preferred to limit its discretion to permanent changes and noted that such changes may be "offsetting among

themselves, so that no change action may be necessary." D. 84-05-036, 1984 Cal. PUC LEXIS 1325; 15 CPUC2d 42.

Here, to the extent the Commission reopens a GRC within a rate cycle to reflect adjustments for deferred taxes, the Commission must treat rate base and depreciation expense consistently. This is a requirement of the Federal tax laws. Section 168 of the Internal Revenue Code requires utilities to use a "consistent" normalization method of accounting in order to realize the benefits of accelerated tax depreciation, including the benefits of the new law. The Code provides that procedures and adjustments are inconsistent with a normalization method if they use an estimate or projection of the taxpayers 1) tax expense, 2) depreciation expense or 3) reserve of accumulated deferred income taxes (ADIT) unless such adjustment or projection is also used with respect to the other two items and with respect to rate base.[1/] In effect, these rules require that when the Commission makes projections for rate purposes of tax benefits and costs, it must do so consistently.

One of the most difficult aspects of adjusting rates during a rate cycle is accounting for adjustments between actual spending and those included in the original rate case forecast. This problem is especially acute here, where capital investments are involved, and the utility may have spent more than originally forecast. While rate base tends to be reduced by increases in deferred taxes, rate base would tend to increase, to the extent capital additions increased. Moreover, to the extent capital spending may have increased, depreciation expense will increase above forecast as well. Should the Commission decide to adjust deferred taxes, it would need to decide whether to true-up spending overall or base the adjustment on forecasted amounts, which

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1/ P.U. Code Section 168(i)(9)(B)(i).

may (or may not) be readily available. In any event, if a true-up were made, and capital additions increase above forecast, it may well be that the increased spending and depreciation expense more than offset the deferred tax-rate base benefit.

4. In addition to being objectionable for numerous ratemaking policy reasons, re-opening rates for this kind of change will also require the Commission to become entangled in numerous complex computations.

As noted above, the potential impact on rates from an increase in deferred taxes is far less than the potential impact associated with tax rate changes. In addition, any computation of deferred tax changes involves complex considerations that are more difficult to resolve than the relatively straight-forward computation applying to rate changes. One of these was mentioned above with regards to how (and whether) deferred taxes would be trued-up to actual spending (which would increase rate base and depreciation expense).

Regardless of whether the Commission decides to true-up capital spending and deferred taxes, there are also other complex considerations that will need to be addressed if the Commission decides to pursue a refund in between rate cycles:

- Offsets. If the Commission were to allow test year/attrition period adjustments for the New Tax Law (that tends to reduce rate base), should it at least allow offsets for those changes that increase rate base or expense? If so, how should these adjustments be implemented?
- Working Cash Adjustment. In utility GRCs, rates are adjusted downward to reflect the lag between the time of payment of the tax and the time of collection of the tax in rates. If rates were adjusted downward to reflect the deferral of tax, then this impact must be

offset by a computation of the working cash adjustment. This adjustment could be substantial.

- Manufacturers' Deduction and Repair Allowance. The availability of bonus depreciation will displace the manufacturers' deduction, which is a permanent tax benefit (not merely timing) and may also reduce repair allowance (which impacts tax expense rather than rate base). These reductions in tax benefits (which directly impact estimates of tax expense) will have to be fully considered as related ratemaking offsets to any benefit of increased tax deferrals.
- Treatment of Attrition Years. There is typically no forecast data available to perform the necessary inputs to determine the appropriate benefit. It is unclear how any benefit would be computed in such a situation.

B. Utility Customers Would Benefit Most From The New Tax Law By Allowing Utilities To Make Additional Investments In Infrastructure.

The New Tax Law provides a significant investment incentive for American businesses to invest in long-term assets. Under the New Tax Law, a 100% federal income tax deduction is generally available for investments placed in service by the end of 2011 and a 50% federal income tax deduction is generally available for investments placed in service by the end of 2012.

The present situation is akin to the Federal Government offering a "sale" on the cost to customers of utility investments. However, time is of the essence, and the benefits of the New Tax Law end, in part, at the end of 2011, and in whole, at the end of 2012. The Commission should encourage utilities to take maximum advantage of this opportunity by allowing them to

use the tax incentives from the New Tax Law on behalf of customer to make additional incentivized investments. Such additional investment, in turn, will help the economy and stimulate jobs. This is a far preferable outcome than entering into protracted discussions over computing tax-timing (financing) benefits and trying to pass them through to customers.

C. The Proposed Resolution Creates Significant Uncertainty That May Delay Necessary Utility Investment And Undermine The Intended Benefits Of The New Tax Law.

As described above, given the New Tax Law's sunset provisions in 2011 and 2012, time is of the essence. For utilities to fully take advantage of the New Tax Law on behalf of their customers, plans must be changed, orders must be submitted, contractors must be hired, and work completed by the statutory deadlines. If the utilities are unsure whether their additional infrastructure investments (made as a result of the New Tax Law) are subject to refund, they will be unable to implement these plans.

To encourage utilities to take advantage of the New Tax Law to the fullest extent possible and increase needed investments, the Commission should not create uncertainty around such investments. It is in the Commission's (and customers') interests to allow the New Tax Law do what it was intended to do, that is, encourage additional investment.. In contrast, the Proposed Resolution discourages such investment by making subject to refund the benefits associated with the New Tax Law and embarking on what will be an extended effort to quantify such benefits.. As such, the Proposed Resolution would impede the utilities' planning process and make it impossible for the utilities to make the commitments necessary to undertake such additional investment in infrastructure.

III. CONCLUSION

For the reasons stated above, the Commission should, at a minimum, delete the Refund Order from the Proposed Resolution. In addition, even in the absence of a Refund Order, the Commission should either withdraw the Proposed Resolution or complete any needed analysis as soon as possible, but no later than 60 days from January 13 (the date the Commission will consider the Proposed Resolution).

Very truly yours,

Jane Yura
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CMB:rt

cc: via e-mail -
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Service List for Draft Resolution W-4867