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April 11, 2011

Commission President Michael Peevey
Commissioner Timothy Alan Simon
Commissioner Michel P. Florio
Commissioner Katherine J.K. Sandoval
Commissioner Mark Ferron
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Re: TURN's Reply To Matters Addressed In The Utilities' Letters of April 8, 2011 On Draft Resolution L-411

Dear Commissioners:

The all-party meeting conducted on March 30, 2011 concluded with an invitation to all present to offer solutions to some of the problems and issues that the utilities had raised regarding the approach set forth in the Fifth Draft Resolution L-411. For the most part, the responses the utilities provided last Friday offered no such solutions, but instead merely reiterated their general opposition to any memorandum account. The responses make clear that if the Commission wishes to achieve anything approaching broad consensus about how the memorandum account should be implemented, it needs to first direct establishment of the memorandum account. And for that reason, TURN urges the Commission to issue a resolution establishing the memorandum account at this week's meeting.[1]

I. The Commission Needs To Take Action, As The Latest Utility Statements Illustrate That Most Will Continue Conjuring Up Reasons To Oppose Creation of a Memorandum Account Unless And Until One Is Ordered.

Draft Resolution L-411 recognizes that the recent federal legislation creates the possibility of large and unexpected decreases in tax expense that, absent regulatory action, a cost-of-service utility could choose to either use to fund infrastructure investment, or retain for other utility (and shareholder) purposes, at least until the next GRC decision went into effect. Starting with the Second Draft Resolution, the framework under consideration has sought to encourage each utility to use the tax expense decrease to fund necessary capital additions; only to the extent the funds were

[1] PG&E's suggestion that the Commission merely provide a less formal signal through a public statement at that meeting, then leave it to the parties to reach concurrence on the remaining issues simply will not work under these circumstances.

not used for that purpose would they be used to reduce rates.[2] And since at least the Fourth Draft Resolution, any utility that wanted to use the savings from the new tax laws to invest in necessary capital additions would be required to first justify that use of the savings through an application or advice letter. The utilities have pointed to this pre-spending authorization requirement as a fundamental flaw of the later versions of Resolution L-411 that led them to oppose the Draft Resolution. The proposal TURN presented in last week's letter sought to address this criticism through creation of something of a "safe harbor" that would permit the utilities to avoid the need to obtain specific authorization first, so long as the spending proposal met certain other criteria.

With one notable exception, the utility responses indicate that their desire to scuttle the Draft Resolution altogether outweighed any interest they had in providing constructive feedback. None of the responses identified any real flaw in the general approach TURN proposed. Several of them simply chose to ignore it. On the other hand, working under the implicit assumption that there would be a memorandum account, in just a few days PG&E and TURN were able to reach concurrence regarding several key elements of the memorandum account's implementation, as described in PG&E's April 8, 2011 letter.

These recent comments highlight the importance of the Commission acting expeditiously to adopt the Draft Resolution and create the memorandum account described therein. They also illustrate that the Commission can do so with the hope, and perhaps even an expectation, that parties can achieve a greater degree of concurrence once the question put to them is how each utility should implement such an account, rather than whether or not an account should be created at all.

II. TURN's Proposal to Permit Certain Infrastructure Replacement Spending To Go Forward Without Pre-Approval Drew Only A Few Overstated Criticisms.

Only PG&E and CWA addressed TURN's "safe harbor" proposal in their comments of April 8, 2011. PG&E described the modifications that PG&E and TURN had developed to improve that proposal while remaining consistent with the underlying principles of TURN's proposal.[3] CWA, on the other hand, characterized the proposal as so inapposite to the water utilities that it illustrates why there should be no memorandum account for those companies. CWA's arguments do not stand up to even minimal scrutiny.

CWA simply has no basis for its assertion that "TURN's proposal is designed solely with the circumstances of the major energy utilities in mind."[4] The proposal was designed to

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[2] The approach described in the Second Draft Resolution "assures the utilities that if they spend the tax savings on additional, needed capital investment the costs of which will not otherwise be recovered in rates, these additional costs will be offset against amounts that otherwise might be used to reduce rates." Second Draft Resolution, p. 4.

[3] As PG&E noted, the parties did not reach agreement on the question of whether or how to include generation investment in any "safe harbor." TURN is hopeful that this reflected more the shortness of time available for discussions than any more substantive disagreement between the parties on this point.

[4] CWA Letter of April 8, 2011, p. 2.

respond to the claims all of the cost-of-service utilities had raised that requiring even an advice letter before embarking on a project enabled by the new federal legislation would somehow render them incapable of moving forward. While it is true that the examples TURN provided were focused on the energy utilities, this reflects nothing more than the fact that TURN's advocates on this matter are most familiar with energy utilities.

CWA fails in its attempt to characterize the water utilities as different in any material way from the major energy utilities with regard to the ability to identify projects that are in the nature of infrastructure replacement that might qualify for the "safe harbor" approach. Citing projects of the scale that might trigger G.O. 131-D compliance is particularly self-serving, given that this particular General Order applies by its own terms to electric utilities but not water utilities (or gas utilities, for that matter). TURN is not aware of any indication from any of the electric utilities that the incremental capital expenditures they would consider pursuing with the tax benefits would implicate G.O. 131-D. The water utilities are indistinguishable from the energy utilities in the more important regard that CWA identifies:

> Water utilities may, and often do, undertake plant investments without specific Commission approval, subject to after-the-fact review during their triennial general rate cases.[5]

This statement is equally true if the words "water utilities" are replaced with "energy utilities."

CWA's one substantive criticism is that the "safe harbor" criteria set forth in TURN's initial proposal would not accommodate new capital investment projects a water utility might pursue "for such purposes as enhanced treatment to meet increasingly stringent water quality standards and installations to help meet water and energy conservation goals."[6] TURN's proposal was not presented as a rigid set of final criteria, and TURN's experience with PG&E to refine those criteria demonstrates that we understand that our first attempt did not achieve a perfect score. CWA may well be right that water utilities should be permitted use of the tax benefits to pursue such projects without first seeking approval through the advice letter or application process. But that would be an argument in support of modifying the criteria. CWA presents it as an argument in support of its current single end goal – scuttling the Draft Resolution altogether or at least ensuring it does not apply at all to the water utilities. As TURN noted earlier, CWA's position only highlights the need for the Commission to adopt Resolution L-411 at its earliest opportunity, with the hope that the utilities may take a more reasoned and constructive approach when it comes to working on the implementation of the adopted Resolution.

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[5] *Id.*

[6] *Id.*

III. SCE's Letter Demonstrates Why The Commission Cannot Accept The Utility Calculations At Face Value.

According to SCE, the 2011 revenue requirement impact from implementing the "Tax Relief Act of 2010"[7] would be an <u>increase</u> of $11 million.[8] The utility goes on to claim that using the escalation rates adopted for attrition purposes to calculate the level of capital expenditures to be treated as "incremental" for purposes of the Draft Resolution would warrant a $243 million increase to the utility's 2011 authorized revenues. In each case, the underlying assumptions or calculations appear to be extremely flawed.

SCE's calculation of the estimated revenue requirement impact in 2011 from the Tax Relief Act is appended to its April 8 letter. The table shows a $197 million reduction to SCE's ratebase due to the change to "weighted average deferred tax." However, that figure is nearly entirely offset by a $161 million increase attributed to "change in working cash." In SCE's letter, the working cash element of the calculation is merely labeled as being "due to the timing of the cash flow."[9] But there would only be a change to working cash if the Commission were to reduce rates immediately to reflect the tax benefits. Such an immediate rate reduction is not an element of the current Draft Resolution. Instead, the tax benefits would be recorded in a memorandum account and not used to reduce rates until some point in the future, and then only to the extent those benefits are not used for the designated capital expenditures. Under those circumstances, there is no "cash flow" or working cash effect at all, because SCE is not treating the tax benefit as a rate base reduction instantaneously passed through in rates.[10] Removing the working cash entry on SCE's table and leaving all else equal produces a net decrease to ratebase of $197 million (rather than $31 million), with an associated reduction in revenue requirement of approximately $27 million (rather than $5 million), for an overall revenue <u>reduction</u> of $10 million, of which 90% would be allocated to CPUC-jurisdictional operations. This is a far cry different from an $11 million <u>increase</u>.

SCE's purported $243 million increase to 2011 authorized revenues if its attrition percentages are used to escalate capital expenditures from the level adopted for its 2009 test year repeats the figure SCE presented in its March 4, 2011 letter. The calculation relies on an unsupported assertion: "If 2009 capital additions are to be escalated into 2011 to compute incremental tax depreciation, then the incremental depreciation and

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[7] Like the other major energy utilities, SCE opted not to calculate the 2011 revenue requirement impact from the "Small Business Jobs Act of 2010" that preceded the Tax Re lief Act.

[8] SCE Letter of April 8, 2011, p. 1.

[9] *Id.*

[10] TURN is aware that SCE purports to have devoted three hours to discussions with Legal Division staff in the utility's effort to "explain the working cash and other elements of SCE's proxy method." S CE Letter of March 4, 2011, fn. 14. TURN submits that any "proxy method" that requires three hours of explanation is a "proxy method" that is likely to be more complicated than it needs to be. Furthermore, whatever portion of that time was devoted to the topic of working cash, SCE's use of working cash for purposes of calculating the estimated revenue requirement impact is incorrect.

return on those capital additions should be recognized as well."[11] SCE never attempts to explain why a proxy the Commission might seek for the limited purpose of assessing whether capital expenditures linked to the Tax Laws benefits are incremental to other capital expenditures would require recognition of amounts the utility may have overspent in recent years on its vehicle fleet or IT infrastructure.

Furthermore, SCE's numbers defy ratemaking logic. The authorized revenue requirement for 2009 covered the depreciation and return on capital additions from that year, and the attrition increases authorized for 2010 and 2011 were intended to "cover costs of doing business in 2010 and 2011 . . . [including] cost increases caused by increased capital spending." D.09-03-025, p. 302. So the only incremental "revenue requirement" not covered by the authorized revenue requirement for 2010 and 2011 would be that associated with the increment of capital expenditures over the authorized level for those years. As SCE notes, there is no such authorized level covering all of its CPUC capital additions for either 2010 or 2011. However, as TURN pointed out, the Commission has adopted such authorized levels for 2010 and 2011 for those expenditures within the RIIM-Authorized Capital Expenditures.[12] As set forth in Resolution E-4313, the increase in authorized RIIM spending from 2009 to 2010 is approximately $46 million, and another $50 million from 2010 to 2011.[13] Using the mid-year convention, this means $23 million of additional rate base at the end of 2010,[14] and $71 million at the end of 2011,[15] both as compared to 2009 authorized levels. Even if depreciation and return were 20% each year on that incremental investment, the "revenue requirement" from that incremental investment would be approximately $4.6 million to $14 million in 2011. And even if this figure were doubled (to reflect SCE's figure for 2009 "CPUC Capital Additions), the total would be less than $30 million, a far cry from the $243 million figure SCE purports to have developed through its Results of Operations model.

IV. The Final Resolution Should Include The Small Business Jobs Act.

Several of the utilities used the opportunity to present further comment to simply reiterate their opposition to inclusion of the Small Business Jobs Act of 2010 in any outcome the Commission might adopt for the Tax Relief Act.[16] SCE labels the inclusion of the Small Business Jobs Act as "particularly inappropriate" in light of the Commission's treatment

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[11] SCE Letter of March 4, 2011, p. 6. SCE's most recent letter contends that the March 4, 2011 comments discuss this issue "in more detail." SCE Letter of April 8, 2011, p. 3. TURN did not find any "more detail" in the March 4 version.

[12] The RIIM-Authorized Capital Expenditures represent more than 50% of the $1.9 billion SCE presents as the full amount of "CPUC Capital Addit ions" for 2009. SCE Letter of March 4, 2011, Attachment 1, p. 2, line 7.

[13] Res. E-4313, p. 4, Table 1.

[14] (0.5)($46 million) = $23 million.

[15] $46 million + (0.5)($50 million) = $71 million.

[16] TURN left the all-party meeting with the understanding that Comm issioners Sandoval and Ferron were interested in knowing the potential revenue requirement impacts of both acts. However, the energy utilities limited their calculations to the Tax Relief Act, consistent with their position asking the Commission to ignore the Small Business Jobs Act.

of similar bonus depreciation measures since 2001.[17] The Sempra Utilities make a similar point about the lack of precedent for Commission action to capture for ratepayers the benefits from bonus depreciation.[18] As TURN noted at the all-party meeting, Commission inaction in the face of no party seeking any Commission action is not much of a precedent for anything. For the other bonus depreciation measures enacted since 2001, there is no indication that any party asked the Commission to reflect the impact of those measures in rates before the next regularly scheduled GRC, nor is there any indication that the Commission considered such an approach *sua sponte*.

PG&E raises a different issue regarding the impact of the "Small Business Act." Based on its assertions that the utility's 2009 and 2010 capital expenditures were above authorized levels and therefore not reflected in the 2011 rate base, PG&E argues that either the earlier Small Business Act should be excluded from the final Resolution or the Commission should make unspecified "compensating adjustments" to include the 2009 and 2010 capital investments.[19] TURN suspects that this is a PG&E-specific issue, as no other utility alleged that its 2009 and 2010 capital expenditures were above levels implicitly approved in its most recent GRC.[20] Therefore, rather than stand as a reason to exclude the Small Business Act of 2010 from the Resolution, TURN submits that this is an implementation issue that might warrant utility-specific treatment given PG&E's unique alleged circumstances.

V. The Commission Must Recognize That A 2012 GRC Provides Nothing To Ratepayers With Regard To 2011 Benefits.

The Sempra Utilities and SCE both also used their April 8 letters to renew their claim that no action is needed for them because the test year 2012 GRC that is underway for each of them will serve to flow to ratepayers the revenue requirement benefits of the new tax laws. Neither utility disputes that this approach would mean that the revenue requirements realized in 2011 would be lost to ratepayers. The Sempra Utilities simply ignore the 2011 issue, focusing exclusively on the 2012 impacts: "SEU's January 1, 2012 rate base forecast for the GRC will be lower than otherwise forecasted… with ratepayers realizing 100% of the forecasted benefits … upon implementation of the 2012 GRC decision."[21] Omitted from the Sempra Utilities' discussion is acknowledgement that until implementation of the 2012 GRC decision, the utilities and their shareholders would realize 100% of the benefits. To its credit, SCE at least reminded the Commission "[t]here was concern expressed in the meeting that savings from bonus depreciation would be lost to ratepayers in 2011."[22] But what follows in the utility's letter is

[17] SCE Letter of April 8, 2011, p. 2.

[18] Sempra Energy Utilities Letter of April 8, p. 3.

[19] PG&E Letter of April 8, p. 2.

[20] TURN is unclear as to why 2009 capital expenditures would be included in PG&E's analysis, given that the Small Business Act of 2010 covers only investments made after January 1, 2010.

[21] Sempra Energy Utilities Letter of April 8, p. 2.

[22] SCE Letter of April 8, p. 2.

regulatory-speak for "that concern is entirely valid, but it won't be that much money, so we'd like the Commission to do nothing in response to that concern."[23]

In sum, the feedback on TURN's proposed criteria for a "safe harbor" of investments that would not require an advice letter or application seeking pre-approval was helpful, as TURN was able to work with PG&E to better explain and refine those criteria consistent with the underlying principles. Unfortunately, this was the one bright spot in letters that otherwise continued the utilities' ongoing efforts to scuttle the entire memorandum account approach altogether. For the reasons described above, the Commission should deem those efforts baseless and overwrought, and move to adopt Resolution L-411 as expeditiously as possible.

Once again, we thank you for your consideration of these matters and stand ready to respond to any questions you might have regarding TURN's position on the New Tax Laws.

Yours truly,

/s/

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Legal Director

cc: Marzia Zafar, CPUC
Paul Clanon, CPUC Executive Director
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[23] SCE's actual words: "Because bonus depreciation must be normalized, the 2011 impact is small, as quantified above. In addition, SCE won't monetize the 2011 cash benefits of the Tax Relief Act until late in the year, just a few months before the effective date of our 2012 GRC. The 13-month average rate base calculation will pick up the majority of these deferred tax offsets in 2012 and for years to come." *Id.*, pp. 2-3.