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VIA EMAIL
March 4, 2011

Marzia Zafar
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Dear Ms. Zafar:

Re: Comments of Pacific Gas and Electric Company In Opposition To Draft Resolution L-411 (Dated February 25, 2011)

Pursuant to Article 14 of the Rules of Practice and Procedure of the California Public Utilities Commission, Pacific Gas and Electric Company (PG&E) hereby files comments on Draft Resolution L-411, as revised and re-circulated on February 25, 2011 ("Third Draft Resolution"). The Third Draft Resolution seeks to require utilities to track benefits not only from the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010,[1/] signed by President Obama on December 17, 2010 (the "New Tax Law"), but also an earlier act, the Small Business Job Act of 2010[2/] (the "Small Business Act"), which provided for 50% bonus depreciation on property placed in service during 2010.

For the reasons stated below, PG&E strongly opposes the Third Draft Resolution as unprecedented, unworkable, and contrary to the public interest. Therefore, PG&E respectfully asks the Commission to reject the Third Draft Resolution in its entirety.

1/ Pub. L. No. 111-312 (Dec. 17, 2010).
2/ Pub. L. No. 111-240 (Sept. 27, 2010).

I. EXECUTIVE SUMMARY

From the outset of the Commission's inquiry into the New Tax Law, PG&E has taken the position that it would increase expenditures on infrastructure consistent with the intention of the New Tax Law, which provides for substantial tax incentives for new property placed in service during 2011 and 2012, and, subject to transition rules, in 2013. While PG&E did not believe a memorandum account was necessary to ensure that the stimulus tax savings would be used for their intended purpose, PG&E was willing to accept the Commission's proposal for a memorandum account to provide assurances that such additional spending would in fact occur. Rather than taking into consideration PG&E's concerns about moving forward expeditiously, however, the Third Draft Resolution has expanded both the scope of the Commission's inquiry and the associated planning uncertainty far beyond what had been included in the first two draft resolutions. In particular, the Third Draft Resolution's inclusion of the Small Business Act makes a one-sided reduction to PG&E's starting rate base in 2011, by looking back to tax benefits derived on property additions beginning January 1, 2010. This has the practical effect of reducing PG&E's 2011 to 2013 revenues below levels needed to maintain its business, which is contrary to the public interest. The Third Draft Resolution also creates significant uncertainty about the recoverability of the utilities' capital investments by adding language either questioning or limiting the types of capital projects that the Commission will allow for recovery. And finally, the Third Draft Resolution includes numerous technical errors that make the memorandum account unworkable and prone to extensive litigation.

In light of the Third Draft Resolution's expanded scope and the attendant adverse effects on PG&E's planning certainty, PG&E strongly urges the Commission to reject the Third Draft Resolution in its entirety. The benefits of the New Tax Law will be squandered in continuing

litigation and permanently lost for customers and the California economy if the Commission continues to engage in this convoluted and unnecessary process.

II. BY ADDING THE SMALL BUSINESS ACT, THE THIRD DRAFT RESOLUTION REACHES BACK IN TIME AND INCORPORATES REDUCTIONS TO 2010 RATE BASE, WHICH IS BOTH UNFAIR AND UNPRECEDENTED.

The most important change between the Third Draft Resolution and the two prior draft resolutions is the inclusion of the Small Business Act. This change fundamentally alters the purpose of the previously proposed memorandum account and reaches back in time to incorporate the changes that took place in 2010 as a result of the Small Business Act. By adding the Small Business Act, the Third Draft Resolution effectively makes it impossible for PG&E to implement the infrastructure spending that it has planned in this GRC cycle (2011 through 2013), while having a reasonable opportunity to earn its authorized rate of return. As explained below, the Commission has never previously reached back in the past to "capture" these kinds of tax law changes between GRCs and should not do so here.

The Small Business Act is generally applicable only to property placed in service before January 1, 2011, but the Third Draft Resolution nonetheless incorporates it on the grounds that "the deferred tax reserves from the bonus depreciation provisions of the Small Business Act continue into 2011 and beyond." (Third Draft Res., p. 2.) By adding the Small Business Act into its scope, the Third Draft Resolution endorses TURN's position that that the benefits of this Act have "an impact on the deferred tax reserves like that of the Tax Relief Act." (*Id.*)

In fact, the circumstances of the two tax acts are markedly different. Because the New Tax Law was passed in December 2010 and is applicable to new property placed in service

during 2011 and 2012, and, subject to transition rules, in 2013,[3/] PG&E can reasonably reflect the impact of the New Tax Law in its future spending and budget process to the benefit of customers. In contrast, by incorporating the Small Business Act, the Third Draft Resolution requires utilities to reach back in time and incorporate *reductions* to rate base for capital spending beginning January 1, 2010, without providing a mechanism for utilities to incorporate *increases* in rate base (and other revenue requirement components) from incremental capital spending above that forecasted in authorized rate base for the historical period. This one-sided approach would effectively result in an authorized rate base for 2011 that is far below actual rate base and render PG&E unable to implement its current GRC-based budget of capital and other spending. Such an outcome would not only constitute a violation of PG&E's right to an opportunity to earn its authorized rate of return, but also produce an outcome contrary to the intended effect of the tax legislation.

The Third Draft Resolution's retroactive reach is not only one-sided and unfair, it is also unprecedented. Even though bonus depreciation in various forms has been enacted on numerous occasions throughout the last decade,[4] the Commission has never tried to make the type of retroactive changes that the Third Draft Resolution proposes. Indeed, the Commission's Generic Investigation into Taxes and Ratemaking (the "Tax OII") rejected arguments for a routine re-

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3/ The New Tax Law also incrementally increases bonus depreciation (from 50% to 100%) for capital additions from September 9, 2010 to December 31, 2010.

4/ On March 9, 2002, the *Job Creation and Worker Assistance Act of 2002* provided 30 percent bonus depreciation for qualified property placed in service after September 10, 2001 and before September 11, 2004 (Pub. L. No. 107-147, Sec 101(a)).
On May 23, 2003, the *Jobs and Growth Tax Relief Reconciliation Act of 2003* extended and increased the percentage of bonus depreciation for qualified property to 50 percent for property placed in service after May 5, 2003 and before January 1, 2005 (Pub. L. No. 108-27, Sec 201(a)).
On February 7, 2008, the *Economic Stimulus Act of 2008* provided 50 percent bonus depreciation for qualified property placed in service after December 31, 2007 and before January 1, 2009 (Pub. L. No. 110-185, Sec 103).
On February 17, 2009, the *American Recovery and Reinvestment Act of 2009* extended 50 percent bonus depreciation for qualified property placed in service before January 1, 2010 (Pub. L. No. 111-5, Sec 1201).

opening of tax computations in the case of tax law changes in between rate cases, observing 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."[5]

In the Third Draft Resolution, the Commission would take the unprecedented step of making a one-sided retroactive look back, via the proposed memorandum account, to provide forward-looking reductions to rate base through a deferred tax reserve, without also incorporating increases to rate base (i.e., increased capital spending made for the benefit of customers) that would offset such reductions. By expanding the scope of the Commission's inquiry to include only a one-sided look at these historical periods to make forward-looking revenue requirements changes, the Third Draft Resolution is unfair, unprecedented, and contrary to the public interest.

III. THE THIRD DRAFT RESOLUTION IMPOSES ADDITIONAL UNCERTAINTY THAT IMPAIRS PG&E'S ABILITY TO PLAN SPENDING TO TAKE FULL ADVANTAGE OF THE NEW TAX LAW ON BEHALF OF CUSTOMERS AND TO IMPROVE THE CALIFORNIA ECONOMY.

Draft Resolution L-411, as originally circulated on February 7, 2011, provided reasonably clear guidance that utilities should increase capital spending to maximize tax benefits on behalf of customers and to help stimulate the economy, consistent with the underlying purpose of the New Tax Law. As PG&E noted in its comments on Draft Resolution W-4867, the New Tax Law amounts to a two-year Federal tax sale that provides a substantial incentive for utility infrastructure in 2011 and 2012.[6] PG&E had cautioned, however, that increasing infrastructure spending takes time to implement, and that to undertake the additional spending in a timely and cost-effective manner to maximize tax benefits, PG&E needs to commence

5/ D. 84-05-036, 15 CPUC2d 42 at 55, 1984 Cal. PUC LEXIS 1325 at *34.

implementation immediately. Rather than endorsing this apparent "win-win" proposition for California customers and the California economy, however, the Third Draft Resolution places numerous roadblocks in the way of utility investments.

First, in language that appears to be directly targeted at PG&E, the Third Draft Resolution states that "it may make sense for the Commission to require a utility, especially a major utility, whose next GRC is some years away to file an application for 'major' investments, rather than having a utility just book the costs as offsets into the memorandum account" and that the Commission "may impose such a requirement at a later date." (Third Draft Res., p. 15.) This cautionary sentiment is also reflected in new Finding and Conclusion #23, which states: "The Commission generally prefers to evaluate large new expenditure programs in a formal application, rather than relying solely on after the fact review of such capital additions." (*Id.,* p. 17.) Footnote 9 similarly provides: "[W]e decline TURN's invitation to prejudge whether investments in software are needed or reasonable." (*Id.*, p. 10, fn. 9.)

This new language effectively hamstrings PG&E's ability to take advantage of the New Tax Law's stimulus, reduce capital costs by initiating infrastructure spending increases during the tax incentive period, and produce much-needed jobs. From a planning standpoint, PG&E will have no way to evaluate what would constitute a "major" investment or a "large new expenditure program." By declining to "prejudge" whether software investments will be deemed "needed or reasonable" under the new memorandum account, the Third Draft Resolution creates further uncertainty about the recoverability of such investments, thereby undermining PG&E's

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6/ From a present value standpoint, the benefits of 100% tax write-off (as compared with traditional tax depreciation) can reduce costs by as much as 20% and the benefit of 50% bonus depreciation can reduce costs by as much as 10%.

incentive to make such investments, notwithstanding any operational or tax benefits that such investments may have for customers.

Second, the Third Draft Resolution proposes to exclude certain types of investments from the memorandum account based on conclusory statements, unsupported by any evidence, about what the "New Tax Laws were intended to encourage." (Third Draft Res., p. 10.) According to the Third Draft Resolution:

> We exclude the purchase of vehicles, because that is not an investment in utility infrastructure and therefore not a desirable use of tax savings. We exclude the purchase of land, because, as a non-depreciable asset it does not qualify for bonus depreciation and therefore is not the kind of investment the New Tax Laws were intended to encourage. While other kinds of real estate, e.g., existing buildings, are depreciable, because their purchase only involves a transfer of assets, and not the creation of a new asset, with the potential for job creation, we also conclude that they are not the kind of investment the New Tax Laws were intended to encourage. Accordingly, the costs of investments in vehicles and real estate may not be used as offsets in the memorandum account. (Third Draft Res., p. 10.)[7/]

As indicated in its previous comments, PG&E intends to focus its capital spending on infrastructure investments that create jobs and produce customer benefits. Maximizing tax benefits is a complex undertaking, especially with transition rules that have yet to be interpreted by IRS regulations. The proscriptive language in the Third Draft Resolution pre-supposes, without any supporting evidence, that certain investments were "not the kind of investments the New Tax Laws were intended to encourage."[8/] However, some capital investments that are

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7/ This excerpt from the Third Draft Resolution reflects a fundamental lack of understanding of the New Tax Law. For example, only depreciable property with a tax life of less than twenty years is eligible for bonus depreciation. (IRC Section 168(k)(2)(A)(i)(I).) Because real property (other than leasehold improvements) has a tax life of longer than twenty years, real property generally does not qualify. Moreover, as to purchasing previously used property, the New Tax Law also addresses that issue (*see* IRC Section 168(k)(2)(A)(ii)). Only property that has its first use in the hands of the taxpayer (i.e., new property) qualifies for bonus depreciation.

8/ For example, one of the largest benefits of the Small Business Act and New Tax Law is reserved for leasehold improvements. (IRC Section 168(k)(3).) Because leasehold improvements are not eligible for accelerated tax depreciation (IRC Section 168(a)(3)(G)), but are eligible for both the 50% bonus depreciation and the 100% bonus depreciation, one of the largest tax benefits available would be derived by accelerating such spending.

disfavored by the Third Draft Resolution may be necessary to effectuate those that are favored thereby. The Commission should reject the Third Draft Resolution's unsupported and perfunctory "command and control" regulation as contrary to the public interest.

IV. THE THIRD DRAFT RESOLUTION'S REVISIONS REFLECT NUMEROUS TECHNICAL ERRORS THAT WILL MAKE THE PROPOSED MEMORANDUM ACCOUNT UNWORKABLE AND PRONE TO EXTENSIVE LITIGATION.

PG&E had supported Draft Resolution L-411, as originally circulated on February 7, 2011, with one caveat: that the Final Resolution should include language that recognizes the complexity of the undertaking and the role of the Commission's technical staff in making the necessary simplifying assumptions to implement the memorandum account in a timely fashion. PG&E was hopeful that, through the advice filing process, the Commission would focus on having a workable memorandum account procedure consistent with the Commission's underlying intent that utilities increase spending on infrastructure to take advantage of the New Tax Law so as to benefit customers.

Rather than recognizing PG&E's concerns and adopting a simplifying approach to the memorandum account, the Third Draft Resolution goes exactly the opposite direction by proposing numerous technical revisions. Such revisions are not only proscriptive and heavy-handed, as discussed in Section III above, but also contain technical errors that will make the proposed memorandum account unworkable and may well result in extensive litigation.[9/]

9/ While PG&E limits its comments to changes between the Third Draft Resolution and the prior draft resolutions, PG&E notes that footnote 1, which was objected to in earlier comments and carried over from the previous version, mischaracterizes normalization requirements. Since 1981, Congress has required that the benefits of accelerated depreciation be used to reduce rate base rather than reduce current tax expense dollar-for-dollar. (*See* IRC Section 168(h).) FERC also extensively analyzed this issue and specifically rejected the analysis quoted in footnote 1, endorsing instead a matching principle. (*See* 46 FR 26613, adopting FERC Rule 144 and changes to 18 CFR Part 2, and 47 FR 8329, adopting Rule 144A.)

A. The Third Draft Resolution's Explanation Of Working Cash Is Incomprehensible And Inaccurate.

The Third Draft Resolution includes a new footnote relating to working cash that states:

> In its comments on the Second Draft Resolution (p.6), SCE seems to suggest that it will have a shortfall in working cash due to the bonus depreciation provisions of the New Tax Laws. However, since the increase in working cash due to the lower tax payments resulting from the New Tax Laws was not included in the utilities' existing rates, the effect of the New Tax Laws is to increase, not decrease, working cash during the Memo Account Period. However, the increase in working cash will occur later than when the increase in deferred tax reserve accrues. (Third Draft Res., pp. 8-9, fn. 8.)

This statement regarding working cash is not only confusing, it is also inaccurate, at least with respect to PG&E. In its GRC applications, PG&E has already given customers the benefit (through a reduction to working cash/rate base) to reflect the fact that tax payments for a particular tax year (e.g., 2011) will not be paid until November of that year (e.g., November 1, 2011 on a weighted average basis). Accordingly, any further deferral of tax payments relating to that tax year, attributable to bonus depreciation, can only be reflected for customers beginning on that date. Such benefits do carry forward as a rate base reduction into 2012 and following years, but as a starting point for the tax year 2011, and therefore, the benefit of the deferral does not begin to accrue, on average, until November.

B. The Third Draft Resolution Omits The Treatment Of Net Operating Losses From The Memorandum Account.

The Third Draft Resolution includes a new Ordering Paragraph 6.b that provides:

> Any utility that wants to include in its memorandum account impacts of the New Tax Laws not specifically authorized for inclusion in the memorandum account by this resolution should request and justify the inclusion of any additional, specific category of impacts in an advice letter filed pursuant to this Ordering Paragraph. (Third Draft Res., p. 19, OP 6.b.)

Meanwhile, on pages 8-9, the Third Draft Resolution includes a discussion of offsets relating to the New Tax Law and Small Business Act, including references to the Section 199 deduction, working cash and CIAC. However, contrary to the implication of new Ordering Paragraph 6.b., this listing of offsets is not exhaustive. It is very likely that the totality of the deductions available to the utilities will result in net operating losses on a ratemaking basis, the cost of which will need to be used as an offset to benefits otherwise available. This is just one example of numerous possible items that should reasonably be included in the memorandum account, which PG&E had proposed in its prior comments to be left to the Commission's technical staff to resolve in consultation with the utilities. By effectively deciding the matter on its own initiative, without the benefit of discussion among the relevant technical experts at the utilities and the Commission, the Third Draft Resolution has made at least one critical omission and rendered the entire memorandum account process unworkable and contrary to the public interest.

C. The Third Draft Resolution Adds New Requirements Regarding Incremental Spending That Are Inconsistent With The Way Incremental Spending Will Be Recorded In The Memorandum Account.

Draft Resolution L-411, as originally circulated on February 7, 2011, adopted a straightforward and workable way of measuring the incremental spending that could be recorded into the balancing account. Rather than looking project by project, the memorandum account would have measured the increment between adopted additions to plant in service (as budgeted prior to the New Tax Law and reflected in the results of operations model or attrition adjustment) and actual additions to plant in service.

The Third Draft Resolution adopts the contradictory concept that utilities will actually be indentifying particular projects that are incremental, rather than simply computing numerically the amount of the incremental capital additions. The Third Draft Resolution states:

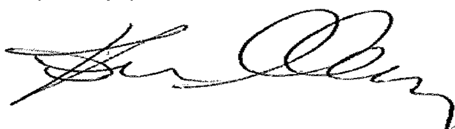
> We are still requiring after-the-fact reasonableness review of projects whose costs are recorded as offsets in the memorandum accounts, and there will also be GRC review of those projects before those projects can be included in rate base for recovery of costs for the next test year and thereafter. (Third Draft Res., p. 15.)

PG&E has no plans to track incremental capital spending project-by-project, and to do so for all incremental amounts tracked in the memorandum account would be impractical and unworkable. Indeed, much of the increased spending will occur in mass asset accounts (such as poles and transformers) where there is no identifiable "project." PG&E fully recognizes that its capital additions will be subject to review in its next GRC, but the notion that individual projects will be tracked and identified adds an entirely new, confusing dimension. Such unreasonable additional requirements constitute yet another reason why PG&E strongly opposes the Third Draft Resolution and requests that this resolution and memorandum account process be terminated.

V. CONCLUSION

In sum, PG&E strenuously objects to the Third Draft Resolution, which PG&E believes is unprecedented, unworkable, and contrary to the public interest. The Commission should continue its previous policies toward bonus depreciation, which require utilities to reflect the impacts of bonus depreciation (along with additional spending by the utilities) in their next GRC. By rejecting the Third Draft Resolution in its entirety and terminating this convoluted process, the Commission will allow utilities such as PG&E to begin the necessary planning process to take maximum advantage of the New Tax Law, which will ultimately benefit California's ratepayers, economy, and the general public.

Very truly yours,



Brian Cherry
Vice President – Regulatory Relations

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