Agenda ID #____

Decision ______________

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of The Utility Reform Network for an Award of Intervenor Compensation for Substantial Contributions to Resolution L-411 and the Commission Proceeding Leading Thereto.	A.11-06-___ Filed June 09, 2011

AMENDED[1] APPLICATION OF THE UTILITY REFORM NETWORK TO FILE[2] CLAIM AND DECISION ON REQUEST FOR INTERVENOR COMPENSATION

Claimant: The Utility Reform Network			**For contribution to Res. L-411**
Claimed ($): $21,598			**Awarded ($):**
Assigned Commissioner: N/A			**Assigned ALJ: N/A**
I hereby certify that the information I have set forth in Parts I, II, and III of this Claim is true to my best knowledge, information and belief. I further certify that, in conformance with the Rules of Practice and Procedure, this Claim has been served this day upon all required persons (as set forth in the Certificate of Service attached as Attachment 1).			
		Signature:	/s/
Date:	**7/8/11**	**Printed Name:**	**Robert Finkelstein**

PART I: PROCEDURAL ISSUES (to be completed by Claimant except where indicated)

[1] This Amended Request for Compensation includes attachments at the request of the ALJ Division since the draft resolutions, TURN's comments thereon, and other documents cited in the Request were not filed in a formal open docket. TURN has also taken advantage of the opportunity to describe an additional substantial contribution associated with TURN's work leading up to the revised Resolution L-411A that the Commission adopted at its June 23, 2011 meeting, and to add the associated 3.5 hours (with a corresponding increase of changes to the subtotals and total amount requested (an increase of $1,645). In all other ways it is identical to the Request for Compensation TURN filed and served on June 9, 2011.

[2] TURN submits this Request for Compensation as a separate "application" in order to minimize filing and processing difficulties where such a request addresses a Commission resolution for which there is no separate application number. TURN consulted with Deputy Chief ALJ Michelle Cooke on this matter, and she gave her permission for TURN to so designate the pleading.

A. Brief Description of Decision: In Resolution L-411, the Commission established a one-way memorandum account for all cost-of-service rate regulated utilities that do not address the New Tax Act[3] in a 2011 or 2012 test year GRC, in order to track the impacts of the New Tax Act. The resolution authorized the impacted utilities to use savings from the new tax law to reduce rates or to invest in additional, needed utility infrastructure, without the need for a formal application or advice letter so long as the investment met specified guidelines.

B. Claimant must satisfy intervenor compensation requirements set forth in Public Utilities Code §§ 1801-1812:

	Claimant	CPUC Verified
Timely filing of notice of intent to claim compensation (§ 1804(a)):		
1. Date of Prehearing Conference:	n/a	
2. Other Specified Date for NOI:	n/a	
3. Date NOI Filed:	n/a	
4. Was the notice of intent timely filed? **See comment below**		
Showing of customer or customer-related status (§ 1802(b)):		
5. Based on ALJ ruling issued in proceeding number:	A.10-11-015	
6. Date of ALJ ruling:	6/3/11	
7. Based on another CPUC determination (specify):		
8. Has the claimant demonstrated customer or customer-related status?		
Showing of "significant financial hardship" (§ 1802(g)):		
9. Based on ALJ ruling issued in proceeding number:	P.10-08-016	
10. Date of ALJ ruling:	11/22/10	
11. Based on another CPUC determination (specify):		
12. Has the claimant demonstrated significant financial hardship?		
Timely request for compensation (§ 1804(c)):		

[3] The "New Tax Act" refers to the federal Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010.

SB_GT&S_0237253

13. Identify Final Decision	Resolution L-411	
14. Date of Issuance of Final Decision:	4/15/11	
15. File date of compensation request:	6/9/11	
16. Was the request for compensation timely?		

C. Additional Comments on Part I (use line reference # as appropriate):

#	Claimant	CPUC	Comment
B4			In D.98-11-049, the Commission determined that an NOI incorporated in the timely-filed Request for Compensation for work on an advice letter is itself timely filed. TURN has attached to this form compensation request our form NOI for this proceeding. In D.09-09-027 (awarding compensation for TURN's substantial contribution to Res. E-4227 on the SCE HECA Advice Letter), the Commission permitted a similar approach without comment.

PART II: SUBSTANTIAL CONTRIBUTION (to be completed by Claimant except where indicated)

A. In the fields below, describe in a concise manner Claimant's contribution to the final decision (*see* § 1802(i), § 1803(a) & D.98-04-059) (For each contribution, support with specific reference to final or record.)

Contribution	Citation to Decision or Record	Showing Accepted by CPUC
1. The resolution that became L-411 started off as Draft Resolution W-4867, issued on approximately December 30, 2010. The initial draft resolution sought to ensure that the cost savings that would flow from the New Tax Act would be reflected in rates. It would have made "subject to refund" the rates of all cost-of-service-regulated utilities; directed workshops to address the impact the New Tax Act is likely to have on the various utilities; and only then have the Utility, Audit, Finance & Compliance Branch of the Division of Water and Audits recommend to the Commission how to resolve issues associated with ensuring the tax-related savings are reflected in rates.	Draft Resolution W-4867.	
Alone among the parties submitting comments at this time, TURN's comments on the original draft resolution supported the general principle of ensuring that the tax benefits under the New Tax Act would be fully reflected in	TURN Comments, January 7, 2011.	

SB_GT&S_0237254

rates. TURN also called for expanding the treatment to the Small Business Job Act of 2010. The final resolution bore a different name, was issued through the Legal Division rather than DWA, and addressed the substance of many of the issues that draft Res. W-4867 would have deferred to workshops. However, it maintained the fundamental principle that the cost savings from the New Tax Act should flow to ratepayers, rather solely to utility shareholders.	Res. L-411, Finding 6.	
2. A second version of the draft resolution (now designated Res. L-411) issued on or about February 7, 2011. The revisions included abandoning the "subject to refund" approach (that would have permitted the Commission to defer more of the issues) in favor of giving the utility the choice of using the benefits to reduce rates or to fund "additional, needed capital investments." TURN submitted lengthier comments on the second version on February 14, 2011. TURN renewed its call for inclusion of the Small Business Job Act, and raised concerns about the "additional, needed capital investments" approach in the draft. TURN also noted that certain types of capital investment should be excluded (such as vehicles and real property), and that the new approach would warrant before-the-fact review (through an advice letter or application) rather than an after-the-fact reasonableness review. In the next version of the Draft Resolution, the Commission included the Small Business Job Act and identified vehicles and real property as capital investments NOT eligible for funding with tax benefits.	Draft Res. L-411, Version 2, pp. 3-4 and Finding and Conclusion 8. TURN Comments, 2/14/11. Draft Resolution Version 3 (2/28/11), p. 10; and Findings and Conclusions 3-4.	
3. A fifth version of Draft Resolution L-411, issued on or about March 10, 2011, provided two ways for a utility to proceed if it wished to invest its tax savings in utility infrastructure rather than use those savings to reduce rates; it could file an application, or submit an advice letter that generally described the type of investment, cost, and how it would be funded with tax savings. Commissioners Sandoval and Ferron convened an all-party meeting on March 30, 2011. The cost-of-service-regulated utilities were represented in substantial numbers. TURN served as the primary representative of consumer interests.	Draft Res. L-411, Version 5, p. 6 and Ordering Paragraph 7.	

SB_GT&S_0237255

(DRA also attended but participated in a very limited fashion.) At the conclusion of the meeting, the Commissioners invited parties to submit alternatives that might serve as approaches to capturing the tax benefits while mitigating some of the concerns raised in the meeting. On April 5, 2011, TURN submitted an alternative approach to the pre-spending application or advice letter that had been a subject of much discussion at the previous week's all-party meeting. TURN proposed that the final Resolution establish clear guidelines of the types of capital spending the Commission seeks to encourage. To the extent a utility stays within those guidelines, it would not need to seek pre-approval of its spending proposal. Should a utility wish to invest the tax benefits in an area outside of the guidelines, it would need to file a pre-spending application or advice letter. TURN submitted six such guidelines for the Commission's consideration. Almost immediately after TURN served the 4/5/11 letter on the other parties, TURN engaged in discussions with PG&E to further refine the proposed guidelines. As a result of these discussions, PG&E's 4/8/11 letter presenting the utility's tax savings estimate also stated the utility's support for TURN's 4/5/11 proposal, with a few modifications that TURN had generally agreed would be consistent with that proposal. Resolution L-411 as adopted included revisions to reflect TURN's proposal.	TURN April 5, 2011 letter. PG&E April 8, 2011 letter. Res. L-411, p. 6.	
Summary: The path from the initial draft resolution to the final version of Res. L-411 was somewhat more tortuous than is usually the case for a resolution, as evidenced by six or seven drafts issued over only a four month period. In the end, though, Resolution L-411 reflects TURN's substantial contribution in two very important ways. First, TURN alone among the active parties supported the underlying goal of ensuring that the tax benefits that cost-of-service-regulated utilities could realize under the New Tax Act would benefit utility customers, either in the form of reduced rates or through investment in necessary utility infrastructure. This element of Resolution L-411 should not be taken for granted, as even at the end of the process several utilities were calling for the Commission to reject it altogether.		

Second, TURN's participation proved to be critical in finding an approach that would balance the need for pre-approval of additional infrastructure spending with the accelerated time frame for such review and approval under the terms of the New Tax Law. TURN's proposal to develop spending categories that would serve as "safe havens" of a sort ended up embodied in the final resolution. On several issues TURN's position was not reflected in the final resolution. However, the Commission should find that TURN made a substantial contribution even on those issues, as several of the earlier draft Resolutions would have adopted outcomes consistent with TURN's position. (See, for example, Version 4 (including the Small Business Job Act) and Version 5 (rejecting calls by SCE to exempt utilities with a 2012 GRC).) The Commission has long recognized that outcomes in a proposed decision, even where not adopted by the Commission, demonstrate the ALJ adopting factual, legal or policy contentions of an intervenor that constitute a "substantial contribution" under Section 1802(i). TURN submits that similar treatment is appropriate for a draft resolution that adopts factual, legal or policy contentions of an intervenor.		
Addendum: On May 19, 2011, the Commission issued Draft Resolution L-411A to correct internal inconsistencies and other errors in Resolution L-411. TURN filed comments on Draft Resolution L-411A on June 8, 2011. The comments reflected the results of TURN's careful comparison of Resolution L-411A as enacted and the Draft Resolution (since TURN's efforts to obtain a "red-lined" version of the Draft Resolution were unsuccessful). TURN's comments addressed the shift in description of the guidelines adopted in Res. L-411 (making them prescriptive rather than illustrative). TURN also addressed positions taken by PG&E and CWA in earlier submissions on the draft resolution. TURN pointed out that PG&E's claims about the impact of the changes proposed in the Draft Resolution would be more meaningful if the utility had identified the potential projects it had in mind that might meet the pre-approval guidelines from the original resolution, but would not meet the revised guidelines. TURN objected to CWA's proposal to eliminate the criteria for eligible projects, instead of modifying the criteria as necessary to make them better fit water utilities, and proposed an alternative approach to clarifying which utilities with 2012 GRCs would be exempted from the	TURN Comments of June 8, 2011.	

adopted resolution. In Resolution L-411A as adopted, the Commission added several paragraphs that described the comments received on the Draft Revised Resolution and the Commission's response to those comments. The Commission agreed with the position taken by TURN and PG&E regarding the illustrative nature of the kinds of infrastructure projects that qualify for the memorandum account treatment, and therefore reverted to the original language on this issue. Rather than removing the restriction of "infrastructure replacement projects" as CWA had requested, the Commission modified the criterion by removing the word "replacement." And to clarify the treatment of utilities with a 2012 GRC, the Commission rejected CWA's approach and instead adopted the clarifying language suggested by TURN.	Resolution L-411A, pp. 14-15.	

B. Duplication of Effort (§§ 1801.3(f) & 1802.5):

	Claimant	CPUC Verified
a. Was DRA a party to the proceeding? (Y/N)	Y	
b. Were there other parties to the proceeding? (Y/N)	Y	
c. If so, provide name of other parties: Each of the four major energy utilities (PG&E, SCE, SoCalGas and SDG&E (jointly as the Sempra Utilities)); the water utilities through California Water Association (CWA); the small local exchange carriers (LECs), Mountain Utilities, NRG EnergyCorp., PacifiCorp, and Alpine Natural Gas.		
d. Describe how you coordinated with DRA and other parties to avoid duplication or how your participation supplemented, complemented, or contributed to that of another party: Coordination in the advice letter process is more challenging than in other Commission proceedings, due to the more compressed time frame and general absence of discovery and briefs. Furthermore, coordination to avoid duplication was largely unnecessary here, as TURN was the only non-utility party who was an active participant in this matter. DRA's participation was generally limited to participation in an all-party meeting conducted relatively late in the process. The Commission should therefore determine that there was no material duplication in the proceeding.		

C. Additional Comments on Part II (use line reference # or letter as appropriate):

#	Claimant	CPUC	Comment

PART III: REASONABLENESS OF REQUESTED COMPENSATION (to be completed by Claimant except where indicated)

A. General Claim of Reasonableness (§§ 1801 & 1806):

Concise explanation as to how the cost of claimant's participation bears a reasonable relationship with benefits realized through participation (include references to record, where appropriate)	CPUC Verified
In Res. L-411 the Commission described how "there could be substantial amounts in deferred tax reserves that do not get reflected in rates unless the Commission takes action." (Res. L-411, p. 3). As PG&E's letter of April 8, 2011 illustrates, these could amount to tens of millions of dollars for a single utility during the 2011-2013 period. (PG&E Letter of April 8, 2011, Appendix A). TURN's request of approximately $20,000 is extremely reasonable given the amounts at stake, TURN's role as the sole voice on behalf of consumers throughout most of the proceeding, and the outcome achieved.	

B. Specific Claim:

CLAIMED						CPUC AWARD			
ATTORNEY AND ADVOCATE FEES									
Item	Year	Hours	Rate $	Basis for Rate*	Total $	Year	Hours	Rate $	Total $
R. Finkelstein	2011	40.25	$470	Res. ALJ-267	$18,918				
				Subtotal:	*$18,918*			*Subtotal:*	
EXPERT FEES									
Item	Year	Hours	Rate $	Basis for Rate*	Total $	Year	Hours	Rate $	Total $
W. Marcus	2011	5.08	$250	D.08-11-053[4]	$1,270				
				Subtotal:	*$1,270*			*Subtotal:*	
INTERVENOR COMPENSATION CLAIM PREPARATION **									
Item	Year	Hours	Rate $	Basis for Rate*	Total $	Year	Hours	Rate $	Total $
R. Finkelstein	2011	6.0	$235	See above	$1,410				
				Subtotal:	*$1,410*			*Subtotal:*	
COSTS									
#	Item	Detail			Amount	Amount			
		TURN does not seek recovery of any costs.							
				Subtotal:	0			*Subtotal:*	
				TOTAL REQUEST $:	$21,598			TOTAL AWARD $:	
When entering items, type over bracketed text; add additional rows as necessary.									

[4] D.08-11-053 approved this rate for work performed in 2008; JBS Energy has not changed its rate for Mr. Marcus's work since then.

SB_GT&S_0237259

*If hourly rate based on CPUC decision, provide decision number; otherwise, attach rationale.
**Reasonable claim preparation time typically compensated at ½ of preparer's normal hourly rate.

C. Attachments or Comments Documenting Specific Claim (Claimant completes; attachments not attached to final Decision):

Attachment or Comment #	Description/Comment
Attach 1	**Certificate of Service**
Attach 2	**Notice of Intent to Claim Compensation**
Attach 3	**Daily Time Records for Attorneys and Experts**
Note 1	**Reasonableness of TURN Hours**: Robert Finkelstein was the sole TURN attorney handling this matter. He received support throughout from William Marcus of JBS Energy, who recorded a very small number of hours for his work in that role. The number of hours recorded by both Mr. Finkelstein and Mr. Marcus followed the same pattern. A relatively small amount of hours was recorded in January (when Resolution W-4867 issued with its simpler approach that would have largely deferred resolution of most of the underlying issues), with slightly higher amounts in February and through mid-March as additional and more complicated versions of the draft Resolution L-411 were issued for comment. In late-March through mid-April, a substantially greater number of hours were recorded, consistent with the need to prepare for and participate in the all-partying meeting on March 30, the development and presentation of TURN's alternative approach to pre-spending review, discussions with PG&E to further develop that alternative approach, and the final comment letter submitted in mid-April, just before the Commission's vote on Resolution L-411. Finally, TURN has included a few hours devoted to reviewing and submitting comments on Draft Resolution L-411A, issued in May of 2011. TURN submits that this is consistent with our past practice of including in a compensation request hours recorded for the implementation of the decision that reflects TURN's substantial contribution, such as a post-decision advice letter. Even with all of this activity, Mr. Finkelstein recorded less than 40 hours total for work on this matter, with approximately 30 hours over the final two week period prior to the Commission's vote. (Mr. Marcus recorded less than 5 hours over that same two-week period.) TURN submits that devoting a few hours per week on average, with approximately two days per week devoted to this matter during its most active phase, is a reasonable number of hours given the importance of the issue and the fact that TURN was the only consistently active party on behalf of ratepayers. Finally, TURN is requesting compensation for 6.0 hours devoted to compensation-related matters, primarily preparation of this request for compensation. The number of draft resolutions and the shifting manner in which each addressed the underlying issues caused TURN to devote more time to the substantial contribution description than would normally be the case for a resolution that addresses a relatively narrow range of issues. TURN submits that this small number should be found reasonable.
Note 2	**Allocation of Hours:** TURN typically includes in its compensation requests an allocation of time among the issues that it addressed. Such an allocation is close to impossible under the circumstances of the process that produced Resolution L-411. First, the overriding issue from the first issuance of draft Res. W-4867 through adoption of Resolution L-411 was whether the

	unanticipated decreases in tax expense due to the New Tax Act would flow to benefit ratepayers. Even at the very last, many of the utilities were calling upon the Commission to abandon the draft resolution altogether and to take no action whatsoever. Second, almost none of the work associated with TURN's efforts in this matter addressed a single issue. Instead, the comments and letters to the Commission addressed an array of the implementation issues. And since comments on the different versions of the draft Resolution were often due within a few days of the issuance of the newest version, TURN generally worked on the issues all at once. Therefore, TURN has not attempted to allocate the individual daily time entries by issue or activity. Instead, TURN submits the following as a reasonable general allocation of the hours among the various issues TURN addressed: The appropriateness of capturing benefits for ratepayers – 20% General need for specificity of "additional, needed capital investment" – 15% Development and presentation of proposed guidelines for "additional, needed capital investment" – 40% Inclusion of Small Business Job Act – 15% Treatment of utilities with a 2012 Test Year GRC – 10% TURN submits that under the circumstances this information should suffice to address the allocation requirement under the Commission's rules. Should the Commission wish to see additional or different information on this point, TURN requests that the Commission so inform TURN and provide a reasonable opportunity for TURN to supplement this showing accordingly.
Note 3	**Hourly Rate for TURN attorney in 2011**: The Commission has not previously authorized an hourly rate for TURN's attorneys or consultants where the substantive work in the proceeding occurred in 2011. In this proceeding TURN requests compensation using the previously-approved 2008 hourly rate for its attorney's work, consistent with Resolution ALJ-267 as applied to these circumstances. TURN also uses the previously approved hourly rate for its consultant because the firm has not sought to increase that hourly rate since then.

D. CPUC Disallowances & Adjustments (CPUC completes):

#	Reason

SB_GT&S_0237261

PART IV: OPPOSITIONS AND COMMENTS

Within 30 days after service of this claim, Commission Staff or any other party may file a response to the claim (*see* § 1804(c))

(CPUC completes the remainder of this form)

A. Opposition: Did any party oppose the claim (Y/N)?

If so:

Party	Reason for Opposition	CPUC Disposition

B. Comment Period: Was the 30-day comment period waived (*see* Rule 14.6(c)(6)) (Y/N)?

If not:

Party	Comment	CPUC Disposition

FINDINGS OF FACT

1. Claimant [has/has not] made a substantial contribution to Decision (D.) _________.
2. The claimed fees and costs [, as adjusted herein,] are comparable to market rates paid to experts and advocates having comparable training and experience and offering similar services.
3. The total of reasonable contribution is $___________.

CONCLUSION OF LAW

1. The claim, with any adjustment set forth above, [satisfies/fails to satisfy] all requirements of Public Utilities Code §§ 1801-1812.

ORDER

1. Claimant is awarded $____________.
2. Within 30 days of the effective date of this decision, _____ shall pay claimant the total award. Payment of the award shall include interest at the rate earned on prime,

three-month commercial paper as reported in Federal Reserve Statistical Release H.15, beginning _____, 200__, the 75th day after the filing of claimant's request, and continuing until full payment is made.

3. The comment period for today's decision [is/is not] waived.

4. [This/these] proceeding[s] [is/are] closed.

5. This decision is effective today.

Dated _____________, at San Francisco, California.

SB_GT&S_0237263

Attachment 1:
Certificate of Service by Customer

I hereby certify that I have this day served a copy of the foregoing **CLAIM AND ORDER ON REQUEST FOR INTERVENOR COMPENSATION** by (check as appropriate):

[ ] hand delivery;
[ ] first-class mail; and/or
[X] electronic mail

to the following persons appearing on the official Service List:

joel.perlstein@cpuc.ca.gov, jtp@cpuc.ca.gov, mp1@cpuc.ca.gov, tas@cpuc.ca.gov, cjs@cpuc.ca.gov, mf1@cpuc.ca.gov, Mark.Ferron@cpuc.ca.gov, kvc@cpuc.ca.gov, pac@cpuc.ca.gov, frl@cpuc.ca.gov, rsk@cpuc.ca.gov, mfg@cpuc.ca.gov, zaf@cpuc.ca.gov, jhawks_cwa@comcast.net, 3rjp@citlink.net, aahebert@paalp.com, acastro@ci.cypress.ca.us, acook@hillfarrer.com, alex@laredolaw.net, ames_doug@yahoo.com, Andrew.mcallister@energycenter.org, andy@mpwmd.dst.ca.us, anginc@goldrush.com, Ariel.Son@PacifiCorp.com, artief@ci.salinas.ca.us, atrowbridge@daycartermurphy.com, aua@bp.com, bambauertowing@sbcglobal.net, bcragg@goodinmacbride.com, bjeider@ci.burbank.ca.us, BKC7@PGE.COM, blaising@braunlegal.com, bmarticorena@rutan.com, Bob.Dodds@CaliforniaPacificElectric.com, bobkelly@bobkelly.com, bobmac@qwest.net, brbarkovich@earthlink.net, brian.prusnek@sce.com, carl.wood@verizon.net, ceyap@earthlink.net, Chantel.mosby@centurytel.com, Charity.Schiller@bbklaw.com, CHARLIE@WEEKSDRILLING.COM, childerbrand@goldenhillssanitation.com, chrisc@ci.salinas.ca.us, Christopher.schindler@hoganlovells.com, cmailloux@turn.org, colettecotton@yahoo.com, creisman@wkrklaw.com, dand@ponderosatel.com, dave@laredolaw.net, davidmorse9@gmail.com, dbyers@landuselaw.com, dclark@kermantelephone.com, ddferrari@paalp.com, dennis@local483.org, dhall@wickland.com, dobegi@nrdc.org, Don.soderberg@swgas.com, douglass@energyattorney.com, doviedc@yahoo.com, dwood8@cox.net, earlb@volcanotel.com, egwolfe@ducortelco.com, ekgrubaugh@iid.com, eosann@nrdc.org, epoole@adplaw.com, ffarina@cox.net, filings@a-klaw.com, fortlieb@sandiego.gov, francis.mcnulty@sce.com, Gail.long@tdstelecom.com, gdialto@semprautilities.com, glen.stransky@loslaureleshoa.com, glw@eslawfirm.com, gpdevelopment@earthlink.net, gweber@glweberlaw.com, h2o@sti.net, h2ocompany@earthlink.net, hayley@turn.org, heidi@laredolaw.net, hmgomez@lcof.net, hydroesq@schat.net, info@lakealpinewater.com, jallen@elthlaw.com, Jason.dubchak@niskags.com, jay@adventurecat.com, JBFARRELL@yahoo.com, jbouler@comcast.net, jeffbates1@comcast.net, jensen.sophie@gmail.com, jfarnkopf@hfh-consultants.com, jffyng@gmail.com, jleslie@luce.com, jlewis@icwuc.org, jpross@sungevity.com,

SB_GT&S_0237264

jroeder@greatoakswater.com, jsluder@paalp.com, jtlowers@sisqtel.net, JW1832@yahoo.com, jweil@aglet.org, jwrttee@earthlink.net, jzischkelaw@charter.net, kabercrombie@valenciawater.com, kaduran@chevron.com, kduran@ci.san-dimas.ca.us, keith.mccrea@sablaw.com, kendall.macvey@bbklaw.com, kgerber@barryswensonbuilder.com, kjsimonsen@ems-ca.com, klatt@energyattorney.com, kmelville@semprautilities.com, kmills@cfbf.com, kstaples@verizon.net, kswitzer@scwater.com, larry@epwater.com, leigh@parkwater.com, liddell@energyattorney.com, ljt@cpuc.ca.gov, llowrey@nheh.com, lmh@eslawfirm.com, Lnalley@tigernaturalgas.com, local350@yahoo.com, Lorrie.bernstein@mossadams.com, LOUIS@LOUISDEMARTINO.COM, LSchavrien@semprautilities.com, luemers.martha@dorsey.com, lwalexander@crimsonpl.com, macollins@chevron.com, Marcie.milner@shell.com, Margo.ormiston@verizon.com, mary.lynch@constellation.com, mcdougaldranch@yahoo.com, mcnultfa@sce.com, mcwch2otim@aol.com, mday@gmssr.com, mdjoseph@adamsbroadwell.com, mgoldstein@goldstein-law.com, mgorman@agclawfirm.com, michael@michaelmillsconstr.com, mljones@paalp.com, mlwhitehead@sgvwater.com, mmattes@nossaman.com, mortonswarmsprings@comcast.net, mpareas@gmail.com, mrw@mrwassoc.com, mschreiber@cwclaw.com, mshames@ucan.org, norman.furuta@navy.mil, npedersen@hanmor.com, palle_jensen@sjwater.com, PGETariffs@PGE.COM, pgg4@PGE.COM, phanschen@mofo.com, pine@littlebearwater.com, pk@utilitycostmanagement.com, pmantey@yahoo.com, pucservice@dralegal.org, Ralf1241a@cs.com, rburkeii@prodigy.net, regclfp@gmail.com, RegMgr@stcg.net, regtss@att.com, regulatory@surewest.com, repowers@venable.com, rgu@cebridge.net, rjames456@yahoo.com, RJonesPE@aol.com, rkmoore@scwater.com, rkoss@adamsbroadwell.com, rlam@agclawfirm.com, rmccann@umich.edu, rmdewante@sbcglobal.net, robert.pettinato@ladwp.com, rochelle@a4nr.org, rrlewish2o@aol.com, rsaunders@ci.santa-clara.ca.us, rschmidt@bartlewells.com, ruralwater@me.com, RVanderleeden@semprautilities.com, saadducci@venable.com, sailingwright2@yahoo.com, Sawymt@fusd.net, scittad@nicor.com, SHEILA@sti.net, silva@amwater.com, sjmoore600@aol.com, slins@ci.glendale.ca.us, ssalomon@ci.visalia.ca.us, steven@iepa.com, stevew@basslakerealty.com, tccprez@roadrunner.com, thay511@yahoo.com, tkim@rwglaw.com, tom.eastment@bakerbotts.com, tom@alcowater.com, TSMEGAL@CALWATER.COM, unionmarti@yahoo.com, waihun@cot.net, wamer@kirkwood.com, waterco@hotmail.com, wem@igc.org, westgas@aol.com, william.sanders@sfgov.org, wmpribyl@jps.net, wshoefler@comcast.net, WWynder@AWAttorneys.com, Yim@ZimmerLucas.com, ysmythe@caltel.com, legal_support@cpuc.ca.gov

Executed this 8th day of July 2011, at San Francisco, California.

/S/

Richard A. Perez
The Utility Reform Network
115 Sansome Street, Suite 900
San Francisco, CA 94104

SB_GT&S_0237266

Name	Category	Code	Description	Date	Hours
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	•	draft comments, revisions to resolution	1/4/11	1.75
[illegible]	[illegible]	•	review Finkelstein redraft	1/6/11	0.25
[illegible]	[illegible]	•	TC Bob re tax resolution.	[illegible]	[illegible]
[illegible]	[illegible]	•	review and comment on draft document	[illegible]	[illegible]
[illegible]	[illegible]	•	review draft, send note to Bob	[illegible]	[illegible]
[illegible]	[illegible]	•	review final version of resolution on tax advice letter, TC Bob.	[illegible]	[illegible]
[illegible]	[illegible]	•	TC Bob, review PG&E letter, draft notes in response	[illegible]	[illegible]
[illegible]	[illegible]	•	TC Bob re utility comments	[illegible]	[illegible]
[illegible]	[illegible]	•	TC Bob Finkelstein re comments	[illegible]	[illegible]
[illegible]	[illegible]	•	review BF draft materials for all-party meeting, provide comments and information	[illegible]	[illegible]
[illegible]	[illegible]	•	review BF memo on possible spending	[illegible]	[illegible]

Attachment	Description	Page nos.
1	Draft Resolution W-4867	1-4
2	TURN Comments on Draft Resolution W-4867, w/ proposed changes (January 7, 2011)	5-12
3	Draft Resolution L-411 (Second Draft Resolution) issued February 7, 2011	13-24
4	TURN Comments on Second Draft Resolution L-411, w/ proposed changes (February 14, 2011)	25-44
5	Draft Resolution L-411 (Rev. 4)	45-62
6	Draft Resolution L-411 (Rev. 5)	63-81
7	TURN Letter of April 5, 2011 following up on All-Party Meeting	82-86
8	PG&E Letter and Attachment April 8, 2011	87-91
9	TURN Letter of April 11, 2011	92-98
10	Draft Resolution L-411A, issued May 19, 2011	99-118
11	TURN Comments on Draft Res. L-411A, June 8, 2011	119-123

DRAFT **Agenda ID 10078**

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Division of Water and Audits
Utility, Audit, Finance & Compliance Branch

San Francisco, California
Date: January 13, 2011
Resolution No. W-4867

RESOLUTION

RESOLUTION ON THE COMMISSION'S OWN MOTION MAKING THE RATES OF ALL COST-OF-SERVICE RATE-REGULATED UTILITIES SUBJECT TO REFUND FOR THE LIMITED PURPOSE OF ALLOWING WHATEVER CHANGES, IF ANY, SHOULD BE MADE TO THE RATES OF THOSE UTILITIES TO REFLECT THE BENEFITS OF THE TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOB CREATION ACT OF 2010

BACKGROUND

On December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 ("New Tax Law"). It has come to the attention of the Commission that this law may provide tax relief to the utilities regulated by this Commission. Among, other provisions, this law provides for 100% accelerated bonus depreciation on certain business property put into service after September 8, 2010. Provisions in the New Tax Law may reduce the utilities' costs of providing service. Many of the utilities regulated by this Commission have their rates set on a cost-of-service basis. These utilities include, without limitation: water and sewer system corporations, small local exchange carrier telephone corporations, gas and electrical corporations, pipeline corporations, and heat corporations. However, the general rates of those utilities are typically reviewed only once every three years.

DISCUSSION

While existing ratemaking mechanisms likely will result in ratepayers benefiting from a portion of the tax benefits utilities receive under the New Tax Law, it is not clear that all of the tax benefits resulting from this new law will have an impact on rates under current mechanisms.[1] Accordingly, it may be desirable to adjust the rates of cost-of-service rate-

[1] For example, many utilities have a deferred tax account that may capture, for ratepayers, benefits of the new tax law. However, if there is a lag in incorporating the actual amount of this account into rates, there may be some portion of the benefits that do not go to ratepayers. .

regulated utilities to more fully reflect the tax benefits, if any, that these utilities realize from the New Tax Law. In order to allow for that possibility, while minimizing any issue of retroactive ratemaking, we will make the rates of all cost-of-service rate-regulated utilities subject to refund from and after the date of this resolution for the limited purpose of allowing ratepayers to benefit, to the extent, if any, the Commission finds reasonable, from tax benefits resulting from the New Tax Law.

The Commission, or Commissioners assigned to particular proceedings, will determine, at a later date, once more information is available, the appropriate forum or forums in which this issue may be reviewed. However, nothing in this resolution prevents a party to a utility General Rate Case (GRC) from raising issues relating to the New Tax Law in a GRC.

To assist the Commission in determining what further steps, if any, should be taken to deal with this issue, the Utility, Audit, Finance & Compliance Branch of the Division of Water and Audits should conduct one or more workshops. The workshop(s) should consider: what impact the New Tax Law is likely to have on the various classes of cost-of-service rate-regulated utilities; the extent to which the benefits of the New Tax Law will accrue to ratepayers under existing ratemaking mechanisms; and what, if anything, the Commission should do to further address the impact of the New Tax Law on utilities' cost of service and their rates. However, the Utility, Audit, Finance & Compliance Branch need not conduct the workshop(s) if it determines that it has sufficient information to recommend to the Commission how to resolve these issues.

COMMENTS ON DRAFT RESOLUTION

Public Utilities Code section 311(g)(1) generally requires draft resolutions to be issued for comment at least 30 days before being voted on by the Commission. However, pursuant to Public Utilities Code section 311(g)(3), the Commission has adopted Rule 14.6(c)(9) of its Rules of Practice and Procedure which permits a reduction in the comment period here. More specifically, Rule 14.6(c)(9) permits the Commission to reduce the 30-day period for public review and comment in circumstances where the public interest in the Commission adopting a resolution before expiration of the 30-day review and comment period clearly outweighs the public interest in having the full 30-day period for review and comment. This resolution does not change utility rates, nor determine that utility rates ought to be changed. It only permits the Commission to consider those issues at a future date, while minimizing retroactive ratemaking concerns. On the other hand, delaying issuance of this resolution to allow for the full 30-day comment period might extend the period of time during which retroactive ratemaking could be a concern. Accordingly, the public interest in adopting this resolution before expiration of a 30 day public comment period clearly outweighs the public interest in allowing for the full 30 day comment period. Accordingly, the draft resolution was

issued for comment on December 30, 2010, served on all persons on the attached service list, and placed on the Commission's Agenda for January 13, 2011. Consistent with Rule 14.6(c)(9), there was a reduced comment period with comments due on January 7, 2011.

FINDINGS AND CONCLUSIONS

1. President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 ("New Tax Law") on December 17, 2010.
2. The New Tax Law may provide tax relief to the utilities regulated by this Commission; among other provisions, this law provides for 100% accelerated bonus depreciation on certain business property put into service after September 8, 2010.
3. The general rates of utilities are typically reviewed only once every three years.
4. While existing ratemaking mechanisms likely will result in ratepayers benefiting from a portion of the tax benefits utilities receive under the New Tax Law, it is not clear that all of the tax benefits resulting from this new law will have an impact on rates under current mechanisms.
5. The Commission should allow for the possibility of revising the rates of these utilities so that more of the benefits of the New Tax Law accrue to ratepayers, while minimizing issues of retroactive ratemaking.
6. The rates of all cost-of-service rate-regulated utilities should be made subject to refund from and after the date of this resolution for the limited purpose of allowing the Commission to determine whether, and if so, to what extent, any tax benefits resulting from New Tax Law that would not otherwise be reflected in rates should benefit ratepayers.
7. The Utility, Audit, Finance & Compliance Branch of the Division of Water and Audits should conduct one or more workshops to consider: what impact the New Tax Law is likely to have on the various classes of cost-of-service rate-regulated utilities; the extent to which the benefits of the New Tax Law will accrue to ratepayers under existing ratemaking mechanisms; and what, if anything, the Commission should do to further address the impact of the New Tax Law on utilities' cost of service and their rates. However, the Utility, Audit, Finance & Compliance Branch need not conduct such workshop(s) if it determines that it has sufficient information to recommend to the Commission how to resolve these issues.
8. This resolution does not change utility rates, nor determine that utility rates ought to be changed. It only permits the Commission to consider, at a future date, the issue of whether utility rates should be changed as a result of the New Tax Law, while minimizing retroactive ratemaking concerns.
9. Delaying issuance of this resolution to allow for a full 30-day comment period might extend the time during which retroactive ratemaking could be a concern.

SB_GT&S_0237271

10. The public interest in adopting this resolution before expiration of a 30 day public comment period clearly outweighs the public interest in allowing for the full 30 day comment period.

ORDER

1. From and after the date of this resolution, the rates of all cost-of-service rate-regulated utilities shall be subject to refund for the limited purpose of allowing the Commission to determine whether, and if so, to what extent, any tax benefits resulting from the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 ("The New Tax Law") that would not otherwise be reflected in rates should benefit ratepayers.
2. The Utility, Audit, Finance & Compliance Branch of the Division of Water and Audits shall conduct one or more workshops to consider: what impact the New Tax Law is likely to have on the various classes of cost-of-service rate-regulated utilities; the extent to which the benefits of the New Tax Law will accrue to ratepayers under existing ratemaking mechanisms; and what, if anything, the Commission should do to further address the impact of the New Tax Law on utilities' cost of service and their rates. However, the Utility, Audit, Finance & Compliance Branch need not conduct the workshop(s) if it determines that it has sufficient information to recommend to the Commission how to resolve these issues.
3. The Division of Water and Audits shall serve a copy of this resolution, by mail or e-mail, on all cost-of-service rate-regulated utilities and any additional persons who submitted comments on the draft resolution.
4. The effective date of this order is today.

I certify that this Resolution was adopted by the California Public Utilities Commission at its regular meeting of January 13, 2011, and that the following Commissioners approved it:

____

PAUL CLANON
Executive Director

SB_GT&S_0237272

Lower bills. Livable planet.

115 Sansome Street, Suite 900
San Francisco, CA 94104
415-929-8876• www.turn.org
Robert Finkelstein, Legal Director

January 7, 2011

Utility, Audit, Finance & Compliance Branch
Division of Water and Audits
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Re: TURN Comments on Draft Resolution W-4867 Making Rates Subject to Refund To Reflect The Benefits Of Recent Federal Tax Legislation

Dear Energy Division:

Pursuant to the notice that appeared in the Commission's Daily Calendar of January 3, 2011, regarding comments on Draft Resolution W-4867 ("Draft Resolution"), The Utility Reform Network (TURN) submits these comments on the Draft Resolution.

The Draft Resolution describes how the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (designated the "New Tax Law" in the Draft Resolution) may provide tax relief to the utilities regulated on a cost-of-service basis by the Commission. It further recognizes that unless the Commission takes further action, existing ratemaking mechanisms and practices might flow only a portion of those benefits to utility ratepayers.

TURN commends the Commission for issuing this draft resolution and strongly supports its adoption, with one important modification. As we describe further below, the "subject to refund" designation should also cover the tax relief the utilities may realize under the Small Business Job Act of 2010 (HR 5297) signed September 27, 2010. Both pieces of legislation include accelerated tax depreciation provisions that, as applied to a cost-of-service rate-regulated utility, may warrant specific rate adjustments in order to ensure that an appropriate portion of those benefits is flowed through to the utility's ratepayers. Setting rates subject to refund now enables the Commission to take the necessary time to study the issue of effects of accelerated tax depreciation on regulated utilities and adopting an appropriate retroactive treatment without risking potential future claims of retroactive ratemaking.

It is important to recognize that the Draft Resolution would only have the Commission take very limited action at this time. Making the rates of each cost-of-service rate-regulated utility subject to refund preserves the Commission's options in the future as it more fully considers how and when rates should reflect the recent federal tax law changes and, in particular, the accelerated depreciation provisions available to the regulated utilities. As the Draft Resolution describes in Finding and Conclusion No. 5, the agency would merely be "allow[ing] for the possibility of revising the rates of these utilities so that more of the benefits of the New Tax Law accrue to

SB_GT&S_0237273

ratepayers, while minimizing issues of retroactive ratemaking."[1] The Draft Resolution amplifies this point in Finding and Conclusion No. 8:

> This resolution does not change utility rates, nor determine that utility rates ought to be changed. It only permits the Commission to consider, at a future date, the issue of whether utility rates should be changed as a result of the New Tax Law, while minimizing retroactive ratemaking concerns.

Therefore the Commission should reject as premature any arguments on the merits of the underlying questions of whether and how utility rates should be changed as a result of the recent federal legislation.

The one change TURN urges the Commission to make is to broaden the Draft Resolution to also include the effects of earlier 2010 legislation that increased tax depreciation for plant in service between January 1, 2010 and to September 8, 2010. In addition to the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 addressed in the Draft Resolution, Congress recently enacted the Small Business Job Act of 2010 (HR 5297) signed September 27, 2010. Like the December legislation, the Small Business Job Act includes provisions that will permit rapid acceleration of depreciation of utility plant in the years 2010, 2011, and 2012.[2] Combined with the effects of the December legislation,[3] the final result is that the cost-of-service rate-regulated utilities will receive unforeseen increases in depreciation tax deductions for three years, 2010 (50% through September 8, 100%, thereafter), 2011 (100%), and 2012 (50%).

TURN therefore recommends that the Commission revise the Draft Resolution to include the potential effects of the Small Business Job Act of 2010 as well as the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010. The necessary changes to make such revisions are relatively minor:[4]

- Language should be added to the title and background section to refer to the Small Business Job Act of 2010 and to briefly describe its provisions (at the same level of detail used to describe the December legislation);
- Language should be added to Finding and Conclusion 1 and Ordering Paragraph 1 to include the Small Business Job Act of 2010; and
- Editorial changes throughout the document to refer to both pieces of legislation together as the "New Laws" and to make the appropriate changes from the singular to the plural.

---

[1] TURN's understanding is that the adoption of the Draft Resolution would *eliminate* rather than *mitigate* issues of retroactive ratemaking, at least as of the date of the Draft Resolution's adoption by the full Commission.

[2] The 50% bonus depreciation of the Small Business Job Act of 2010 (Section 2022) generally allows a taxpayer to deduct 50% of the purchase price of qualifying assets placed in service for the 2010 tax year.

[3] Section 401 of HR 4853 allows businesses to expense 100% of depreciation on most property placed in service from September 8, 2010 through the end of 2011 and 50% through 2012.

[4] TURN has included a version of the Draft Resolution that shows the proposed changes necessary to include the Small Business Job Act of 2010.

SB_GT&S_0237274

TURN further urges the Commission to adopt this resolution with these revisions as expeditiously as possible, preferably at the January 13 meeting.

Finally, TURN wishes to give special recognition and thanks to those at the Commission who made extraordinary efforts to ensure that the agency is in a position to take timely action on this issue. The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 was signed into law after the final Commission meeting for 2010. In order to have the issue addressed at the earliest opportunity in 2011, many at the Commission devoted substantial time and effort during the holiday season to recognize the ratemaking implications and develop an approach that preserved the widest range of regulatory responses to address those implications in the future. TURN suspects that none of the persons involved in that effort had this issue in their work plan or on their "to do" list in mid-December, yet a timely and very sound Draft Resolution issued before the end of the year. Such quick action on behalf of California's consumers is to be commended.

Yours truly,

/s/

Robert Finkelstein
Legal Director

cc: Marzia Zafar
All CPUC Commissioners
Paul Clanon, CPUC Executive Director
Frank Lindh, CPUC General Counsel
Julie Fitch, Director of Energy Division

SB_GT&S_0237275

TURN PROPOSED CHANGES TO **DRAFT** **Agenda ID 10078**

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Division of Water and Audits
Utility, Audit, Finance & Compliance Branch

San Francisco, California
Date: January 13, 2011
Resolution No. W-4867

RESOLUTION

RESOLUTION ON THE COMMISSION'S OWN MOTION MAKING THE RATES OF ALL COST-OF-SERVICE RATE-REGULATED UTILITIES SUBJECT TO REFUND FOR THE LIMITED PURPOSE OF ALLOWING WHATEVER CHANGES, IF ANY, SHOULD BE MADE TO THE RATES OF THOSE UTILITIES TO REFLECT THE BENEFITS OF THE SMALL BUSINESS JOB CREATION ACT OF 2010 AND THE TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOB CREATION ACT OF 2010

BACKGROUND

On September 27, 2010, President Obama signed the Small Business Job Act of 2010, and on December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 (collectively "New Tax Laws"). It has come to the attention of the Commission that these laws may provide tax relief to the utilities regulated by this Commission. Among, other provisions, these laws provide for 50% accelerated bonus depreciation on certain business property put into service between January 1, 2010 and September 8, 2010 and 100% accelerated bonus depreciation on certain business property put into service after September 8, 2010. Provisions in the New Tax Laws may reduce the utilities' costs of providing service. Many of the utilities regulated by this Commission have their rates set on a cost-of-service basis. These utilities include, without limitation: water and sewer system corporations, small local exchange carrier telephone corporations, gas and electrical corporations, pipeline corporations, and heat corporations. However, the general rates of those utilities are typically reviewed only once every three years.

Unknown
Formatted: Underline

1/7/11 11:16 AM
Deleted: i

1/7/11 11:24 AM
Deleted: this

1/7/11 11:24 AM
Deleted: s

DISCUSSION

While existing ratemaking mechanisms likely will result in ratepayers benefiting from a portion of the tax benefits utilities receive under the New Tax Laws, it is not clear that all

SB_GT&S_0237276

of the tax benefits resulting from the new laws will have an impact on rates under current mechanisms.[1] Accordingly, it may be desirable to adjust the rates of cost-of-service rate-regulated utilities to more fully reflect the tax benefits, if any, that these utilities realize from the New Tax Laws. In order to allow for that possibility, while minimizing any issue of retroactive ratemaking, we will make the rates of all cost-of-service rate-regulated utilities subject to refund from and after the date of this resolution for the limited purpose of allowing ratepayers to benefit, to the extent, if any, the Commission finds reasonable,from tax benefits resulting from the New Tax Laws.

1/7/11 11:25 AM
Deleted: this

1/7/11 11:25 AM
Deleted:

The Commission, or Commissioners assigned to particular proceedings, will determine, at a later date, once more information is available, the appropriate forum or forums in which this issue may be reviewed. However, nothing in this resolution prevents a party to a utility General Rate Case (GRC) from raising issues relating to the New Tax Laws in a GRC.

To assist the Commission in determining what further steps, if any, should be taken to deal with this issue, the Utility, Audit, Finance & Compliance Branch of the Division of Water and Audits should conduct one or more workshops. The workshop(s) should consider: what impact the New Tax Laws are likely to have on the various classes of cost-of-service rate-regulated utilities; the extent to which the benefits of the New Tax Laws will accrue to ratepayers under existing ratemaking mechanisms; and what, if anything, the Commission should do to further address the impact of the New Tax Laws on utilities' cost of service and their rates. However, the Utility, Audit, Finance & Compliance Branch need not conduct the workshop(s) if it determines that it has sufficient information to recommend to the Commission how to resolve these issues.

1/7/11 11:25 AM
Deleted: is

COMMENTS ON DRAFT RESOLUTION

Public Utilities Code section 311(g)(1) generally requires draft resolutions to be issued for comment at least 30 days before being voted on by the Commission. However, pursuant to Public Utilities Code section 311(g)(3), the Commission has adopted Rule 14.6(c)(9) of its Rules of Practice and Procedure which permits a reduction in the comment period here. More specifically, Rule 14.6(c)(9) permits the Commission to reduce the 30-day period for public review and comment in circumstances where the public interest in the Commission adopting a resolution before expiration of the 30-day review and comment period clearly outweighs the public interest in having the full 30-day period for review and comment. This resolution does not change utility rates, nor determine that utility rates ought to be changed. It only permits the Commission to consider those issues at a future date, while minimizing retroactive ratemaking concerns.

[1] For example, many utilities have a deferred tax account that may capture, for ratepayers, benefits of the new tax law. However, if there is a lag in incorporating the actual amount of this account into rates, there may be some portion of the benefits that do not go to ratepayers.

SB_GT&S_0237277

On the other hand, delaying issuance of this resolution to allow for the full 30-day comment period might extend the period of time during which retroactive ratemaking could be a concern. Accordingly, the public interest in adopting this resolution before expiration of a 30 day public comment period clearly outweighs the public interest in allowing for the full 30 day comment period. Accordingly, the draft resolution was issued for comment on December 30, 2010, served on all persons on the attached service list, and placed on the Commission's Agenda for January 13, 2011. Consistent with Rule 14.6(c)(9), there was a reduced comment period with comments due on January 7, 2011.

FINDINGS AND CONCLUSIONS

1. President Obama signed the Small Business Job Act of 2010 on September 27, 2010 and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 on December 17, 2010 (collectively "New Tax Laws").

1/7/11 11:25 AM
Deleted: ("New Tax Law")

2. The New Tax Laws may provide tax relief to the utilities regulated by this Commission; among other provisions, this law provides for 100% accelerated bonus depreciation on certain business property put into service after September 8, 2010.

3. The general rates of utilities are typically reviewed only once every three years.

4. While existing ratemaking mechanisms likely will result in ratepayers benefiting from a portion of the tax benefits utilities receive under the New Tax Laws, it is not clear that all of the tax benefits resulting from this new law will have an impact on rates under current mechanisms.

5. The Commission should allow for the possibility of revising the rates of these utilities so that more of the benefits of the New Tax Laws accrue to ratepayers, while minimizing issues of retroactive ratemaking.

6. The rates of all cost-of-service rate-regulated utilities should be made subject to refund from and after the date of this resolution for the limited purpose of allowing the Commission to determine whether, and if so, to what extent, any tax benefits resulting from New Tax Laws that would not otherwise be reflected in rates should benefit ratepayers.

7. The Utility, Audit, Finance & Compliance Branch of the Division of Water and Audits should conduct one or more workshops to consider: what impact the New Tax Laws are likely to have on the various classes of cost-of-service rate-regulated utilities; the extent to which the benefits of the New Tax Laws will accrue to ratepayers under existing ratemaking mechanisms; and what, if anything, the Commission should do to further address the impact of the New Tax Laws on

1/7/11 11:25 AM
Deleted: is

utilities' cost of service and their rates. However, the Utility, Audit, Finance & Compliance Branch need not conduct such workshop(s) if it determines that it has sufficient information to recommend to the Commission how to resolve these issues.

8. This resolution does not change utility rates, nor determine that utility rates ought to be changed. It only permits the Commission to consider, at a future date, the issue of whether utility rates should be changed as a result of the New Tax Laws, while minimizing retroactive ratemaking concerns.

9. Delaying issuance of this resolution to allow for a full 30-day comment period might extend the time during which retroactive ratemaking could be a concern.

10. The public interest in adopting this resolution before expiration of a 30 day public comment period clearly outweighs the public interest in allowing for the full 30 day comment period.

ORDER

1. From and after the date of this resolution, the rates of all cost-of-service rate-regulated utilities shall be subject to refund for the limited purpose of allowing the Commission to determine whether, and if so, to what extent, any tax benefits resulting from the Small Business Job Act of 2010 and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 ("The New Tax Laws") that would not otherwise be reflected in rates should benefit ratepayers.

2. The Utility, Audit, Finance & Compliance Branch of the Division of Water and Audits shall conduct one or more workshops to consider: what impact the New Tax Laws are likely to have on the various classes of cost-of-service rate-regulated utilities; the extent to which the benefits of the New Tax Law will accrue to ratepayers under existing ratemaking mechanisms; and what, if anything, the Commission should do to further address the impact of the New Tax Laws on utilities' cost of service and their rates. However, the Utility, Audit, Finance & Compliance Branch need not conduct the workshop(s) if it determines that it has sufficient information to recommend to the Commission how to resolve these issues.

1/7/11 11:25 AM
Deleted: is

3. The Division of Water and Audits shall serve a copy of this resolution, by mail or email, on all cost-of-service rate-regulated utilities and any additional persons who submitted comments on the draft resolution.
4. The effective date of this order is today.

I certify that this Resolution was adopted by the California Public Utilities Commission

SB_GT&S_0237279

at its regular meeting of January 13, 2011, and that the following Commissioners approved it:

PAUL CLANON
Executive Director

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Legal Division

San Francisco, California
Date: February 24, 2011
Resolution No. L-411

RESOLUTION

RESOLUTION ON THE COMMISSION'S OWN MOTION ESTABLISHING A MEMORANDUM ACCOUNT FOR ALL COST-OF-SERVICE RATE-REGULATED UTILITIES, OTHER THAN CLASS C AND D WATER AND SEWER UTILITIES, TO ALLOW THE COMMISSION TO CONSIDER REDUCING RATES TO REFLECT THE BENEFITS OF THE TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOB CREATION ACT OF 2010

BACKGROUND

On December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 ("New Tax Law"). It has come to the attention of the Commission that this law may provide tax relief to the utilities regulated by this Commission. Provisions in the New Tax Law may reduce the utilities' costs of providing service. Many of the utilities regulated by this Commission have their rates set on a cost-of-service basis. These utilities include, without limitation: water and sewer system corporations, small local exchange carrier telephone corporations, gas and electrical corporations, pipeline corporations, and heat corporations.

Among, other provisions, the New Tax Law provides for 100% bonus depreciation on certain business property put into service after September 8, 2010 and before January 1, 2012. The New Tax Law also provides for 50% bonus depreciation for property placed into service thereafter and before January 1, 2013 and for property placed into service in 2013 where construction begins prior to January 1, 2013.

Consistent with the Internal Revenue Code, the Commission's ratemaking procedures do not reflect in rates the full reduction in tax expense in the year in which accelerated depreciation is taken for tax purposes. Rather, rates are set as if depreciation for tax purposes were being calculated on the straight line method over the projected life of the asset (the same depreciation method used for setting rates). Thus, the utility collects in

rates taxes that will not need to be paid until a later time, if at all.[1] Nevertheless, ratepayers do get a benefit from the accelerated depreciation. This is accomplished through "normalization" and the use of a "deferred tax reserve". The deferred tax reserve for any particular asset reflects the amount of depreciation taken for tax purposes that exceeds the amount used in setting rates. This difference is then multiplied by a tax rate to yield the amount of deferred tax reserve. Thus, for example, if a utility puts into service a new capital asset costing $100,000 with a 10 year service life and takes 100% bonus depreciation and the tax rate is 40%, the corresponding deferred tax reserve at the end of a year will be $36,000 (i.e. the $100,000 depreciation taken for tax purposes, minus the $10,000 taken for ratemaking purposes times 40%.) The combined deferred tax reserve on all of the utility's assets is, in turn, deducted from rate base in calculating the utility's revenue requirement, thus reducing rates.

However, the general rates of cost-of-service utilities are typically reviewed only once every three years. When they are reviewed, the actual amount of the deferred tax reserve is generally reflected in setting new rates. Unless a utility's rates are adjusted for the years between general rates cases (GRCs) in a way that takes account of the actual amount of the deferred tax reserve, the increase in the deferred tax reserve caused by the New Tax Law would not be reflected in rates until after the utility's next GRC. Because the New Tax Law provides for 100% bonus depreciation on qualifying assets put into service after September 8, 2010 and before January 1, 2012 (with 50% bonus depreciation thereafter), and because it may be some time before all of the cost-of-service rate-regulated utilities have their rates adjusted to reflect the amounts actually recorded in their deferred tax reserves, there could be substantial amounts in deferred tax reserves that do not get reflected in rates unless the Commission takes action.

DISCUSSION

The purpose of this resolution:

The purpose of this resolution is to preserve the opportunity for the Commission to decide at a future date whether some of the benefits of the New Tax Law, not otherwise reflected in rates, ought to benefit ratepayers through a decrease in rates, without having to be concerned with issues of retroactive ratemaking.

When a utility begins to experience a large and unexpected increase in costs, it sometimes requests authority from the Commission to establish a memorandum account. As we said in D10-04-031.

---

[1] See *City of Los Angeles v. Public Utilities Commission*, 15 Cal. 3d 680, 686 (1975) (for an enterprise that is either expanding or stable, accelerated depreciation does not merely defer taxes, but eliminates them entirely).

SB_GT&S_0237282

> A memorandum account allows a utility to track costs arising from events that were not reasonably foreseen in the utility's last general rate case. By tracking these costs in a memorandum account, a utility preserves the opportunity to seek recovery of these costs at a later date without raising retroactive ratemaking issues. However, when the Commission authorizes a memorandum account, it has not yet determined whether recovery of booked costs is appropriate, unless so specified.

Here we face the possibility of large and unexpected *decreases* in tax expense. Due to the timing of rate cases, benefits of the tax decrease may not accrue to ratepayers in the same way they would if the tax decrease had been expected. We wish to preserve the opportunity to consider whether some or all of the tax impacts not otherwise reflected in rates should benefit ratepayers, without having to face issues of retroactive ratemaking.

The approach the Commission should adopt to achieve this purpose:

On December 30, 2010, the Commission issued a different version of this draft resolution (the Original Draft Resolution) for comment. The Original Draft Resolution proposed to accomplish the above purpose by making the rates of all cost-of-service rate regulated utilities subject to refund for the limited purpose of allowing ratepayers to benefit, to the extent, if any, the Commission finds reasonable, from tax benefits resulting from the New Tax Law.

In their comments and discussions with Commission staff, the utilities pointed out several disadvantages of this approach, primarily the uncertainty created by the "subject to refund" language. The utilities noted that the purpose of the bonus depreciation provisions of the New Tax Law is to encourage additional capital investment, thereby stimulating employment and the economy. The utilities could use tax savings realized under the New Tax Law to fund additional, needed capital investment not otherwise funded by rates. We concur that this would be a good use of the tax savings. This may be an opportune time to increase capital investment, given decreases in construction costs and the availability of bonus depreciation for plant put into service before 2013. At least some of the utilities intend to use tax savings from the New Tax Law to fund additional, needed capital investment. However, the utilities informed staff that they would be reluctant to do so if some unknown amount of the tax savings were instead needed to fund rate reductions. On the other hand, if utilities realize tax savings and do not use them to increase capital investment, or if the costs of the increased capital investment are covered by other rates, there may still be tax benefits that should benefit ratepayers through a decrease in rates.

In light of these factors, this second version of the draft resolution (the Second Draft Resolution) has been revised to eliminate the subject to refund language. Instead, this Second Draft Resolution uses a memorandum account to track the various benefits and costs of the New Tax Law and the increased capital investment it may stimulate that are not otherwise reflected in rates. This approach still permits the Commission to determine at a later date whether some of the benefits of the New Tax Law should benefit ratepayers through a decrease in rates, without having to be concerned about retroactive ratemaking issues. However, this approach replaces the uncertainty of "subject to refund" language with specific calculations that will be contained in a memorandum account, and 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, those additional costs will be offset against amounts that otherwise might be used to reduce rates. As a result, this Second Draft Resolution should not impede the capital investment that the New Tax Law is intended to encourage.

Which utilities should be exempt from having memorandum accounts:

In general, it is appropriate to establish this kind of a memorandum account for all utilities that have their rates set on a cost of service. As noted above, these generally include water and sewer system corporations, small local exchange carrier telephone corporations, gas and electrical corporations, pipeline corporations, and heat corporations. However, we conclude that Class C and D water and sewer corporations should be exempt from this memorandum account requirement. There are two main considerations underlying this conclusion. First, many of these utilities have their rates set using a "rate of margin" (ROM), rather than a rate of return. Because rate of return is not a factor in setting the rates of these ROM utilities, their rates do not change when there is change in rate base. Similarly, a deduction of a deferred tax reserve from rate base would likewise have no impact on rates. Indeed, most of the items that would be tracked in the memorandum account are not relevant to these ROM utilities. Second, Class C and D water and sewer utilities are very small utilities for whom the administrative burden of keeping track of the necessary accounting entries would be an excessive burden, even if their rates are set on a rate-of-return basis.

The details of the memorandum account:

This resolution will establish for each cost-of-service rate-regulated utility, except for Class C and D water and sewer utilities, (collectively the Covered Utilities) a memorandum account to reflect, on a CPUC-jurisdictional, revenue requirement basis, impacts from the New Tax Law.

The memorandum account will be used to determine whether any future rate reductions are appropriate to reflect impacts of the New Tax Law for the period from the date of this resolution until the effective date of revenue requirement changes in each Covered

SB_GT&S_0237284

Utility's next GRC ("Memo Account Period"). The memorandum account will be used by each Covered Utility to track the revenue requirement impacts of the New Tax Law during the Memo Account Period, reflecting on a revenue requirement basis the effects of the New Tax Law not otherwise reflected in rates. In determining an appropriate revenue requirement adjustment, if any, for the Memo Account Period, the Commission will take into account, and each Covered Utility will record:[2] (a) decreases in its revenue requirement resulting from increases in its deferred tax reserve; (b) offsets to reflect any additional costs or expenses, not otherwise recovered in rates, incurred as a result of additional utility infrastructure investment enabled by the bonus depreciation provisions of the New Tax Law, and (c) amounts to reflect the impacts of any decrease in Section 199 deductions resulting from bonus depreciation taken, changes in working cash resulting from the New Tax Law, and, for energy utilities, any decrease in the tax component of contributions-in-aid-of-construction (CIAC) received due to changes in the tariffed tax component of CIAC to reflect the New Tax Law.

In each Covered Utility's next GRC, or at such other time as ordered in that GRC decision, the Commission will address the disposition of amounts (a) recorded in the memorandum account and (b) forecast for the remainder of the Memo Account Period, and may reflect any net revenue requirement reduction in prospective rates. In any such GRC decision, the Commission may impose measures to ensure that plant forecast to be placed into service during the remainder of the Memo Account Period (made with savings realized from the New Tax Law) is actually placed into service during the Memo Account Period, and if not, that rates will thereafter be reduced to reflect the amount of forecast costs and expenses not actually incurred during the Memo Account Period.

Consistent with standard Commission practice, the recording of the costs of particular utility infrastructure in the memorandum account, or amortization of the memorandum account, will not, in and of itself, substitute for the reasonableness review to which capital investment is normally subject. Utility infrastructure whose costs are recorded in the memorandum account will be subject to reasonableness review in the same manner as other utility capital investments. This reasonableness review may occur in the same GRC in which disposition of the memorandum account is considered, or in another forum.

This memorandum account will be a one-way memorandum account, i.e., it will be available for the Commission to consider *only* whether utility rates should be *reduced* to reflect the tax benefits of the New Tax Law. This memorandum account cannot be used by any Covered Utility to recover any net revenue requirement increase recorded during the Memo Account Period. If, at the end of the Memo Account Period, this

[2] Although this resolution refers to amounts "recorded" in the memorandum account, because this is a memorandum account, and not a balancing account, the amounts tracked or recorded in the memorandum account are not recorded in the utilities' financial statements, e.g., in the balance sheet.

SB_GT&S_0237285

memorandum account reflects a net revenue requirement increase, the memorandum account will be terminated without any impact on rates.

The following paragraphs describe in further detail some of the wording we have used above in describing the memorandum account.

Amounts in the memorandum account will be recorded on a "revenue requirement basis." This means that each utility will be tracking the revenue requirement impact of each change resulting from the New Tax Law and of the additional, needed infrastructure investment enabled by the tax savings resulting from the bonus depreciation provisions of the New Tax Law. This is important, because, consistent with the Internal Revenue Code, the tax savings from accelerated depreciation are not passed through directly to ratepayers, but instead, as explained above, ratepayers benefit through the process of normalization and the creation of a deferred tax reserve that is deducted from rate base. We also ensure that all amounts recorded in the memorandum account will be recorded on a consistent basis by requiring that they all be recorded on a revenue requirement basis.

In several places, we refer to amounts not otherwise reflected or recovered in rates. We use this terminology to exclude costs and expenses recovered through previously authorized rates, e.g., rates set in a prior GRC. We also use it to exclude costs or expenses recovered through rates set after the date of this resolution, e.g., through a balancing account or another memorandum account, or a formal proceeding prior to the utility's next GRC.

Another key, related concept is "additional utility infrastructure investment." By additional utility infrastructure investment we mean investment made possible by the tax savings from the New Tax Law that is in addition to investment otherwise included in rates. For utilities that have an adopted figure for additions to plant in service during the year(s) included within the Memo Account Period, the additional utility infrastructure investment will ordinarily be the amount by which additions to plant in service for that Period exceed the adopted figure for that same Period.[3] For some utilities, the Memo Account Period will include Attrition Year(s) for which there is no specific adopted figure for additions to plant in service. Those utilities may calculate the amount of investment that is included in rates by inflating the Test Year figure for additions to plant in service by the same percentage by which the Attrition Year's revenue requirement exceeds the Test Year's revenue requirement. If a utility without an adopted figure for additions to plant in service during any portion of the Memo Account Period contends

[3] The Memo Account Period will begin in the middle of Test Years or Attrition Years for Covered Utilities. This will at least require some proration of the adopted figure. Furthermore, infrastructure investment may occur in large lumps. Therefore, it may be necessary to look at plant additions during the period(s) immediately preceding the Memo Account Period for a Covered Utility to see how much of the plant additions during the Memo Account Period were actually "additional" to the adopted amount.

SB_GT&S_0237286

that the foregoing methodology inaccurately reflects the amount of plant additions not already included in rates, it may propose an alternative methodology.

We note that additional utility infrastructure investment may have several impacts on revenue requirements, including both depreciation and return on investment. None of these impacts occur, however, until plant is placed into service. Therefore, for plant that is forecast to be placed into service during a Covered Utility's next GRC Test Year, all of the costs of that additional plant should be reflected in the utility's Test Year rates, and none of them should be recorded in the memorandum account. That will be true even if the cash flow used to fund the construction of the infrastructure comes from tax savings from the New Tax Law.

In their comments on the First Draft Resolution, the energy utilities pointed out that the bonus depreciation afforded by the New Tax Law will decrease their taxable income, and therefore may decrease, or eliminate, the Internal Revenue Code Section 199 Manufacturer's tax deduction that they are entitled to, which is already reflected in their revenue requirements. The utilities also pointed out that the New Tax Law will have impacts on their working cash, an item that is a component of their rate base and therefore also reflected in their revenue requirements. These Section 199 and working cash impacts are specifically mentioned as items to be included in the memorandum account, on a revenue requirement basis. The energy utilities also argued that the New Tax Law will impact their CIAC (contributions-in-aid-of-construction) revenues. Energy utilities are taxed on plant contributed by others, such as real estate developers. Accordingly, when such entities contribute plant to the utility they must also contribute an amount to cover the tax impacts (the tax component of CIAC). This tax component of CIAC is adjusted from time to time to reflect changes in the utilities' taxes. If the energy utilities modify their CIAC tariffs to reflect new effective tax rates resulting from the New Tax Law, it appears that there will then be a decrease in the tax component of the CIAC they receive thereafter. Presumably, there will also be a change in the amount of tax they have to pay on CIAC. The energy utilities are authorized to include these CIAC impacts in their memorandum accounts on a revenue requirement basis and consistent with any requirements of the Internal Revenue Code.

What it means when we establish a memorandum account:

The establishment of a memorandum account does not change rates, nor guarantee that rates will be changed in the future. This mechanism simply allows the Commission to determine at a future date whether rates should be changed, without the impediment of claims of retroactive ratemaking. Thus, all we are determining here is that it may be desirable to adjust the rates of the Covered Utilities to more fully reflect the tax benefits, if any, that these utilities realize from the New Tax Law, while avoiding any issue of retroactive ratemaking. Furthermore, the specific terms of the memorandum account established by this resolution ensure that if the utilities spend the tax savings from the

SB_GT&S_0237287

New Tax Law on additional, needed capital investment the costs of which will not otherwise be recovered in rates, those additional costs will be offset against amounts that otherwise might be used to reduce rates.

When advice letters should be filed:

It will be necessary for the Covered Utilities to file advice letters to incorporate the memorandum account into their tariffs. Rather than requiring each of the Covered Utilities to quickly file such advice letters, we will instead require only the four major energy utilities to file such advice letters within 15 days. Any other Covered Utility may also file such an advice letter within 15 days of the date of this resolution. In addition, any entity that has filed comments on any draft of this resolution may, within 15 days, submit to the Legal Division suggested memorandum account language that would apply to any group of utilities. This should provide a more efficient means for Commission staff to review language that should apply to a class of utilities. In each case, the proposed tariff language should describe in detail the debits and credits that are to be entered into the memorandum account. After consideration of the language submitted by means of advice letters and any suggestions made to the Legal Division, the Commission's Staff, will provide appropriate memorandum account language to each Covered Utility that did not file an advice letter advice letter within 15 days of the date of this resolution. Each of those utilities will then need to file an advice letter incorporating that language within 15 days after Staff sends the memorandum account language. This will result in some delay before advice letters are approved for all of the Covered Utilities. However, this should not be problematic because the memorandum accounts are effective for all Covered Utilities as of the date of this resolution.

COMMENTS ON DRAFT RESOLUTION

Public Utilities Code section 311(g)(1) generally requires draft resolutions to be issued for comment at least 30 days before being voted on by the Commission. However, pursuant to Public Utilities Code section 311(g)(3), the Commission has adopted Rule 14.6(c)(9) of its Rules of Practice and Procedure which permits a reduction in the comment period here. More specifically, Rule 14.6(c)(9) permits the Commission to reduce the 30-day period for public review and comment in circumstances where the public interest in the Commission adopting a resolution before expiration of the 30-day review and comment period clearly outweighs the public interest in having the full 30-day period for review and comment. This resolution does not change utility rates, nor determine that utility rates ought to be changed. It only permits the Commission to consider those issues at a future date, while minimizing retroactive ratemaking concerns. On the other hand, delaying issuance of this resolution to allow for the full 30-day comment period might extend the period of time during which retroactive ratemaking could be a concern. Accordingly, the public interest in adopting this resolution before expiration of a 30 day public comment period clearly outweighs the public interest in

allowing for the full 30 day comment period. Accordingly, the First Draft Resolution was issued for comment on December 30, 2010, served on all persons on the attached service list. Consistent with Rule 14.6(c)(9), there was a reduced comment period with comments due on January 7, 2011. Comments were filed by January 7, 2011.

Most of these comments have been addressed above, or rendered irrelevant in light of our elimination of the "subject to refund" language. However, there are several other subjects raised in the comments that we wish to address.

There were comments to the effect that the Commission had not previously taken action to reduce rates when the Internal Revenue Code was revised to provide for bonus depreciation. We note that utilities often request memo accounts for unexpected increases in expenses between GRCs. However, they do not come to us requesting memorandum accounts or rate decreases when there has been a large and unexpected decrease in expenses between rate cases. We believe that an even-handed approach to regulation requires us to consider, when there has been a large and unexpected decrease in expenses between rate cases, whether it is appropriate to establish a memorandum account to allow for a future decrease in rates. In this case, we believe that the establishment of such a memorandum account is appropriate.

There was also some concern expressed about a need to recalculate the entirety of the utilities' deferred tax reserve. However, there is no need to do so. The bonus depreciation provisions of the New Tax Law only apply to property placed into service after September 8, 2010. Therefore, only the increase in deferred tax reserve resulting from property placed into service after September 8, 2010 needs to be calculated.

In light of the major changes made in the Second Draft Resolution, this Second Draft is being issued for public comment on February 7, 2011, although an additional comment period is not legally required. The Second Draft Resolution will be served on all persons served with the Original Draft Resolution. Comments must be received by the Commission by 10 a.m. on February 14, 2011. Commenters who would like changes to the memorandum account, should provide red-lined versions of the Ordering Paragraph(s) they want revised.

FINDINGS AND CONCLUSIONS

1. President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 ("New Tax Law") on December 17, 2010.
2. The New Tax Law may provide tax relief to the utilities regulated by this Commission. Among other provisions, this law provides for 100% bonus depreciation on certain business property put into service after September 8, 2010 and before January 1, 2012, with 50% bonus depreciation for at least a year thereafter. .

3. The general rates of utilities are typically reviewed only once every three years.
4. While existing ratemaking mechanisms likely will result in ratepayers benefiting from a portion of the tax benefits utilities receive under the New Tax Law, it is not clear that all of the tax benefits resulting from this new law will have an impact on rates under current mechanisms.
5. The Commission should allow for the possibility of revising the rates of the utilities whose rates are set on a cost-of-service basis, so that some or all of the benefits of the New Tax Law not otherwise reflected in rates may accrue to ratepayers, while minimizing issues of retroactive ratemaking.
6. The appropriate method for preserving the opportunity to consider, at a later time, whether some or all of the benefits of the New Tax Law not otherwise reflected in rates should be reflected in rates is to establish a memorandum account.
7. The memorandum account should reflect not only the tax benefits of the New Tax Law, but other resulting changes in the utilities' revenue requirements, including the Section 199 deduction and the tax component of contributions in aid of construction.
8. .So as not to discourage utilities from using the tax savings resulting from the New Tax Law for investment in additional, needed infrastructure, the costs and expenses of that infrastructure not otherwise reflected in rates should also be reflected in the memorandum account.
9. Utility infrastructure whose costs are recorded in the memorandum account authorized by this resolution should remain subject to reasonableness review in the same manner as other utility capital investments.
10. Class C and D water and sewer utilities should be exempted from the establishment of this memorandum account.
11. This resolution does not change utility rates, nor determine that utility rates ought to be changed. It only permits the Commission to consider, at a future date, the issue of whether utility rates should be changed as a result of the New Tax Law, while minimizing retroactive ratemaking concerns.
12. Delaying issuance of this resolution to allow for a full 30-day comment period might extend the time during which retroactive ratemaking could be a concern.
13. The public interest in adopting this resolution before expiration of a 30 day public comment period clearly outweighs the public interest in allowing for the full 30 day comment period.

ORDER

1. There is hereby established for each cost-of-service rate-regulated utility, with the exception of Class C and D water and sewer utilities, (collectively the Covered

SB_GT&S_0237290

Utilities) a memorandum account to reflect, on a CPUC-jurisdictional, revenue requirement basis, impacts from the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 ("The New Tax Law").

2. This memorandum account shall track on a revenue requirement basis the impacts of the New Tax Law not otherwise reflected in rates during the period starting on the date of this resolution until the effective date of revenue requirement changes in each Covered Utility's next General Rate Case ("Memo Account Period"). Each Covered Utility shall record in this memorandum account: (a) decreases in its revenue requirement resulting from increases in its deferred tax reserve; (b) offsets to reflect any additional costs or expenses, not otherwise recovered in rates, incurred as a result of additional utility infrastructure investment enabled by the bonus depreciation provisions of the New Tax Law; and (c) amounts to reflect the impacts of any decrease in Section 199 deductions resulting from bonus depreciation taken, changes in working cash resulting from the New Tax Law, and, for energy utilities, any decrease in the tax component of contributions-in-aid-of-construction (CIAC) received due to changes in the tariffed tax component of CIAC to reflect the New Tax Law.
3. This memorandum account shall be used in determining whether any future rate reduction is appropriate to reflect impacts of the New Tax Law during the Memo Account Period for each Covered Utility. This memorandum account shall not be used to recover any net revenue requirement increase recorded during the Memorandum Account Period. If, at the end of the Memo Account Period, this memorandum account reflects a net revenue requirement increase, the memorandum account shall be terminated without any impact on rates.
4. In each Covered Utility's next General Rate Case (GRC), or at such other time as ordered in that GRC decision, the Commission shall address the disposition of amounts (a) recorded in the memorandum account and (b) forecast for the remainder of the Memo Account Period, and may reflect any net revenue requirement reduction in prospective rates. In any such GRC decision, the Commission may impose measures to ensure that plant forecast to be placed into service during the remainder of the Memo Account Period is actually placed into service during the Memo Account Period, and if not, that rates will thereafter be reduced to reflect the amount of forecast costs and expenses not actually incurred during the Memo Account Period.
5. Utility infrastructure whose costs are recorded in the memorandum account authorized by this resolution shall remain subject to reasonableness review in the same manner as other utility capital investments.
6. Within 15 days of the date of this resolution, Pacific Gas &Electric, Southern California Edison, Southern California Gas, and San Diego Gas & Electric shall, and any other Covered Utility may, file an advice letter to add a memorandum account to its tariffs consistent with the requirements of Ordering Paragraphs 1, 2, and 3, above.

SB_GT&S_0237291

The proposed tariff language shall describe in detail the debits and credits that are to be entered into the memorandum account.

7. Within 15 days of the date of this resolution, any entity that has submitted comments on any draft of this resolution may submit to the Legal Division a draft of tariff language for any group of Covered Utilities that it thinks is appropriate to implement Ordering Paragraphs 1, 2, and 3, above.
8. After consideration of the advice letters and submissions made pursuant to Ordering Paragraphs 6 and 7 above, the Commission's Staff shall provide appropriate tariff language to implement Ordering Paragraphs 1, 2, and 3, above, to each Covered Utility that does not file an advice letter pursuant to Ordering Paragraph 6 for that utility to file within 15 days after Staff sends the tariff language.
9. The Legal Division shall serve a copy of this resolution, by mail or e-mail, on all cost-of-service rate-regulated utilities and any additional persons who submitted comments on the draft resolution.
10. The effective date of this order is today.

I certify that this Resolution was adopted by the California Public Utilities Commission at its regular meeting of February 24, 2011, and that the following Commissioners approved it:

____

PAUL CLANON
Executive Director

SB_GT&S_0237292

Lower bills. Livable planet.

115 Sansome Street, Suite 900
San Francisco, CA 94104
415-929-8876 • www.turn.org
Robert Finkelstein, Legal Director

February 14, 1011

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

Re: TURN Comments on Draft Resolution L-411 Establishing a Memorandum Account for all Cost-of-Service Rate-Regulated Utilities To Reflect The Benefits Of Recent Federal Tax Legislation

Dear Ms. Zafar:

Pursuant to the notice that appeared in the Commission's Daily Calendar of February 8, 2011, regarding Draft Resolution L-411, The Utility Reform Network (TURN) submits these comments on Draft Resolution L-411. Consistent with the designation used throughout this revised draft, TURN refers to the most recent iteration as the Second Draft Resolution.[1]

The Second Draft Resolution describes how the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (designated the "New Tax Law" in the Draft Resolution) may provide tax relief to the utilities regulated on a cost-of-service basis by the Commission. It correctly recognizes that unless the Commission takes action, existing ratemaking mechanisms and practices might flow only a portion of those benefits to utility ratepayers. However, the Second Draft Resolution would abandon the "subject to refund" approach proposed in the earlier draft resolution, in response to utility claims that such an approach would result in "uncertainty." Instead, the Second Draft Resolution attempts to create conditions that will give each utility a choice of spending the tax savings on "additional, needed capital investment" or using those savings to reduce rates. TURN acknowledges that this revised approach is still an important improvement over the Commission taking no action on this matter, as it eliminates the opportunity for a utility to have the some or all of the tax savings flow directly to their shareholders. However, it is easy to predict how a cost-of-service rate-regulated utility is likely to respond to a choice between using such funds to invest in rate base (without having to raise the necessary capital through normal avenues), or to reduce rates.

TURN's comments focus on three issues. First, TURN renews our earlier call to also include the federal legislation creating similar tax relief that was enacted a few months before the "New Tax Law" addressed in the Second Draft Resolution. While TURN raised this point in comments on the earlier draft resolution, the Second Draft Resolution only acknowledged and responded to modifications sought in the utilities' comments. Second, TURN reminds the Commission that unregulated firms are different than cost-of-service regulated utilities, such that there may be

[1] An earlier draft resolution, issued on December 30, 2010, came from the Division of Water and Audits and had a different resolution number (W-4867).

SB_GT&S_0237293

reasons to analyze the New Tax Laws differently for utilities, particularly given the adverse future rate impacts under their preferred approach. Third, TURN urges the Commission to better explain what would qualify as "additional, needed capital investment," to acknowledge and address the cost premium that would likely come with such a mid-GRC spending increase, and commit to before-the-fact review of the utility spending plans.

1. **The Adopted Ratemaking Treatment Should Also Cover the Small Business Job Act of 2010, Which Provided Similar Tax Relief Available During The Same Time Frame.**

The first draft resolution would have had the Commission adopt ratemaking measures tailored to address the benefits under the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (designated the "New Tax Law"). TURN's comments on that first draft resolution urged the Commission to also include the tax relief the utilities may realize under the Small Business Job Act of 2010 (HR 5297) signed September 27, 2010.

> The one change TURN urges the Commission to make is to broaden the Draft Resolution to also include the effects of earlier 2010 legislation that increased tax depreciation for plant in service between January 1, 2010 and to September 8, 2010. In addition to the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 addressed in the Draft Resolution, Congress recently enacted the Small Business Job Act of 2010 (HR 5297) signed September 27, 2010. Like the December legislation, the Small Business Job Act includes provisions that will permit rapid acceleration of depreciation of utility plant in the years 2010, 2011, and 2012.[2] Combined with the effects of the December legislation,[3] the final result is that the cost-of-service rate-regulated utilities will receive unforeseen increases in depreciation tax deductions for three years, 2010 (50% through September 8, 100%, thereafter), 2011 (100%), and 2012 (50%).[4]

TURN therefore recommended revisions that would include the potential effects of the Small Business Job Act of 2010 as well as the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010. While this earlier law affects only plant installed before September 8 2010, the ramifications for utility ratemaking persist into 2011 and beyond because the amount of Accumulated Deferred Income Taxes is higher in 2011 because of this change to 2010 tax law. It is therefore indistinguishable from the December 2010 legislation, and should be included in this resolution.

---

[2] The 50% bonus depreciation of the Small Business Job Act of 2010 (Section 2022) generally allows a taxpayer to deduct 50% of the purchase price of qualifying assets placed in service for the 2010 tax year.

[3] Section 401 of HR 4853 allows businesses to expense 100% of depreciation on most property placed in service from September 8, 2010 through the end of 2011 and 50% through 2012.

[4] TURN Comments on Draft Res. W-4867 (January 7, 2011), p. 2.

SB_GT&S_0237294

However, the Second Draft Resolution fails to mention that recommendation, and does not include any discussion that might enable the Commission to determine why such starkly different treatment is appropriate for such similar pieces of legislation enacted within months of each other. Both pieces of legislation include accelerated tax depreciation provisions that, as applied to a cost-of-service rate-regulated utility, may warrant specific rate adjustments in order to ensure that those benefits either flow to the utility's ratepayers or, if the Commission decides to include this option, are used to fund "additional, needed" infrastructure investments. Adopting specific ratemaking treatment for one but not the other smacks of arbitrary and capricious action on the part of the agency.

The necessary changes to make such revisions are relatively minor:[5]

- Language should be added to the title and background section to refer to the Small Business Job Act of 2010 and to briefly describe its provisions (at the same level of detail used to describe the December legislation);
- Language should be added to Finding and Conclusion 1 and 2 and Ordering Paragraph 1 to include the Small Business Job Act of 2010; and
- Editorial changes throughout the document to refer to both pieces of legislation together as the "New Laws" and to make the appropriate changes from the singular to the plural.

2. **The Second Draft Resolution Fails To Explain Why The Commission Should Permit Cost-of-Service Rate-Regulated Utilities To Use The Federal Tax Savings To Fund Additional Capital Spending Rather Than Rate Reductions.**

In their "comments and discussion with Commission staff," the utilities noted that the purpose of the New Tax Laws is to encourage additional capital investment, thereby stimulating employment and the economy.[6] As a general principle this is true; however, that general principle may not apply to regulated utilities with equal force as it does to unregulated firm. The Commission needs to consider the important ways that cost-of-service rate-regulated utilities are different than other firms that might achieve tax savings by making additional capital investment under the new laws.

First, the fact that the utilities are regulated on a cost-of-service basis means that their rates are set at a level reflecting the costs of providing service. The premise of the New Tax Laws is that the tax relief is necessary to get firms to make capital investments that they have postponed due to the continuing economic conditions; that is, firms are under-spending as compared to what would happen in a good economy. That premise does not necessarily fit with cost-of-service regulated utilities. Even in a poor economy, the Commission can reasonably expect the utility to spend the full amount authorized for capital projects such as infrastructure replacement or any other spending necessary to provide safe and reliable service. And the Commission adopted the

[5] TURN has included a version of the Draft Resolution that shows the proposed changes necessary to include the Small Business Job Act of 2010.

[6] Second Draft Resolution, p. 3.

SB_GT&S_0237295

authorized amount based on its determination of what is necessary to achieve safe and reliable service during the GRC period. There is no need for a further incentive in order to convince these utilities to spend at the adopted level. But faced with a directive that would require the tax savings under the New Tax Laws to flow to ratepayers, the utilities instead seek to use those savings to fund additional investment, at levels above and beyond those authorized as necessary to achieve safe and reliable service.

Second, the cost-of-service rate-regulated utilities are different from unregulated firms in terms of the long-term rate impacts of permitting the utilities to use the tax savings to fund additional capital spending. If the additional capital investment is added to rate base, the resulting revenue requirement will be higher than it would have been absent that additional investment, with higher rates for decades to come.[7] The positive impact on employment and the economy from the increased capital spending is short-term; once the increased capital spending stops, so do these benefits. But the resulting higher rates will continue long into the future, with deleterious impacts on employment and the economy as greater amounts are collected in utility bills and correspondingly lower amounts are available to businesses to add employees, and to households to spend supporting smaller businesses. These elements are unique to the cost-of-service rate-regulated utilities, and therefore warrant a careful and specific analysis of whether the additional capital spending that might be achieved under the Second Draft Resolution's approach is appropriate under the circumstances. Unfortunately, the Second Draft Resolution includes no such analysis, but instead merely relies on the utility assertions that using the tax savings to fund increased capital spending should be given priority over rate reductions.

3. If The Commission Chooses To Permit Utilities To Use Tax Savings to Fund Capital Investment, It Must Further Clarify What Constitutes "Additional, Needed" Investment, Address the Cost Premium That Is Likely To Come With Such a Mid-GRC Spending Increase, And Employ Before-The-Fact Review Of Utility Proposals Rather Than Rely Exclusively On After-the-Fact Reasonableness Reviews.

In their "comments and discussions with Commission staff," the utilities argued that but for the uncertainty caused by the "subject to refund" language in the original draft resolution, they "could use tax savings realized under the New Tax Law to fund additional, needed capital investment not otherwise funded by rates."[8] The Second Draft Resolution would have the Commission concur that this would be a good use of the tax savings.[9] Therefore the new approach "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."[10] But it's not entirely a blank check under the approach set out in the Second Draft Resolution: "Utility infrastructure whose costs are recorded in the memorandum account will be subject to reasonableness review

---

[7] TURN assumes that distribution infrastructure investment has an average service life of approximately 30 years.

[8] Second Draft Resolution, p. 3.

[9] *Id.*

[10] *Id.* at 4.

SB_GT&S_0237296

in the same manner as other utility capital investments. This reasonableness review may occur in the same GRC in which disposition of the memorandum account is considered, or in another forum."[11]

There are several very substantial flaws inherent in this approach. First, it presumes there is "additional, needed" infrastructure investment that is not sufficiently covered in the currently authorized revenue requirement and capital budget for these cost-of-service rate-regulated utilities. TURN is unaware of any recent Commission decision that recognized such "additional, needed" capital investment exists (whether given that label or designated differently) yet excluded that investment from the authorized revenue requirement or capital budget for the utility. In adopting the authorized revenue requirement and capital budget that is currently in place for each cost-of-service rate regulated utility, the Commission exercised its judgment to find a balance that would achieve safe and reliable service at a reasonable cost, thereby producing reasonable rates. In TURN's experience, the utilities are always capable of pointing to additional capital investment that they could be making at any given time. Of course, this is not the same as a determination by the Commission that there is additional capital investment that they should be making. Yet the Second Draft Resolution accepts without further analysis the utilities' assertion that there exists "additional, needed capital investment not otherwise funded by rates"[12] and that using the tax savings to fund that investment should be given priority over achieving rate reductions.

At a minimum, the Commission needs to provide clear and detailed guidelines as to what would (and, perhaps more importantly, would not) constitute "additional, needed capital investment." For example, for the regulated energy utilities any increased spending on infrastructure must be limited to Commission-regulated electric distribution plant. It should not include spending on real estate and vehicles (lower priority items that do not create significant California jobs), or software (where utilities have experienced massive cost overruns in the past that, if repeated now, could absorb stimulus tax dollars). It should not include spending on FERC jurisdictional assets (where no such memorandum account is being proposed at the present time, so the utility would be in a position to double-recover).

The Commission should also exclude from "additional, needed capital investment" any spending on assets in excess of commission-approved or utility-identified levels, particularly where the Commission has placed the risk of cost overruns at least partly on the utility. Examples of this include but are not limited to photovoltaic construction in excess of amounts previously approved by the Commission, and programs such as "smart meters" where spending in excess of the authorized capital budget would require the utility to bear a portion of the costs. If the PG&E Smart Meter program exceeds its authorized budget, the utility's shareholders would bear 10% of the first $100 million of cost overruns.[13] Without further guidance on what would qualify as "additional, needed capital investment," it is not at all clear that should such cost overruns occur, PG&E could use the tax savings to offset the share of those overruns that would otherwise be

[11] *Id.* at 5.
[12] Second Draft Resolution, p. 3.
[13] D.06-07-027, p. 13.

borne by shareholders. Finally, generation projects already identified by utilities should not be allowed because those projects are by definition not incremental spending caused by the Tax Law. This would also remove utilities' incentives to keep costs down on projects they have already identified (e.g., the 2011 portion of Edison's extreme request for $32 million for Catalina Island generation - $7000 per kW of island peak load – which still requires reliance on existing dirty diesel generation ***after*** spending all this money).

Second, even if there exist examples of "additional, needed capital investment not otherwise funded by rates" for any of the cost-of-service rate-regulated utilities, pursuing such investment between rate cases is likely to require a cost premium. A substantial portion of such capital projects is the labor expense. The Commission should presume that each utility has its workforce sized at a level consistent with the currently authorized revenue requirement and capital budget. In order to pursue any "additional, needed capital investment not otherwise funded in rates" a utility would have to either pay its existing work force overtime or rely on outside contractors (with their additional overhead) to get the work done. Even if the Commission had made some determination that this "additional, needed capital investment" exists, there has been no determination that it would be reasonable to make such investment in a manner that is likely to carry a premium to cover overtime and outside contractor expenses.

Third, the Commission needs to acknowledge that after-the-fact reasonableness review is a far less effective tool than a before-the-fact review that requires the utility to explain and justify its plans before the money is spent. The Second Draft Resolution seeks to protect ratepayers by committing to a reasonableness review of the recorded spending:

> Utility infrastructure whose costs are recorded in the memorandum account will be subject to reasonableness review in the same manner as other utility capital investments.[14]

TURN submits that this is a somewhat hollow promise. In recent years, TURN's experience has been that the Commission has only very rarely denied rate recovery of capital investments already made. On the other hand, when given the opportunity to consider proposed but not yet initiated capital projects, the agency has been more likely to find such spending not reasonable, at least in part. The clearest recent example is the PG&E Distribution Reliability Improvement Program (designated "Cornerstone" by PG&E) that was the subject of A.08-05-023. According to the utility's application and testimony, the capital projects sought to improve "the resiliency and reliability of its electric distribution system" to a level better than that achieved through existing GRC funding levels.[15] The utility proposed a $2.0 billion capital spending effort over a seven-year period. The Commission instead approved a $357 million project over a four-year period and, in doing so, gave directions for any future request:

> In developing future reliability improvement programs or projects PG&E must be able to demonstrate the need for such programs or projects, and if there is a need, whether the project or program represents the optimal

[14] *Id.*, at 5.

[15] D.10-06-048 (in A.08-05-023), p. 3.

> solution when considering alternatives and cost-effectiveness in the identification and prioritization process.[16]

After-the-fact reasonableness review does not provide the Commission (or other interested parties) a meaningful opportunity to challenge the need for a program or project, or whether the selected approach represents the optimal or most cost-effective solution. If the Commission wishes to give utilities the opportunity to use the tax savings under the New Tax Laws to fund "additional, necessary capital investment" rather than to reduce rates, it must require the utilities to make a before-the-fact showing of what that additional capital investment will be, why it is needed, and why it is the optimal solution. An after-the-fact reasonableness review will be too little, too late.

Yours truly,

/s/

Robert Finkelstein
Legal Director

cc: All CPUC Commissioners
Paul Clanon, CPUC Executive Director
Frank Lindh, CPUC General Counsel
Julie Fitch, Director of Energy Division

[16] *Id.*, pp. 2-3.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Legal Division

San Francisco, California
Date: February 24, 2011
Resolution No. L-411

RESOLUTION

RESOLUTION ON THE COMMISSION'S OWN MOTION ESTABLISHING A MEMORANDUM ACCOUNT FOR ALL COST-OF-SERVICE RATE-REGULATED UTILITIES, OTHER THAN CLASS C AND D WATER AND SEWER UTILITIES, TO ALLOW THE COMMISSION TO CONSIDER REDUCING RATES TO REFLECT THE BENEFITS OF THE SMALL BUSINESS JOB ACT OF 2010 AND THE TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOB CREATION ACT OF 2010

BACKGROUND

On September 27, 2010, President Obama signed the Small Business Job Act of 2010, and on December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 ("New Tax Laws"). It has come to the attention of the Commission that these laws may provide tax relief to the utilities regulated by this Commission. Provisions in the New Tax Laws may reduce the utilities' costs of providing service. Many of the utilities regulated by this Commission have their rates set on a cost-of-service basis. These utilities include, without limitation: water and sewer system corporations, small local exchange carrier telephone corporations, gas and electrical corporations, pipeline corporations, and heat corporations.

Among other provisions, the New Tax Laws provide for 50% accelerated bonus depreciation on certain business property put into service between January 1, 2010 and September 8, 2010 and 100% bonus depreciation on certain business property put into service after September 8, 2010 and before January 1, 2012. The New Tax Laws also provide for 50% bonus depreciation for property placed into service thereafter and before January 1, 2013 and for property placed into service in 2013 where construction begins prior to January 1, 2013.

Author
Deleted: is

Author
Deleted: ,

Author
Deleted: s

Author
Deleted: for

Author
Deleted: s

Consistent with the Internal Revenue Code, the Commission's ratemaking procedures do not reflect in rates the full reduction in tax expense in the year in which accelerated

depreciation is taken for tax purposes. Rather, rates are set as if depreciation for tax purposes were being calculated on the straight line method over the projected life of the asset (the same depreciation method used for setting rates). Thus, the utility collects in rates taxes that will not need to be paid until a later time, if at all.[1] Nevertheless, ratepayers do get a benefit from the accelerated depreciation. This is accomplished through "normalization" and the use of a "deferred tax reserve". The deferred tax reserve for any particular asset reflects the amount of depreciation taken for tax purposes that exceeds the amount used in setting rates. This difference is then multiplied by a tax rate to yield the amount of deferred tax reserve. Thus, for example, if a utility puts into service a new capital asset costing $100,000 with a 10 year service life and takes 100% bonus depreciation and the tax rate is 40%, the corresponding deferred tax reserve at the end of a year will be $36,000 (i.e. the $100,000 depreciation taken for tax purposes, minus the $10,000 taken for ratemaking purposes times 40%.) The combined deferred tax reserve on all of the utility's assets is, in turn, deducted from rate base in calculating the utility's revenue requirement, thus reducing rates.

However, the general rates of cost-of-service utilities are typically reviewed only once every three years. When they are reviewed, the actual amount of the deferred tax reserve is generally reflected in setting new rates. Unless a utility's rates are adjusted for the years between general rates cases (GRCs) in a way that takes account of the actual amount of the deferred tax reserve, the increase in the deferred tax reserve caused by the New Tax Laws would not be reflected in rates until after the utility's next GRC. Because the New Tax Laws provide for 50% accelerated bonus depreciation on certain business property put into service between January 1, 2010 and September 8, 2010 and 100% bonus depreciation on qualifying assets put into service after September 8, 2010 and before January 1, 2012 (with 50% bonus depreciation thereafter), and because it may be some time before all of the cost-of-service rate-regulated utilities have their rates adjusted to reflect the amounts actually recorded in their deferred tax reserves, there could be substantial amounts in deferred tax reserves that do not get reflected in rates unless the Commission takes action.

Author
Deleted: New Tax Law

Author
Deleted: s

DISCUSSION

The purpose of this resolution:

The purpose of this resolution is to preserve the opportunity for the Commission to decide at a future date whether some of the benefits of the New Tax Laws, not otherwise reflected in rates, ought to benefit ratepayers through a decrease in rates, without having to be concerned with issues of retroactive ratemaking.

Author
Deleted: New Tax Law

[1] See *City of Los Angeles v. Public Utilities Commission*, 15 Cal. 3d 680, 686 (1975) (for an enterprise that is either expanding or stable, accelerated depreciation does not merely defer taxes, but eliminates them entirely).

When a utility begins to experience a large and unexpected increase in costs, it sometimes requests authority from the Commission to establish a memorandum account. As we said in D10-04-031.

> A memorandum account allows a utility to track costs arising from events that were not reasonably foreseen in the utility's last general rate case. By tracking these costs in a memorandum account, a utility preserves the opportunity to seek recovery of these costs at a later date without raising retroactive ratemaking issues. However, when the Commission authorizes a memorandum account, it has not yet determined whether recovery of booked costs is appropriate, unless so specified.

Here we face the possibility of large and unexpected *decreases* in tax expense. Due to the timing of rate cases, benefits of the tax decrease may not accrue to ratepayers in the same way they would if the tax decrease had been expected. We wish to preserve the opportunity to consider whether some or all of the tax impacts not otherwise reflected in rates should benefit ratepayers, without having to face issues of retroactive ratemaking.

The approach the Commission should adopt to achieve this purpose:

On December 30, 2010, the Commission issued a different version of this draft resolution (the Original Draft Resolution) for comment. The Original Draft Resolution proposed to accomplish the above purpose by making the rates of all cost-of-service rate regulated utilities subject to refund for the limited purpose of allowing ratepayers to benefit, to the extent, if any, the Commission finds reasonable, from tax benefits resulting from the New Tax Laws.

Author
Deleted: New Tax Law

In their comments and discussions with Commission staff, the utilities pointed out several disadvantages of this approach, primarily the uncertainty created by the "subject to refund" language. The utilities noted that the purpose of the bonus depreciation provisions of the New Tax Laws is to encourage additional capital investment, thereby stimulating employment and the economy. The utilities could use tax savings realized under the New Tax Laws to fund additional, needed capital investment not otherwise funded by rates. We concur that this would be a good use of the tax savings. This may be an opportune time to increase capital investment, given decreases in construction costs and the availability of bonus depreciation for plant put into service before 2013. At least some of the utilities intend to use tax savings from the New Tax Laws to fund additional, needed capital investment. However, the utilities informed staff that they would be reluctant to do so if some unknown amount of the tax savings were instead needed to fund rate reductions. On the other hand, if utilities realize tax savings and do not use

Author
Deleted: New Tax Law

Author
Deleted: New Tax Law

Author
Deleted: New Tax Law

SB_GT&S_0237302

them to increase capital investment, or if the costs of the increased capital investment are covered by other rates, there may still be tax benefits that should benefit ratepayers through a decrease in rates.

In light of these factors, this second version of the draft resolution (the Second Draft Resolution) has been revised to eliminate the subject to refund language. Instead, this Second Draft Resolution uses a memorandum account to track the various benefits and costs of the New Tax Laws and the increased capital investment it may stimulate that are not otherwise reflected in rates. This approach still permits the Commission to determine at a later date whether some of the benefits of the New Tax Laws should benefit ratepayers through a decrease in rates, without having to be concerned about retroactive ratemaking issues. However, this approach replaces the uncertainty of "subject to refund" language with specific calculations that will be contained in a memorandum account, and 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, those additional costs will be offset against amounts that otherwise might be used to reduce rates. As a result, this Second Draft Resolution should not impede the capital investment that the New Tax Laws are intended to encourage.

Author
Deleted: New Tax Law

Author
Deleted: New Tax Law

Author
Deleted: New Tax Law

Author
Deleted: is

Which utilities should be exempt from having memorandum accounts:

In general, it is appropriate to establish this kind of a memorandum account for all utilities that have their rates set on a cost of service. As noted above, these generally include water and sewer system corporations, small local exchange carrier telephone corporations, gas and electrical corporations, pipeline corporations, and heat corporations. However, we conclude that Class C and D water and sewer corporations should be exempt from this memorandum account requirement. There are two main considerations underlying this conclusion. First, many of these utilities have their rates set using a "rate of margin" (ROM), rather than a rate of return. Because rate of return is not a factor in setting the rates of these ROM utilities, their rates do not change when there is change in rate base. Similarly, a deduction of a deferred tax reserve from rate base would likewise have no impact on rates. Indeed, most of the items that would be tracked in the memorandum account are not relevant to these ROM utilities. Second, Class C and D water and sewer utilities are very small utilities for whom the administrative burden of keeping track of the necessary accounting entries would be an excessive burden, even if their rates are set on a rate-of-return basis.

The details of the memorandum account:

This resolution will establish for each cost-of-service rate-regulated utility, except for Class C and D water and sewer utilities, (collectively the Covered Utilities) a memorandum account to reflect, on a CPUC-jurisdictional, revenue requirement basis, impacts from the New Tax Laws.

Author
Deleted: New Tax Law

SB_GT&S_0237303

The memorandum account will be used to determine whether any future rate reductions are appropriate to reflect impacts of the New Tax Laws for the period from the date of this resolution until the effective date of revenue requirement changes in each Covered Utility's next GRC ("Memo Account Period"). The memorandum account will be used by each Covered Utility to track the revenue requirement impacts of the New Tax Laws during the Memo Account Period, reflecting on a revenue requirement basis the effects of the New Tax Laws not otherwise reflected in rates. In determining an appropriate revenue requirement adjustment, if any, for the Memo Account Period, the Commission will take into account, and each Covered Utility will record:[2] (a) decreases in its revenue requirement resulting from increases in its deferred tax reserve; (b) offsets to reflect any additional costs or expenses, not otherwise recovered in rates, incurred as a result of additional utility infrastructure investment enabled by the bonus depreciation provisions of the New Tax Laws, and (c) amounts to reflect the impacts of any decrease in Section 199 deductions resulting from bonus depreciation taken, changes in working cash resulting from the New Tax Laws, and, for energy utilities, any decrease in the tax component of contributions-in-aid-of-construction (CIAC) received due to changes in the tariffed tax component of CIAC to reflect the New Tax Laws.

Author
Deleted: New Tax Law

Author
Deleted: New Tax Law

Author
Deleted: New Tax Law

Author
Deleted: New Tax Law

Author
Deleted: New Tax Law

Author
Deleted: New Tax Law

In each Covered Utility's next GRC, or at such other time as ordered in that GRC decision, the Commission will address the disposition of amounts (a) recorded in the memorandum account and (b) forecast for the remainder of the Memo Account Period, and may reflect any net revenue requirement reduction in prospective rates. In any such GRC decision, the Commission may impose measures to ensure that plant forecast to be placed into service during the remainder of the Memo Account Period (made with savings realized from the New Tax Laws) is actually placed into service during the Memo Account Period, and if not, that rates will thereafter be reduced to reflect the amount of forecast costs and expenses not actually incurred during the Memo Account Period.

Author
Deleted: New Tax Law

Consistent with standard Commission practice, the recording of the costs of particular utility infrastructure in the memorandum account, or amortization of the memorandum account, will not, in and of itself, substitute for the reasonableness review to which capital investment is normally subject. Utility infrastructure whose costs are recorded in the memorandum account will be subject to reasonableness review in the same manner as other utility capital investments. This reasonableness review may occur in the same GRC in which disposition of the memorandum account is considered, or in another forum.

[2] Although this resolution refers to amounts "recorded" in the memorandum account, because this is a memorandum account, and not a balancing account, the amounts tracked or recorded in the memorandum account are not recorded in the utilities' financial statements, e.g., in the balance sheet.

SB_GT&S_0237304

This memorandum account will be a one-way memorandum account, i.e., it will be available for the Commission to consider *only* whether utility rates should be *reduced* to reflect the tax benefits of the New Tax Laws. This memorandum account cannot be used by any Covered Utility to recover any net revenue requirement increase recorded during the Memo Account Period. If, at the end of the Memo Account Period, this memorandum account reflects a net revenue requirement increase, the memorandum account will be terminated without any impact on rates.

Author
Deleted: New Tax Law

The following paragraphs describe in further detail some of the wording we have used above in describing the memorandum account.

Amounts in the memorandum account will be recorded on a "revenue requirement basis." This means that each utility will be tracking the revenue requirement impact of each change resulting from the New Tax Laws and of the additional, needed infrastructure investment enabled by the tax savings resulting from the bonus depreciation provisions of the New Tax Laws. This is important, because, consistent with the Internal Revenue Code, the tax savings from accelerated depreciation are not passed through directly to ratepayers, but instead, as explained above, ratepayers benefit through the process of normalization and the creation of a deferred tax reserve that is deducted from rate base. We also ensure that all amounts recorded in the memorandum account will be recorded on a consistent basis by requiring that they all be recorded on a revenue requirement basis.

Author
Deleted: New Tax Law

Author
Deleted: New Tax Law

In several places, we refer to amounts not otherwise reflected or recovered in rates. We use this terminology to exclude costs and expenses recovered through previously authorized rates, e.g., rates set in a prior GRC. We also use it to exclude costs or expenses recovered through rates set after the date of this resolution, e.g., through a balancing account or another memorandum account, or a formal proceeding prior to the utility's next GRC.

Another key, related concept is "additional utility infrastructure investment." By additional utility infrastructure investment we mean investment made possible by the tax savings from the New Tax Laws that is in addition to investment otherwise included in rates. For utilities that have an adopted figure for additions to plant in service during the year(s) included within the Memo Account Period, the additional utility infrastructure investment will ordinarily be the amount by which additions to plant in service for that Period exceed the adopted figure for that same Period.[3] For some utilities, the Memo Account Period will include Attrition Year(s) for which there is no specific adopted

Author
Deleted: New Tax Law

[3] The Memo Account Period will begin in the middle of Test Years or Attrition Years for Covered Utilities. This will at least require some proration of the adopted figure. Furthermore, infrastructure investment may occur in large lumps. Therefore, it may be necessary to look at plant additions during the period(s) immediately preceding the Memo Account Period for a Covered Utility to see how much of the plant additions during the Memo Account Period were actually "additional" to the adopted amount.

figure for additions to plant in service. Those utilities may calculate the amount of investment that is included in rates by inflating the Test Year figure for additions to plant in service by the same percentage by which the Attrition Year's revenue requirement exceeds the Test Year's revenue requirement. If a utility without an adopted figure for additions to plant in service during any portion of the Memo Account Period contends that the foregoing methodology inaccurately reflects the amount of plant additions not already included in rates, it may propose an alternative methodology.

We note that additional utility infrastructure investment may have several impacts on revenue requirements, including both depreciation and return on investment. None of these impacts occur, however, until plant is placed into service. Therefore, for plant that is forecast to be placed into service during a Covered Utility's next GRC Test Year, all of the costs of that additional plant should be reflected in the utility's Test Year rates, and none of them should be recorded in the memorandum account. That will be true even if the cash flow used to fund the construction of the infrastructure comes from tax savings from the New Tax Laws.

Author
Deleted: New Tax Law

In their comments on the First Draft Resolution, the energy utilities pointed out that the bonus depreciation afforded by the New Tax Laws will decrease their taxable income, and therefore may decrease, or eliminate, the Internal Revenue Code Section 199 Manufacturer's tax deduction that they are entitled to, which is already reflected in their revenue requirements. The utilities also pointed out that the New Tax Laws will have impacts on their working cash, an item that is a component of their rate base and therefore also reflected in their revenue requirements. These Section 199 and working cash impacts are specifically mentioned as items to be included in the memorandum account, on a revenue requirement basis. The energy utilities also argued that the New Tax Laws will impact their CIAC (contributions-in-aid-of-construction) revenues. Energy utilities are taxed on plant contributed by others, such as real estate developers. Accordingly, when such entities contribute plant to the utility they must also contribute an amount to cover the tax impacts (the tax component of CIAC). This tax component of CIAC is adjusted from time to time to reflect changes in the utilities' taxes. If the energy utilities modify their CIAC tariffs to reflect new effective tax rates resulting from the New Tax Laws, it appears that there will then be a decrease in the tax component of the CIAC they receive thereafter. Presumably, there will also be a change in the amount of tax they have to pay on CIAC. The energy utilities are authorized to include these CIAC impacts in their memorandum accounts on a revenue requirement basis and consistent with any requirements of the Internal Revenue Code.

Author
Deleted: New Tax Law

Author
Deleted: New Tax Law

Author
Deleted: New Tax Law

Author
Deleted: New Tax Law

What it means when we establish a memorandum account:

The establishment of a memorandum account does not change rates, nor guarantee that rates will be changed in the future. This mechanism simply allows the Commission to determine at a future date whether rates should be changed, without the impediment of

SB_GT&S_0237306

claims of retroactive ratemaking. Thus, all we are determining here is that it may be desirable to adjust the rates of the Covered Utilities to more fully reflect the tax benefits, if any, that these utilities realize from the New Tax Laws, while avoiding any issue of retroactive ratemaking. Furthermore, the specific terms of the memorandum account established by this resolution ensure that if the utilities spend the tax savings from the New Tax Laws on additional, needed capital investment the costs of which will not otherwise be recovered in rates, those additional costs will be offset against amounts that otherwise might be used to reduce rates.

Author
Deleted: New Tax Law

Author
Deleted: New Tax Law

When advice letters should be filed:

It will be necessary for the Covered Utilities to file advice letters to incorporate the memorandum account into their tariffs. Rather than requiring each of the Covered Utilities to quickly file such advice letters, we will instead require only the four major energy utilities to file such advice letters within 15 days. Any other Covered Utility may also file such an advice letter within 15 days of the date of this resolution. In addition, any entity that has filed comments on any draft of this resolution may, within 15 days, submit to the Legal Division suggested memorandum account language that would apply to any group of utilities. This should provide a more efficient means for Commission staff to review language that should apply to a class of utilities. In each case, the proposed tariff language should describe in detail the debits and credits that are to be entered into the memorandum account. After consideration of the language submitted by means of advice letters and any suggestions made to the Legal Division, the Commission's Staff, will provide appropriate memorandum account language to each Covered Utility that did not file an advice letter advice letter within 15 days of the date of this resolution. Each of those utilities will then need to file an advice letter incorporating that language within 15 days after Staff sends the memorandum account language. This will result in some delay before advice letters are approved for all of the Covered Utilities. However, this should not be problematic because the memorandum accounts are effective for all Covered Utilities as of the date of this resolution.

COMMENTS ON DRAFT RESOLUTION

Public Utilities Code section 311(g)(1) generally requires draft resolutions to be issued for comment at least 30 days before being voted on by the Commission. However, pursuant to Public Utilities Code section 311(g)(3), the Commission has adopted Rule 14.6(c)(9) of its Rules of Practice and Procedure which permits a reduction in the comment period here. More specifically, Rule 14.6(c)(9) permits the Commission to reduce the 30-day period for public review and comment in circumstances where the public interest in the Commission adopting a resolution before expiration of the 30-day review and comment period clearly outweighs the public interest in having the full 30-day period for review and comment. This resolution does not change utility rates, nor determine that utility rates ought to be changed. It only permits the Commission to

consider those issues at a future date, while minimizing retroactive ratemaking concerns. On the other hand, delaying issuance of this resolution to allow for the full 30-day comment period might extend the period of time during which retroactive ratemaking could be a concern. Accordingly, the public interest in adopting this resolution before expiration of a 30 day public comment period clearly outweighs the public interest in allowing for the full 30 day comment period. Accordingly, the First Draft Resolution was issued for comment on December 30, 2010, served on all persons on the attached service list. Consistent with Rule 14.6(c)(9), there was a reduced comment period with comments due on January 7, 2011. Comments were filed by January 7, 2011.

Most of these comments have been addressed above, or rendered irrelevant in light of our elimination of the "subject to refund" language. However, there are several other subjects raised in the comments that we wish to address.

There were comments to the effect that the Commission had not previously taken action to reduce rates when the Internal Revenue Code was revised to provide for bonus depreciation. We note that utilities often request memo accounts for unexpected increases in expenses between GRCs. However, they do not come to us requesting memorandum accounts or rate decreases when there has been a large and unexpected decrease in expenses between rate cases. We believe that an even-handed approach to regulation requires us to consider, when there has been a large and unexpected decrease in expenses between rate cases, whether it is appropriate to establish a memorandum account to allow for a future decrease in rates. In this case, we believe that the establishment of such a memorandum account is appropriate.

There was also some concern expressed about a need to recalculate the entirety of the utilities' deferred tax reserve. However, there is no need to do so. The bonus depreciation provisions of the New Tax Law only apply to property placed into service after January 1, 2010. Therefore, only the increase in deferred tax reserve resulting from property placed into service after January 1, 2010 needs to be calculated.

Author
Deleted: September
Author
Deleted: 8
Author
Deleted: September
Author
Deleted: 8

In light of the major changes made in the Second Draft Resolution, this Second Draft is being issued for public comment on February 7, 2011, although an additional comment period is not legally required. The Second Draft Resolution will be served on all persons served with the Original Draft Resolution. Comments must be received by the Commission by 10 a.m. on February 14, 2011. Commenters who would like changes to the memorandum account, should provide red-lined versions of the Ordering Paragraph(s) they want revised.

FINDINGS AND CONCLUSIONS

1. President Obama signed the Small Business Job Act of 2010 on September 27, 2010 and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 on December 17, 2010 (collectively, "New Tax Laws").
2. The New Tax Laws may provide tax relief to the utilities regulated by this Commission. Among other provisions, this law provides for 50% accelerated bonus depreciation on certain business property put into service between January 1, 2010 and September 8, 2010, and 100% bonus depreciation on certain business property put into service after September 8, 2010 and before January 1, 2012, with 50% bonus depreciation for at least a year thereafter.
3. The general rates of utilities are typically reviewed only once every three years.
4. While existing ratemaking mechanisms likely will result in ratepayers benefiting from a portion of the tax benefits utilities receive under the New Tax Laws, it is not clear that all of the tax benefits resulting from this new law will have an impact on rates under current mechanisms.
5. The Commission should allow for the possibility of revising the rates of the utilities whose rates are set on a cost-of-service basis, so that some or all of the benefits of the New Tax Laws not otherwise reflected in rates may accrue to ratepayers, while minimizing issues of retroactive ratemaking.
6. The appropriate method for preserving the opportunity to consider, at a later time, whether some or all of the benefits of the New Tax Laws not otherwise reflected in rates should be reflected in rates is to establish a memorandum account.
7. The memorandum account should reflect not only the tax benefits of the New Tax Laws, but other resulting changes in the utilities' revenue requirements, including the Section 199 deduction and the tax component of contributions in aid of construction.
8. .So as not to discourage utilities from using the tax savings resulting from the New Tax Laws for investment in additional, needed infrastructure, the costs and expenses of that infrastructure not otherwise reflected in rates should also be reflected in the memorandum account.
9. If a utility intends to use the tax savings resulting from the New Tax Laws for investment in additional, needed infrastructure, it shall first present its planned investment for Commission review and approval. Utility infrastructure whose costs are recorded in the memorandum account authorized by this resolution should remain subject to reasonableness review in the same manner as other utility capital investments.
10. Class C and D water and sewer utilities should be exempted from the establishment of this memorandum account.
11. This resolution does not change utility rates, nor determine that utility rates ought to be changed. It only permits the Commission to consider, at a future date, the issue of

Author
Deleted: ("New Tax Law")

Author
Deleted: .

SB_GT&S_0237309

whether utility rates should be changed as a result of the New Tax Laws, while minimizing retroactive ratemaking concerns.

12. Delaying issuance of this resolution to allow for a full 30-day comment period might extend the time during which retroactive ratemaking could be a concern.
13. The public interest in adopting this resolution before expiration of a 30 day public comment period clearly outweighs the public interest in allowing for the full 30 day comment period.

ORDER

1. There is hereby established for each cost-of-service rate-regulated utility, with the exception of Class C and D water and sewer utilities, (collectively the Covered Utilities) a memorandum account to reflect, on a CPUC-jurisdictional, revenue requirement basis, impacts from the Small Business Job Act of 2010 on September 27, 2010 and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 ("New Tax Laws").

Author
Deleted: "The

2. This memorandum account shall track on a revenue requirement basis the impacts of the New Tax Laws not otherwise reflected in rates during the period starting on the date of this resolution until the effective date of revenue requirement changes in each Covered Utility's next General Rate Case ("Memo Account Period"). Each Covered Utility shall record in this memorandum account: (a) decreases in its revenue requirement resulting from increases in its deferred tax reserve; (b) offsets to reflect any additional costs or expenses, not otherwise recovered in rates, incurred as a result of additional utility infrastructure investment enabled by the bonus depreciation provisions of the New Tax Laws; and (c) amounts to reflect the impacts of any decrease in Section 199 deductions resulting from bonus depreciation taken, changes in working cash resulting from the New Tax Laws, and, for energy utilities, any decrease in the tax component of contributions-in-aid-of-construction (CIAC) received due to changes in the tariffed tax component of CIAC to reflect the New Tax Laws.

   2a. If a utility intends to use the tax savings resulting from the New Tax Laws for investment in additional, needed infrastructure, it shall first present its planned investment for Commission review and approval.

3. This memorandum account shall be used in determining whether any future rate reduction is appropriate to reflect impacts of the New Tax Law sduring the Memo Account Period for each Covered Utility. This memorandum account shall not be used to recover any net revenue requirement increase recorded during the Memorandum Account Period. If, at the end of the Memo Account Period, this memorandum account reflects a net revenue requirement increase, the memorandum account shall be terminated without any impact on rates.

4. In each Covered Utility's next General Rate Case (GRC), or at such other time as ordered in that GRC decision, the Commission shall address the disposition of amounts (a) recorded in the memorandum account and (b) forecast for the remainder of the Memo Account Period, and may reflect any net revenue requirement reduction in prospective rates. In any such GRC decision, the Commission may impose measures to ensure that plant forecast to be placed into service during the remainder of the Memo Account Period is actually placed into service during the Memo Account Period, and if not, that rates will thereafter be reduced to reflect the amount of forecast costs and expenses not actually incurred during the Memo Account Period.
5. Utility infrastructure whose costs are recorded in the memorandum account authorized by this resolution shall remain subject to reasonableness review in the same manner as other utility capital investments.
6. Within 15 days of the date of this resolution, Pacific Gas &Electric, Southern California Edison, Southern California Gas, and San Diego Gas & Electric shall, and any other Covered Utility may, file an advice letter to add a memorandum account to its tariffs consistent with the requirements of Ordering Paragraphs 1, 2, and 3, above. The proposed tariff language shall describe in detail the debits and credits that are to be entered into the memorandum account.
7. Within 15 days of the date of this resolution, any entity that has submitted comments on any draft of this resolution may submit to the Legal Division a draft of tariff language for any group of Covered Utilities that it thinks is appropriate to implement Ordering Paragraphs 1, 2, and 3, above.
8. After consideration of the advice letters and submissions made pursuant to Ordering Paragraphs 6 and 7 above, the Commission's Staff shall provide appropriate tariff language to implement Ordering Paragraphs 1, 2, and 3, above, to each Covered Utility that does not file an advice letter pursuant to Ordering Paragraph 6 for that utility to file within 15 days after Staff sends the tariff language.
9. The Legal Division shall serve a copy of this resolution, by mail or e-mail, on all cost-of-service rate-regulated utilities and any additional persons who submitted comments on the draft resolution.
10. The effective date of this order is today.

I certify that this Resolution was adopted by the California Public Utilities Commission at its regular meeting of February 24, 2011, and that the following Commissioners approved it:

PAUL CLANON
Executive Director

SB_GT&S_0237311

SB_GT&S_0237312

DRAFT **49 (10078)**
(Rev. 4)

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Legal Division

San Francisco, California
Date: March 10, 2011
Resolution No. L-411

RESOLUTION

RESOLUTION ON THE COMMISSION'S OWN MOTION ESTABLISHING A MEMORANDUM ACCOUNT FOR ALL COST-OF-SERVICE RATE-REGULATED UTILITIES, EXCEPT FOR CLASS C AND D WATER AND SEWER UTILITIES, MOUNTAIN UTILITIES AND NRG ENERGY CENTER, TO ALLOW THE COMMISSION TO CONSIDER REVISING RATES TO REFLECT THE TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOB CREATION ACT OF 2010 AND THE BONUS DEPRECIATION PROVISION OF THE SMALL BUSINESS JOB ACT OF 2010

SUMMARY

This resolution establishes a two-way memorandum account for all cost-of-service rate regulated utilities, except for Class C and D water and sewer utilities, and except for Mountain Utilities and NRG Energy Center, to track the impacts of the Tax Relief, Unemployment Insurance Reauthorization, And Job Creation Act Of 2010 and the bonus depreciation provision of the Small Business Job Act Of 2010. More specifically, this account will track on a CPUC-jurisdictional, revenue requirement basis: (a) decreases in each covered utility's revenue requirement resulting from increases in its deferred tax reserve; and (b) other direct changes in revenue requirement resulting from each utility's taking advantage of the New Tax Laws. This resolution also authorizes any covered utility that wishes to use savings from these new tax laws to invest in additional, needed utility infrastructure, not otherwise funded in rates, within a time frame shorter than would be practicable through the formal application process, to file a Tier 3 advice letter requesting establishment of a separate memorandum account into which to record the revenue requirement associated with such additional capital investment.
The establishment of a memorandum account does not change rates, nor guarantee that rates will be changed in the future. This mechanism simply allows the Commission to determine at a future date whether rates should be changed, without having to concern itself with issues of retroactive ratemaking.

BACKGROUND

On December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 ("Tax Relief Act"). It has come to the attention of the Commission that this law may provide tax relief to the utilities regulated by this Commission. Provisions in the Tax Relief Act may reduce the utilities' costs of providing service. Many of the utilities regulated by this Commission have their rates set on a cost-of-service basis. These utilities include, without limitation: water and sewer system corporations, small local exchange carrier telephone corporations, gas and electrical corporations, pipeline corporations, and heat corporations.

Among, other provisions, the Tax Relief Act provides for 100% bonus depreciation on certain business property put into service after September 8, 2010 and before January 1, 2012. The Tax Relief Act also provides for 50% bonus depreciation for property placed into service thereafter and before January 1, 2013 and for property placed into service in 2013 where construction begins prior to January 1, 2013.

Consistent with the Internal Revenue Code, the Commission's ratemaking procedures do not reflect in rates the full reduction in tax expense in the year in which accelerated depreciation is taken for tax purposes. Rather, rates are set as if depreciation for tax purposes were being calculated on the straight line method over the projected life of the asset (the same depreciation method used for setting rates). Thus, the utility collects in rates taxes that will not need to be paid until a later time, if at all.[1] Nevertheless, ratepayers do get a benefit from the accelerated depreciation. This is accomplished through "normalization" and the use of a "deferred tax reserve". The deferred tax reserve for any particular asset reflects the amount of depreciation taken for tax purposes that exceeds the amount used in setting rates. This difference is then multiplied by a tax rate to yield the amount of deferred tax reserve. Thus, for example, assume a utility puts into service a new capital asset costing $100,000 with a 10 year service life and takes 100% bonus depreciation and the federal tax rate is 40%, the corresponding deferred federal tax reserve at the end of a year will be $36,000 (i.e. the $100,000 depreciation taken for tax purposes, minus the $10,000 taken for ratemaking purposes times 40%.) The combined deferred tax reserve on all of the utility's assets is, in turn, deducted from rate base in calculating the utility's revenue requirement, thus reducing rates.

However, the general rates of cost-of-service utilities are typically reviewed only once every three years. When they are reviewed, the actual amount of the deferred tax reserve is generally reflected in setting new rates. Unless a utility's rates are adjusted for the

[1] See *City of Los Angeles v. Public Utilities Commission*, 15 Cal. 3d 680, 686 (1975) (for an enterprise that is either expanding or stable, accelerated depreciation does not merely defer taxes, but eliminates them entirely).

SB_GT&S_0237314

years between general rates cases (GRCs) in a way that takes account of the actual amount of the deferred tax reserve, the increase in the deferred tax reserve caused by the Tax Relief Act would not be reflected in rates until the rates set in the utility's next GRC take effect. Because the Tax Relief Act provides for 100% bonus depreciation on qualifying assets put into service after September 8, 2010 and before January 1, 2012 (with 50% bonus depreciation thereafter), and because it may be some time before all of the cost-of-service rate-regulated utilities have their rates adjusted to reflect the amounts actually recorded in their deferred tax reserves, there could be substantial amounts in deferred tax reserves that do not get reflected in rates unless the Commission takes action.

In comments on drafts of this resolution, the Utility Reform Network (TURN) requested that the scope of the resolution be broadened to cover the effects of the Small Business Job Act of 2010 (Small Business Act), HR 5297,signed on September 27, 2010. TURN noted that the Small Business Act authorized 50% bonus depreciation for certain property placed into service during 2010, thus having an impact on deferred tax reserves like that of the Tax Relief Act. Even though the Small Business Act does not impact property placed into service during 2011, the deferred tax reserves resulting from the bonus depreciation provision of the Small Business Act continue into 2011 and beyond. Accordingly, we will broaden the scope of this resolution to include both the effects of the Tax Relief Act and the bonus depreciation provision of the Small Business Act, which we will collectively refer to as the "New Tax Laws".

DISCUSSION

The purpose of this resolution:

The purpose of this resolution is to preserve the opportunity for the Commission to decide at a future date whether some of the impacts of the New Tax Laws, not otherwise reflected in rates, ought to be reflected in future rates, without having to be concerned with issues of retroactive ratemaking.

When a utility begins to experience a large and unexpected increase in costs, it sometimes requests authority from the Commission to establish a memorandum account. As we said in D10-04-031.

> A memorandum account allows a utility to track costs arising from events that were not reasonably foreseen in the utility's last general rate case. By tracking these costs in a memorandum account, a utility preserves the opportunity to seek recovery of these costs at a later date without raising retroactive ratemaking issues. However, when the Commission authorizes a memorandum account, it has not yet

SB_GT&S_0237315

determined whether recovery of booked costs is appropriate, unless so specified.

Here we face the possibility of large and unexpected *decreases* in tax expense. Due to the timing of rate cases, benefits of the tax decrease may not accrue to ratepayers in the same way they would if the tax decrease had been expected. We wish to preserve the opportunity to consider whether some or all of the tax impacts not otherwise reflected in rates should benefit ratepayers, without having to face issues of retroactive ratemaking.

At the same time, we recognize that taking bonus depreciation under the New Tax Laws may have impacts on components of a utility's revenue requirement other than the deferred tax reserve. In particular, there is likely to be an impact on (i) working cash calculations, and there may be (ii) a reduction in, or elimination of, the Section 199 deduction available due to taking bonus depreciation, and (iii) impacts involving contributions-in-aid-of-construction (CIAC). Other impacts are also possible. Some of these impacts result in revenue requirement increases primarily in the year(s) in which bonus depreciation is taken, while the revenue requirement reduction resulting from the increase in the deferred tax reserve is spread over a longer period. Thus, although the overall revenue requirement impact of taking bonus depreciation benefits ratepayers, the revenue requirement impact in the years in which bonus depreciation is taken may actually be a revenue requirement increase.[2]

The approach the Commission should adopt to achieve this purpose:

The Original Draft Resolution[3] proposed to accomplish the above purpose by making the rates of all cost-of-service rate regulated utilities subject to refund for the limited purpose of allowing ratepayers to benefit, to the extent, if any, the Commission finds reasonable, from tax benefits resulting from the Tax Relief Act.

In their comments and discussions with Commission staff, the utilities pointed out several disadvantages of this approach, primarily the uncertainty created by the "subject to refund" language. The utilities noted that the purpose of the bonus depreciation provisions of the New Tax Laws is to encourage additional capital investment, thereby stimulating employment and the economy. The utilities could use tax savings realized under the New Tax Laws to fund additional, needed utility infrastructure investment not otherwise funded by rates. This may be an opportune time to increase capital investment,

[2] This point was illustrated by figures provided by Southern California Edison (SCE) in its comments on the Second Draft Resolution. Three different versions of this resolution have been issued for public comment. The Original Draft Resolution bore the number Resolution W-4867 and was issued for comment on December 30, 2010. A substantially revised Second Draft Resolution was issued for comment on February 7, 2011, and then re-numbered as Resolution L-411. A Third Draft Resolution was issued for comment on February 25, 2011.

[3] See immediately preceding footnote.

SB_GT&S_0237316

given decreases in construction costs and the availability of bonus depreciation for plant put into service before 2013. At least some of the utilities intend to use tax savings from the New Tax Laws to fund additional, needed utility infrastructure investment. However, the utilities informed staff that they would be reluctant to do so if some unknown amount of the tax savings were instead needed to fund rate reductions.

In light of these factors, this resolution has been revised to eliminate the subject to refund language. Instead, this resolution uses a memorandum account to track the various benefits and costs of the New Tax Laws. This approach still permits the Commission to determine at a later date whether some of the impacts of the New Tax Laws should be reflected in rates, without having to be concerned about retroactive ratemaking issues. However, this approach replaces the uncertainty of "subject to refund" language with specific calculations that will be contained in a memorandum account. As a result, this resolution should not impede the capital investment that the New Tax Laws are intended to encourage.

The second and third drafts of this resolution attempted to accommodate the desire of some utilities to use the tax savings realized under the New Tax Laws to fund additional, needed utility infrastructure investment not otherwise funded in rates, by allowing the revenue requirement impacts of such additional investment enabled by the bonus depreciation provisions of the New Tax Laws to be booked as an offset to the memorandum account. This resolution no longer authorizes such an offset. Instead, it provides a different mechanism to allow utilities to make timely additional, needed utility infrastructure investments with the tax savings realized from the New Tax Laws.

There are several reasons why we are no longer allowing an offset to the memorandum account created by this resolution for needed utility infrastructure investment not otherwise funded in rates. First, provision of such an offset unduly complicated the creation and terms of the memorandum account. Second, provision of such an offset would allow utilities to recover costs for infrastructure investment without any preliminary Commission review of the scope and kind of investments that might be made. Other changes we are making to the resolution would exacerbate this problem.

SCE has demonstrated that some utilities may well have a revenue requirement increase due to the New Tax Laws during 2011, while the revenue requirement decreases will be fully reflected in rates for their 2012 GRC test years and the years thereafter.[4] In response to this showing, we believe that fairness requires that we allow the memorandum account to be a two-way memorandum account to reflect both revenue requirement decreases and revenue requirement increases flowing directly from the New

[4] In this regard, we note that an explanation of the circumstances under which the memorandum account might contain a revenue requirement increase was much more persuasive than abstract arguments for a two-way account.

SB_GT&S_0237317

Tax Laws. However, allowing a two-way memorandum account in which utilities could book the revenue requirement associated with additional, needed utility infrastructure enabled by the bonus depreciation provisions of the New Tax Laws, could allow even larger, unidentified, and unreviewed additional capital investments to be made, and their costs recovered from ratepayers (subject only to after-the-fact reasonableness review).[5]

For the foregoing reasons we are eliminating any offset to the memorandum account to track the revenue requirement associated with additional utility infrastructure investment. Instead, there will be two ways in which utilities that wish to invest the tax savings from the New Tax Laws in additional, needed utility infrastructure investment can proceed. In general, we prefer that large utility infrastructure investment programs be presented to the Commission by means of an application, which allows a full, advance review by the Commission of such a program. However, there are several factors relating to the New Tax Laws that may make the use of an application a less than optimum approach. First, in order to qualify for bonus depreciation, construction will have to commence before the end of 2012 and be completed by the end of 2013. Second, construction costs may be lower now and a key purpose of the New Tax Laws is to encourage additional investment and thereby employment. Accordingly, if a utility for which this resolution establishes a memorandum account wishes to use savings from the New Tax Laws to invest in additional, needed utility infrastructure, not otherwise funded in rates, within a time frame shorter than would be practicable by filing an application, the utility may file a Tier 3 advice letter requesting the creation of a memorandum account into which to record the revenue requirement associated with such additional capital investment. In this advice letter the utility should explain, in addition to any other relevant points: (i) why the additional revenue requirement should be recorded in a memorandum account, rather than awaiting the approval of an application; (ii) the kinds of investments it intends to make and why those investments should be made promptly; (iii) the amount of additional investments it intends to make and the impact that will have on its revenue requirement; and (iv) how this proposed investment will in fact be funded with money made available by the bonus depreciation provisions of the New Tax Laws or money that otherwise might be refunded to ratepayers by means of the memorandum account created by this resolution.

Which utilities should be exempt from having memorandum accounts:

In general, it is appropriate to establish this kind of a memorandum account for all utilities that have their rates set on a cost of service. As noted above, these generally include water and sewer system corporations, small local exchange carrier telephone corporations, gas and electrical corporations, pipeline corporations, and heat

[5] Under a two-way memorandum account, the amount of additional investment revenue requirement that could thus be recovered would no longer be limited to the amount of revenue requirement savings during the period covered by the memorandum account.

corporations. However, we conclude that Class C and D water and sewer corporations should be exempt from this memorandum account requirement. There are two main considerations underlying this conclusion. First, many of these utilities have their rates set using a "rate of margin" (ROM), rather than a rate of return. Because rate of return is not a factor in setting the rates of these ROM utilities, their rates do not change when there is change in rate base. Similarly, a deduction of a deferred tax reserve from rate base would likewise have no impact on rates. Indeed, most of the items that would be tracked in the memorandum account are not relevant to these ROM utilities. Second, Class C and D water and sewer utilities are very small utilities for whom the administrative burden of keeping track of the necessary accounting entries would be an excessive burden, even for those whose rates are set on a rate-of-return basis.

In comments on the Second Draft Resolution, Mountain Utilities requested that it be exempted from the memorandum account requirement. Mountain Utilities is organized for the purpose of providing sole-source generation, distribution, and sale of electricity exclusively to a customer base of fewer than 2,000 customers and therefore is an "electric microutility" pursuant to Public Utilities (PU) Code section 2780.[6] More specifically, Mountain Utilities serves approximately 700 customers. Thus, it is similar in size to a Class C water utility (which has between 500 and 2,000 service connections). Also, like a Class C water utility, the administrative burden of keeping track of the necessary accounting entries would likely be excessive. Accordingly, we will exempt Mountain Utilities from the requirement to establish a memorandum account. We note that section 2780.1 does not technically apply here (because this is not *hearing* in a proceeding to which Mountain Utilities is a *respondent*), nevertheless the principle behind that section (namely not to impose unnecessary regulatory costs on a microutility) is relevant here.

In comments on the Second Draft Resolution, NRG Energy Center San Francisco LLC (NRG Energy Center) also requested an exemption from the memorandum account requirement. The rates of NRG Energy Center are not currently set using a rate of return. Furthermore, it does not currently have regular general rate cases, indeed it has not had one for many years. Accordingly, NRG Energy Center should also be exempted from the memo account requirement.

Some utilities with 2012 test year GRCs argue that they should be exempted from the memorandum account requirement. In support of this argument they point out that the Tax Relief Act will not have any effect on their cash flow until late 2011. However, these utilities' rates are set on an accrual, not a cash, basis, and the benefits of the Tax Relief Act have already begun accruing or will accrue later during 2011[7]. Because this

[6] All section references are to the California Public Utilities Code unless noted otherwise.

[7] In their comments on the Third Draft Resolution, the Sempra Utilities argue that they have not yet begun to accrue any deferred income tax liabilities because they have also created an offsetting income tax receivable. By referencing the possibility that the tax benefits may begin to accrue sometime during 2011, we do not agree, or disagree, with this contention of the Sempra Utilities. We only note that even

SB_GT&S_0237319

exemption request would prevent ratepayers from sharing in the benefits of the New Tax Laws that accrue during the remainder of 2011, we deny this request for exemption.

The details of the memorandum account:

This resolution will establish for each cost-of-service rate-regulated utility, except for Class C and D water and sewer utilities, and except for Mountain Utilities and NRG Energy Center, (collectively the Covered Utilities) a memorandum account to reflect, on a CPUC-jurisdictional, revenue requirement basis, impacts from the New Tax Laws.

The memorandum account will be used to determine whether any future rate changes are appropriate to reflect impacts of the New Tax Laws for the period from the date of this resolution until the effective date of revenue requirement changes in each Covered Utility's next GRC ("Memo Account Period"). The memorandum account will be used by each Covered Utility to track the revenue requirement impacts of the New Tax Laws during the Memo Account Period, reflecting on a CPUC-jurisdictional, revenue requirement basis the effects of the New Tax Laws not otherwise reflected in rates. In determining an appropriate revenue requirement adjustment, if any, for the Memo Account Period, the Commission will take into account, and each Covered Utility will record:[8] (a) decreases in its revenue requirement resulting from increases in its deferred tax reserve; and (b) other direct changes in revenue requirement resulting from each utility's taking advantage of the New Tax Laws. In their comments on the drafts of this resolution, the utilities have established that, depending on the utility involved, there may be impacts from a decrease in, or elimination of, the Section 199 deduction resulting from bonus depreciation taken, changes in working cash, and, for energy utilities, changes in CIAC calculations. Other impacts may be possible.

In each Covered Utility's next GRC, or at such other time as ordered in that GRC decision, the Commission will address the disposition of amounts (a) recorded in the memorandum account and (b) forecast for the remainder of the Memo Account Period, and may reflect any net revenue requirement change in prospective rates.

This memorandum account will be a two-way memorandum account, i.e., it will be available for the Commission to consider whether utility rates should be reduced or increased to reflect the tax impacts of the New Tax Laws during the Memo Account Period

---

under their view of the tax impacts, benefits will begin to accure "sometime in 2011." (Sempra Utilities Comments, March 4, 2011, p. 5.)

[8] Although this resolution refers to amounts "recorded" in the memorandum account, because this is a memorandum account, and not a balancing account, the amounts tracked or recorded in the memorandum account are not recorded in the utilities' financial statements, e.g., in the balance sheet.

SB_GT&S_0237320

The following paragraphs describe in further detail some of the wording we have used above in describing the memorandum account.

Amounts in the memorandum account will be recorded on a "revenue requirement basis." This means that each utility will be tracking the revenue requirement impact of each change resulting from the New Tax Laws. This is important, because, consistent with the Internal Revenue Code, the tax savings from accelerated depreciation are not passed through directly to ratepayers, but instead, as explained above, ratepayers benefit through the process of normalization and the creation of a deferred tax reserve that is deducted from rate base. We also ensure that all amounts recorded in the memorandum account will be recorded on a consistent basis by requiring that they all be recorded on a revenue requirement basis.

We refer to amounts not otherwise reflected (or recovered) in rates. We use this terminology to exclude costs and expenses recovered through previously authorized rates, e.g., rates set in a prior GRC. We also use it to exclude costs or expenses recovered through rates set after the date of this resolution, e.g., through a balancing account or another memorandum account, or a formal proceeding prior to the utility's next GRC.

In their comments on the Original Draft Resolution, the energy utilities pointed out that the bonus depreciation afforded by the New Tax Laws will decrease their taxable income, and therefore may decrease, or eliminate, the Internal Revenue Code Section 199 Manufacturer's tax deduction that they are entitled to, which is already reflected in their revenue requirements. The utilities also pointed out that the New Tax Laws will have impacts on their working cash, an item that is a component of their rate base and therefore also reflected in their revenue requirements. We agree that each of these items can properly be reflected in the memorandum account. The energy utilities also argued that the New Tax Laws will impact their CIAC (contributions-in-aid-of-construction) revenues. Energy utilities are taxed on plant contributed by others, such as real estate developers. Accordingly, when such entities contribute plant to the utility they must also contribute an amount to cover the tax impacts (the tax component of CIAC). We agree that the New Tax Laws are likely to have a revenue requirement impact relating to energy utility CIAC. The energy utilities are authorized to include these CIAC impacts in their memorandum accounts on a revenue requirement basis and consistent with any requirements of the Internal Revenue Code.

In its comments on the Second Draft Resolution, CWA raised concerns about how the requirement to establish the memorandum account will apply to multi-district water utilities. Accordingly, we provide the following guidance here. Each district whose rates are separately set will need a separate memorandum account, with a separate Memo Account Period. However, only those districts that have plant placed into service and benefiting from bonus depreciation before their next GRC will need to record any entries in their memorandum accounts. Where plant benefits more than one district, the revenue

SB_GT&S_0237321

requirement impacts shall be proportionally allocated among districts according to previously adopted methodologies, according to benefit received, or as determined in the next GRC.

In its comments on the Second Draft Resolution, Southern California Edison (SCE), suggested that the memorandum account should include "all other changes to SCE's 2011 cost of service due to the New Tax Law". All direct changes in revenue requirement resulting from a utility's taking advantage of the New Tax Laws may be reflected in that utility's memorandum account, whether or not they are specifically mentioned in this resolution. . The specific categories of revenue requirement impact that each utility wishes to include in its memorandum account should be spelled out in the advice letter it files pursuant to this resolution. For kinds of revenue requirement impact not specifically mentioned in this resolution, the utility will need to provide some justification in its advice letter. The utilities are encouraged to discuss with staff, prior to filing their advice letters, the appropriateness of including kinds of revenue requirement impacts not mentioned in this resolution

What it means when we establish a memorandum account:

The establishment of a memorandum account does not change rates, nor guarantee that rates will be changed in the future. This mechanism simply allows the Commission to determine at a future date whether rates should be changed, without the impediment of claims of retroactive ratemaking. Thus, all we are determining here is that it may be desirable to adjust the rates of the Covered Utilities to more fully reflect the tax impacts, if any, that these utilities realize from the New Tax Laws, while avoiding any issue of retroactive ratemaking.

When advice letters should be filed:

It will be necessary for the Covered Utilities to file advice letters to incorporate the memorandum account into their tariffs. Rather than requiring each of the Covered Utilities to quickly file such advice letters, we will instead require only the four major energy utilities to file such advice letters within 30 days. Any other Covered Utility may also file such an advice letter within 30 days of the date of this resolution. In addition, any entity that has filed comments on any draft of this resolution may, within 30 days, submit to the Legal Division suggested memorandum account language that would apply to any group of utilities. This should provide a more efficient means for Commission staff to review language that should apply to a class of utilities. However, as requested in the comments of the California Water Association on the Second Draft Resolution, these 30 day periods will be extended to 60 days for Class A and B water utilities.[9] In each

[9] We grant this extension to the water utilities, and not other utilities, as only the water utilities requested it; although we have extended the time for other utilities to file from 15 to 30 days. Furthermore, many of the water utilities have to deal with the additional complexity of multiple districts whose rates are

SB_GT&S_0237322

case, the proposed tariff language should describe in detail the kinds of impacts that are to be entered into the memorandum account. After consideration of the language submitted by means of advice letters and any suggestions made to the Legal Division, the Commission's Staff will provide appropriate memorandum account language to each Covered Utility that did not initially file an advice letter. Each of those utilities will then need to file an advice letter incorporating that language within 15 days after Staff sends the memorandum account language. This will result in some delay before advice letters are approved for all of the Covered Utilities. However, this should not be problematic because the memorandum accounts are effective for all Covered Utilities as of the date of this resolution.

COMMENTS ON DRAFT RESOLUTION

The Original Draft Resolution

Public Utilities Code section 311(g)(1) generally requires draft resolutions to be issued for comment at least 30 days before being voted on by the Commission. However, pursuant to Public Utilities Code section 311(g)(3), the Commission has adopted Rule 14.6(c)(9) of its Rules of Practice and Procedure which permitted a reduction in the comment period here. More specifically, Rule 14.6(c)(9) permits the Commission to reduce the 30-day period for public review and comment in circumstances where the public interest in the Commission adopting a resolution before expiration of the 30-day review and comment period clearly outweighs the public interest in having the full 30-day period for review and comment. This resolution does not change utility rates, nor determine that utility rates ought to be changed. It only permits the Commission to consider those issues at a future date, while avoiding retroactive ratemaking concerns. On the other hand, delaying issuance of this resolution to allow for the full 30-day comment period might extend the period of time during which retroactive ratemaking could be a concern. Accordingly, the public interest in adopting this resolution before expiration of a 30 day public comment period clearly outweighs the public interest in allowing for the full 30 day comment period. Accordingly, the Original Draft Resolution was issued for comment on December 30, 2010, served on all persons on the service list attached to it. Consistent with Rule 14.6(c)(9), there was a reduced comment period with comments due on January 7, 2011.

---

separately set. We also note that the major energy utilities have been engaged in on-going discussions with Commission staff concerning the memorandum account and its contents, while the water utilities have not yet had such extensive discussions with Staff. However, we find one of the reasons advanced by CWA for granting a longer time to prepare tariff language unpersuasive. CWA argued that the utilities need time "to respond to the yet-to-be-published guidance from the federal government to assist taxpayers in applying the New Tax Law." We note that such guidance may be necessary in order to properly record amounts in the memorandum account, but it should not be necessary in order to devise tariff language to implement this resolution.

Comments were submitted by Pacific Gas and Electric (PG&E), TURN, SCE, the California Water Association (CWA), the City of Visalia, jointly by Southern California Gas (SoCal Gas) and San Diego Gas and Electric (SDG&E) (collectively the "Sempra Utilities") and collectively by the small local exchange carriers, (the "Small LECs"). Most of these comments have been addressed above, or rendered irrelevant in light of our elimination of the "subject to refund" language.

The Second Draft Resolution

In light of the major changes made, a Second Draft Resolution was issued for public comment on February 7, 2011, although an additional comment period was not legally required. The Second Draft Resolution was served on all persons served with the Original Draft Resolution. Comments were due by 10 a.m. on February 14, 2011. Comments were received from PG&E, TURN, SCE, CWA, the Sempra Utilities, the Small LECs, Mountain Utilities, NRG Energy Center, and PacifiCorp.

The Third Draft Resolution

A Third Draft of this Resolution was issued for public comment on February 25, 2011, although an additional comment period was not legally required. Comments were limited to language not included in the Second Draft Resolution and were due by Friday, March 4, 2011. Comments were received from PG&E, SCE, CWA, the Sempra Utilities, and the Small LECs.

Given that there have now been three separate opportunities to comment on drafts of this resolution, the public interest in having an opportunity to comment on the draft resolution has been amply respected.

Additional Responses to Comments

There are a number of comments, not addressed above, that we wish to address here.

There were comments to the effect that the Commission had not previously taken action to reduce rates when the Internal Revenue Code was revised to provide for bonus depreciation. We note that utilities often request memo accounts for unexpected increases in expenses between GRCs. These requests, and the resulting memorandum accounts, typically do not include any possibility of decreasing rates. Rather, they allow for the possibility that rates may increase or stay the same. Utilities do not come to us requesting memorandum accounts or rate decreases when there has been a large and unexpected decrease in expenses between rate cases. We believe that an even-handed approach to regulation requires us to consider, when there has been a large and unexpected decrease in expenses between rate cases, whether it is appropriate to establish a memorandum account to allow for a future decrease in rates. For the reasons noted

above, this memorandum account will also allow for a future increase in rates where the direct revenue requirement impact of the New Tax Laws during the Memo Account Period is an increase in revenue requirement.

In comments on the Original Draft Resolution, there was some concern expressed about a need to recalculate the entirety of the utilities' deferred tax reserve. However, there is no need to do so. The bonus depreciation provisions of the New Tax Laws only apply to property placed into service beginning with the 2010 Tax Year. Therefore, only the increase in deferred tax reserve resulting from property placed into service beginning January 1, 2010 needs to be calculated.

In its comments on the Second Draft Resolution, SCE suggested that the revenue requirement impacts to be recorded in its memorandum account should be based on its "2011 weighted average Commission-jurisdictional rate base". We agree that only CPUC-jurisdictional impacts should be tracked. Based on its comments on the Third Draft Resolution, it appears that SCE is proposing to determine the revenue requirement impacts based on the forecast amount of plant in service during 2011 to be adopted in its 2012 GRC. While this would avoid the difficult task of determining an amount of 2011 plant in service contemplated by its 2009 GRC, it is not clear what the effects of using this particular methodology would be. Accordingly, this issue will need to be addressed in SCE's GRC (or perhaps when SCE files tariff language). In either event, SCE will need to address the impact of adopting this methodology, as opposed to other possible methodologies, in detail at that time.[10]

In their comments on the Second Draft Resolution, the small LECs argue that the resolution tries to justify impermissible retroactive ratemaking. It does not do so. Although the memorandum account tracks the revenue requirement effects of property placed into service during and after the 2010 tax year, it tracks only those revenue requirement effects occurring after the date of the resolution. Therefore the effect of the resolution is entirely prospective.

In its comments on the Second Draft Resolution, PacifiCorp requests that the Commission allow flexibility so that the Commission can consider other important factors not addressed in the draft resolution, such as a covered utility's financial health, in

[10] In its comments on the Second and Third Draft Resolutions, SCE also requests to use its 2012 Test Year Results of Operations (RO) Model submitted in its pending GRC, to calculate the amounts to be entered into the memorandum account. As a general matter, it would seem appropriate to use an RO model to calculate revenue requirement impacts. However, this particular RO Model has not yet been fully vetted in the current GRC.

In their comments on the Third Draft Resolution, the Sempra Utilities refer to SCE's proposed proxy and argue that different utilities may need to use different proxies for calculating 2011 plant in service where there has been no express figure adopted for the utility. We agree that the appropriate proxy to be used by each utility that needs one is not a matter that should be determined on a generic basis at this time.

SB_GT&S_0237325

determining whether any balance in the memorandum account should benefit ratepayers. While we do not include in the Ordering Paragraphs the specific language that PacifiCorp has requested, we do agree with PacifiCorp that it, and other utilities, may present to the Commission whatever factors they believe are relevant to the Commission's ultimate decision as to what, if anything, to do with any balance in the memorandum account that is available to benefit ratepayers. In this connection, we note that this resolution creates a memorandum account, and not a balancing account. As noted above, this resolution does not change utility rates, nor determine that utility rates ought to be changed. It only permits the Commission to consider those issues at a future date, while avoiding retroactive ratemaking concerns.

In its comments on the Second Draft Resolution, TURN requests that we return to the "subject to refund" approach of the Original Draft Resolution, and that we require advance review of additional capital investments, rather than relying on after-the-fact reasonableness review. We have explained above why we are adopting a memorandum account, rather than the subject-to-refund approach. A key consideration in that regard is that the subject-to-refund approach would likely deter the utilities from increasing capital spending, while the New Tax Laws were intended to stimulate additional capital spending in the short term. For the reasons explained above, we are no longer allowing the revenue requirement associated with additional utility infrastructure investment to be recorded in the memorandum account required by this resolution. On the other hand, we will be allowing covered utilities to file advice letters for separate memorandum accounts if they can demonstrate a need to use the tax savings generated by the New Tax Laws for additional utility infrastructure investment before it is feasible to process a formal application. This will require more of an advance showing before utilities are allowed to recover the costs of additional infrastructure investment in memorandum accounts, and will also require the filing of a formal application where that is feasible. The use of advice letters to request such additional memorandum accounts should avoid our interfering with the goal of the New Tax Laws to promptly stimulate the economy.

PG&E argues that the revenue requirement impacts of the bonus depreciation provision of the Small Business Act, from and after the date of this resolution, should not be included in this resolution because PG&E cannot now adequately reflect those impacts in its "future spending and budget process" (PG&E's comments on the Third Draft Resolution, March 4, 2011, at page 4). In making this argument, PG&E stresses that the Small Business Act only impacted property placed into service during 2010, while ignoring the fact that the Small Business Act was not enacted until September 27, 2010, late in the year and less than three months before the Tax Relief Act was enacted. Thus, there has been little time during which the impacts of the Small Business Act might have affected PG&E's capital planning. Furthermore, this resolution authorizes PG&E to seek recovery, through a separate memorandum account, of increases to its revenue requirement resulting from additional, needed utility infrastructure investment using funds made available by the bonus depreciation provision of the Small Business Act.

Accordingly, we conclude that inclusion of the impacts of the Small Business Act in the memorandum account established by this resolution (i) should not unduly interfere with PG&E's spending and budget process, and (ii) does not preclude PG&E from seeking recovery of the revenue requirement associated with additional capital expenditures made possible by the bonus depreciation provisions of the Small Business Act. Therefore, we are not removing the Small Business Act from the scope of this resolution.

FINDINGS AND CONCLUSIONS

1. President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 ("Tax Relief Act") on December 17, 2010.
2. The Tax Relief Act may provide tax relief to the utilities regulated by this Commission. Among other provisions, this law provides for 100% bonus depreciation on certain business property put into service after September 8, 2010 and before January 1, 2012, with 50% bonus depreciation for at least a year thereafter. .
3. President Obama signed the Small Business Job Act of 2010 (Small Business Act), on September 27, 2010, which authorized 50% bonus depreciation for certain property placed into service during 2010.
4. This resolution refers to the Tax Relief Act together with the bonus depreciation provision of the Small Business Act as the "New Tax Laws".
5. The benefits of bonus or accelerated depreciation are generally reflected in rates through "normalization" and the use of a deferred tax reserve.
6. While existing ratemaking mechanisms likely will result in ratepayers benefiting from a portion of the tax benefits utilities receive under the New Tax Laws, it is not clear that all of the tax benefits resulting from these new laws will have an impact on rates under current mechanisms, because the general rates of utilities are typically reviewed only once every three years.
7. The Commission should allow for the possibility of revising the rates of the utilities whose rates are set on a cost-of-service basis, so that some or all of the benefits of the New Tax Laws not otherwise reflected in rates may accrue to ratepayers, while avoiding issues of retroactive ratemaking.
8. Because the immediate impacts of the New Tax Laws on some utilities may be a revenue requirement increase, the Commission should also allow for the possibility of increasing utility rates to reflect the impacts of the New Tax Laws not otherwise reflected in rates, while avoiding issues of retroactive ratemaking.
9. The appropriate method for preserving the opportunity to consider, at a later time, whether some or all of the impacts of the New Tax Laws not otherwise reflected in rates should be reflected in rates is to establish a memorandum account.

SB_GT&S_0237327

10. The memorandum account should reflect not only the tax benefits of the New Tax Laws, but other direct changes in revenue requirement resulting from each utility's taking advantage of the New Tax Laws. Such changes may include, but are not limited to, impacts on Section 199 deductions, working cash, and contributions in aid of construction. ..
11. An even-handed approach to regulation requires the Commission to consider, when there has been a large and unexpected decrease in expenses between rate cases, to consider establishing a memorandum account to allow for a future decrease in rates. It also requires the Commission to consider whether a two-way memorandum account should be authorized where the expected impacts may be both revenue requirement decreases and revenue requirement increases.
12. Many Class C and D water and sewer utilities have their rates set based on a Rate of Margin basis, rather than a rate-of-return basis, such that rate base, and therefore deferred tax reserve, do not have an impact on rates.
13. Class C and D water and sewer utilities are very small utilities for whom the administrative burden of keeping track of the necessary accounting entries would be an excessive burden, even if their rates are set on a rate-of-return basis.
14. Class C and D water and sewer utilities should be exempted from the establishment of this memorandum account.
15. Mountain Utilities should be exempted from the establishment of this memorandum account because it is also a very small utility.
16. NRG Energy Center San Francisco LLC should be exempted from the establishment of this memorandum account because its rates are not currently set on a rate-of-return basis and because it does not have regularly scheduled General Rate Cases.
17. This resolution does not change utility rates, nor determine that utility rates ought to be changed. It only permits the Commission to consider, at a future date, the issue of whether utility rates should be changed as a result of the New Tax Laws, while avoiding retroactive ratemaking concerns.
18. Delaying issuance of this resolution to allow for a full 30-day comment period might extend the time during which retroactive ratemaking could be a concern.
19. The public interest in adopting this resolution before expiration of a 30 day public comment period clearly outweighs the public interest in allowing for the full 30 day comment period.
20. Although the memorandum account tracks the revenue requirement effects of property placed into service during and after the 2010 tax year, it tracks only those revenue requirement effects occurring after the date of the resolution. Therefore the effect of this resolution is entirely prospective.

SB_GT&S_0237328

ORDER

1. There is hereby established for each cost-of-service rate-regulated utility, with the exception of Class C and D water and sewer utilities, and with the exception of Mountain Utilities and of NRG Energy Center San Francisco LLC, (collectively the Covered Utilities) a memorandum account to reflect, on a CPUC-jurisdictional, revenue requirement basis, impacts from the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 and the bonus depreciation provision of the Small Business Job Act of 2010 (collectively "The New Tax Laws").
2. This memorandum account shall track on a CPUC-jurisdictional, revenue requirement basis the impacts of the New Tax Laws not otherwise reflected in rates during the period starting on the date of this resolution until the effective date of revenue requirement changes in each Covered Utility's next General Rate Case ("Memo Account Period"). Each Covered Utility shall record in this memorandum account: (a) decreases in its revenue requirement resulting from increases in its deferred tax reserve; (b) direct changes in revenue requirement resulting from each utility's taking advantage of the New Tax Laws..
3. This memorandum account shall be used in determining whether any future rate adjustment is appropriate to reflect impacts of the New Tax Laws during the Memo Account Period for each Covered Utility. .
4. In each Covered Utility's next General Rate Case (GRC), or at such other time as ordered in that GRC decision, the Commission shall address the disposition of amounts (a) recorded in the memorandum account and (b) forecast for the remainder of the Memo Account Period, and may reflect any net revenue requirement impact in prospective rates.
5. a. Within 30 days of the date of this resolution, Pacific Gas &Electric, Southern California Edison, Southern California Gas, and San Diego Gas & Electric shall, and any other Covered Utility may, file an advice letter to add a memorandum account to its tariffs consistent with the requirements of Ordering Paragraphs 1 and 2, above. The proposed tariff language shall describe in detail the kinds of revenue requirement impacts that are to be entered into the memorandum account. Class A and B water utilities may file these advice letters within 60 days of the date of this resolution, with a separate memorandum account for each district whose rates are separately set.

   b. Any utility that wants to include in its memorandum account impacts of the New Tax Laws not mentioned in this resolution should justify the inclusion of each such category of impacts in the advice letter filed pursuant to this Ordering Paragraph.
6. Within 30 days of the date of this resolution, any entity that has submitted comments on any draft of this resolution may submit to the Legal Division a draft of tariff language for any group of Covered Utilities that it thinks is appropriate to implement

SB_GT&S_0237329

Ordering Paragraphs 1, 2, and 3, above, except that proposed tariff language for water utilities may be submitted within 60 days of the date of this resolution.

7. After consideration of the advice letters and submissions made pursuant to Ordering Paragraphs 6 and 7 above, the Commission's Staff shall provide appropriate tariff language to implement Ordering Paragraphs 1 and 2, above, to each Covered Utility that did not file an advice letter pursuant to Ordering Paragraph 6 which that utility shall file within 15 days after Staff sends the tariff language.
8. All of the memorandum accounts established pursuant to this resolution shall be effective as of the date of this resolution.
9. The Legal Division shall serve a copy of this resolution, by mail or e-mail, on all cost-of-service rate-regulated utilities and any additional persons who submitted comments on the draft resolution.
10. Any Covered Utility that wishes to use savings from the New Tax Laws to invest in additional, needed utility infrastructure, not otherwise funded in rates, within a time frame shorter than would be practicable through the formal application process may file a Tier 3 advice letter requesting establishment of a separate memorandum account into which to record the revenue requirement associated with such additional capital investment. In this advice letter the utility should explain, in addition to any other relevant points: (i) why the additional revenue requirement should be recorded in a memorandum account, rather than awaiting the approval of an application; (ii) the kinds of investments it intends to make and why those investments should be made promptly; (iii) the amount of additional investments it intends to make and the impact that will have on its revenue requirement; and (iv) how this proposed investment will in fact be funded with money made available by the bonus depreciation provisions of the New Tax Laws or money that otherwise might be refunded to ratepayers by means of the memorandum account created by this resolution. .
11. The effective date of this order is today.

I certify that this Resolution was adopted by the California Public Utilities Commission at its regular meeting of March 10, 2011, and that the following Commissioners approved it:

PAUL CLANON
Executive Director

SB_GT&S_0237330

DRAFT **49 (10078)**
(Rev. 5)

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Legal Division

San Francisco, California
Date: March 10, 2011
Resolution No. L-411

RESOLUTION

RESOLUTION ON THE COMMISSION'S OWN MOTION ESTABLISHING A MEMORANDUM ACCOUNT FOR ALL COST-OF-SERVICE RATE-REGULATED UTILITIES, EXCEPT FOR CLASS C AND D WATER AND SEWER UTILITIES, MOUNTAIN UTILITIES, ALPINE NATURAL GAS, AND NRG ENERGY CENTER, TO ALLOW THE COMMISSION TO CONSIDER REVISING RATES TO REFLECT THE TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOB CREATION ACT OF 2010 AND THE BONUS DEPRECIATION PROVISION OF THE SMALL BUSINESS JOB ACT OF 2010

SUMMARY

This resolution establishes a two-way memorandum account for all cost-of-service rate regulated utilities, except for Class C and D water and sewer utilities, and except for Mountain Utilities, Alpine Natural Gas, and NRG Energy Center, to track the impacts of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 and the bonus depreciation provision of the Small Business Job Act of 2010. More specifically, this account will track on a CPUC-jurisdictional, revenue requirement basis: (a) decreases in each covered utility's revenue requirement resulting from increases in its deferred tax reserve; and (b) other direct changes in revenue requirement resulting from each utility's taking advantage of the New Tax Laws. This resolution also authorizes any covered utility that wishes to use savings from these new tax laws to invest in additional, needed utility infrastructure, not otherwise funded in rates, within a time frame shorter than would be practicable through the formal application process, to file an advice letter requesting establishment of a separate memorandum account into which to record the revenue requirement associated with such additional capital investment. The establishment of a memorandum account does not change rates, nor guarantee that rates will be changed in the future. This mechanism simply allows the Commission to determine at a future date whether rates should be changed, without having to be concerned with issues of retroactive ratemaking.

SB_GT&S_0237331

BACKGROUND

On December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 ("Tax Relief Act"). It has come to the attention of the Commission that this law may provide tax relief to the utilities regulated by this Commission. Provisions in the Tax Relief Act may reduce the utilities' costs of providing service. Many of the utilities regulated by this Commission have their rates set on a cost-of-service basis. These utilities include, without limitation: water and sewer system corporations, small local exchange carrier telephone corporations (small LECs), gas and electrical corporations, pipeline corporations, and heat corporations.

Among, other provisions, the Tax Relief Act provides for 100% bonus depreciation on certain business property put into service after September 8, 2010 and before January 1, 2012. The Tax Relief Act also provides for 50% bonus depreciation for property placed into service thereafter and before January 1, 2013 and for property placed into service in 2013 where construction begins prior to January 1, 2013.

Consistent with the Internal Revenue Code, the Commission's ratemaking procedures do not reflect in rates the full reduction in tax expense in the year in which accelerated depreciation is taken for tax purposes. Rather, rates are set as if depreciation for tax purposes were being calculated on the straight line method over the projected life of the asset (the same depreciation method used for setting rates). Thus, the utility collects in rates taxes that will not need to be paid until a later time, if at all.[1] Nevertheless, ratepayers do get a benefit from the accelerated depreciation. This is accomplished through "normalization" and the use of a "deferred tax reserve". The deferred tax reserve for any particular asset reflects the amount of depreciation taken for tax purposes that exceeds the amount used in setting rates. This difference is then multiplied by a tax rate to yield the amount of deferred tax reserve. Thus, for example, assume a utility puts into service a new capital asset costing $100,000 with a 10 year service life and takes 100% bonus depreciation and the federal tax rate is 40%, the corresponding deferred federal tax reserve at the end of a year will be $36,000 (i.e. the $100,000 depreciation taken for tax purposes, minus the $10,000 taken for ratemaking purposes times 40%.) The combined deferred tax reserve on all of the utility's assets is, in turn, deducted from rate base in calculating the utility's revenue requirement, thus reducing rates.

However, the general rates of cost-of-service utilities are typically reviewed only once every three years. When they are reviewed, the actual amount of the deferred tax reserve

[1] See *City of Los Angeles v. Public Utilities Commission*, 15 Cal. 3d 680, 686 (1975) (for an enterprise that is either expanding or stable, accelerated depreciation does not merely defer taxes, but eliminates them entirely).

SB_GT&S_0237332

is generally reflected in setting new rates. Unless a utility's rates are adjusted for the years between general rates cases (GRCs) in a way that takes account of the actual amount of the deferred tax reserve, the increase in the deferred tax reserve caused by the Tax Relief Act would not be reflected in rates until the rates set in the utility's next GRC take effect. Because the Tax Relief Act provides for 100% bonus depreciation on qualifying assets put into service after September 8, 2010 and before January 1, 2012 (with 50% bonus depreciation thereafter), and because it may be some time before all of the cost-of-service rate-regulated utilities have their rates adjusted to reflect the amounts actually recorded in their deferred tax reserves, there could be substantial amounts in deferred tax reserves that do not get reflected in rates unless the Commission takes action.

In comments on drafts of this resolution, the Utility Reform Network (TURN) requested that the scope of the resolution be broadened to cover the effects of the Small Business Job Act of 2010 (Small Business Act), HR 5297, signed on September 27, 2010. TURN noted that the Small Business Act authorized 50% bonus depreciation for certain property placed into service during 2010, thus having an impact on deferred tax reserves like that of the Tax Relief Act. Even though the Small Business Act does not impact property placed into service during 2011, the deferred tax reserves resulting from the bonus depreciation provision of the Small Business Act continue into 2011 and beyond. Accordingly, we will broaden the scope of this resolution to include both the effects of the Tax Relief Act and the bonus depreciation provision of the Small Business Act, which we will collectively refer to as the "New Tax Laws".

DISCUSSION

The purpose of this resolution:

The purpose of this resolution is to preserve the opportunity for the Commission to decide at a future date whether some of the impacts of the New Tax Laws, not otherwise reflected in rates, ought to be reflected in future rates, without having to be concerned with issues of retroactive ratemaking.

When a utility begins to experience a large and unexpected increase in costs, it sometimes requests authority from the Commission to establish a memorandum account. As we said in D10-04-031:

> A memorandum account allows a utility to track costs arising from events that were not reasonably foreseen in the utility's last general rate case. By tracking these costs in a memorandum account, a utility preserves the opportunity to seek recovery of these costs at a later date without raising

SB_GT&S_0237333

> retroactive ratemaking issues. However, when the Commission authorizes a memorandum account, it has not yet determined whether recovery of booked costs is appropriate, unless so specified.

Here we face the possibility of large and unexpected *decreases* in tax expense. Due to the timing of rate cases, benefits of the tax decrease may not accrue to ratepayers in the same way they would if the tax decrease had been expected. We wish to preserve the opportunity to consider whether some or all of the tax impacts not otherwise reflected in rates should benefit ratepayers, without having to face issues of retroactive ratemaking.

At the same time, we recognize that taking bonus depreciation under the New Tax Laws may have impacts on components of a utility's revenue requirement other than the deferred tax reserve. In particular, there is likely to be an impact on (i) working cash calculations, and there may be (ii) a reduction in, or elimination of, the Section 199 deduction available due to taking bonus depreciation, and (iii) impacts involving contributions-in-aid-of-construction (CIAC). Other impacts are also possible. Some of these impacts result in revenue requirement increases primarily in the year(s) in which bonus depreciation is taken, while the revenue requirement reduction resulting from the increase in the deferred tax reserve is spread over a longer period. Thus, although the overall revenue requirement impact of taking bonus depreciation benefits ratepayers, the revenue requirement impact in the years in which bonus depreciation is taken may actually be a revenue requirement increase.[2]

The approach the Commission should adopt to achieve this purpose:

The Original Draft Resolution[3] proposed to accomplish the above purpose by making the rates of all cost-of-service rate regulated utilities subject to refund for the limited purpose of allowing ratepayers to benefit, to the extent, if any, the Commission finds reasonable, from tax benefits resulting from the Tax Relief Act.

In their comments and discussions with Commission staff, the utilities pointed out several disadvantages of this approach, primarily the uncertainty created by the "subject to refund" language. The utilities noted that the purpose of the bonus depreciation provisions of the New Tax Laws is to encourage additional capital investment, thereby

[2] This point was illustrated by figures provided by Southern California Edison (SCE) in its comments on the Second Draft Resolution. Three different versions of this resolution have been issued for public comment. The Original Draft Resolution bore the number Resolution W-4867 and was issued for comment on December 30, 2010. A substantially revised Second Draft Resolution was issued for comment on February 7, 2011, and then re-numbered as Resolution L-411. A Third Draft Resolution was issued for comment on February 25, 2011.

[3] See immediately preceding footnote.

SB_GT&S_0237334

stimulating employment and the economy. The utilities could use tax savings realized under the New Tax Laws to fund additional, needed utility infrastructure investment not otherwise funded by rates. This may be an opportune time to increase capital investment, given decreases in construction costs and the availability of bonus depreciation for plant put into service before 2013. At least some of the utilities intend to use tax savings from the New Tax Laws to fund additional, needed utility infrastructure investment. However, the utilities informed staff that they would be reluctant to do so if some unknown amount of the tax savings were instead needed to fund rate reductions.

In light of these factors, this resolution has been revised to eliminate the subject to refund language. Instead, this resolution uses a memorandum account to track the various benefits and costs of the New Tax Laws. This approach still permits the Commission to determine at a later date whether some of the impacts of the New Tax Laws should be reflected in rates, without having to be concerned about retroactive ratemaking issues. However, this approach replaces the uncertainty of "subject to refund" language with specific calculations that will be contained in a memorandum account. As a result, this resolution should not impede the capital investment that the New Tax Laws are intended to encourage.

The second and third drafts of this resolution attempted to accommodate the desire of some utilities to use the tax savings realized under the New Tax Laws to fund additional, needed utility infrastructure investment not otherwise funded in rates, by allowing the revenue requirement impacts of such additional investment enabled by the bonus depreciation provisions of the New Tax Laws to be tracked as an offset to the memorandum account. This resolution no longer authorizes such an offset. Instead, it provides a different mechanism to allow utilities to make timely, additional, needed utility infrastructure investments with the tax savings realized from the New Tax Laws.

There are several reasons why we are no longer allowing an offset to the memorandum account created by this resolution for needed utility infrastructure investment not otherwise funded in rates. First, provision of such an offset unduly complicated the creation and terms of the memorandum account. Second, provision of such an offset would allow utilities to recover costs for infrastructure investment without any preliminary Commission review of the scope and kind of investments that might be made. Other changes we are making to the resolution would exacerbate this problem.

Southern California Edison (SCE) has demonstrated that it may well have a revenue requirement increase due to the New Tax Laws during 2011, while the revenue requirement decreases will be fully reflected in rates for their 2012 GRC test year and the years thereafter.[4] In response to this showing, we believe that fairness requires that we

[4] In this regard, we note that an explanation of the circumstances under which the memorandum account might contain a revenue requirement increase was much more persuasive than abstract arguments for a two-way account.

SB_GT&S_0237335

allow the memorandum account to be a two-way memorandum account to reflect both revenue requirement decreases and revenue requirement increases flowing directly from the New Tax Laws. However, allowing a two-way memorandum account in which utilities could book the revenue requirement associated with additional, needed utility infrastructure enabled by the bonus depreciation provisions of the New Tax Laws, could allow even larger, unidentified, and unreviewed additional capital investments to be made, and their costs recovered from ratepayers (subject only to after-the-fact reasonableness review).[5]

For the foregoing reasons we are eliminating any offset to the memorandum account to track the revenue requirement associated with additional utility infrastructure investment. Instead, there will be two ways in which utilities that wish to invest the tax savings from the New Tax Laws in additional, needed utility infrastructure investment can proceed. In general, we prefer that large utility infrastructure investment programs be presented to the Commission by means of an application, which allows a full, advance review by the Commission of such a program. However, there are several factors relating to the New Tax Laws that may make the use of an application a less than optimum approach. First, in order to qualify for bonus depreciation, construction will have to commence before the end of 2012 and be completed by the end of 2013. Second, construction costs may be lower now and a key purpose of the New Tax Laws is to encourage additional investment and thereby employment. Accordingly, if a utility for which this resolution establishes a memorandum account wishes to use savings from the New Tax Laws to invest in additional, needed utility infrastructure, not otherwise funded in rates, within a time frame shorter than would be practicable by filing an application, the utility may file an advice letter requesting the creation of a memorandum account into which to record the revenue requirement associated with such additional capital investment. In this advice letter the utility should explain, in addition to any other relevant points: (i) why the additional revenue requirement should be recorded in a memorandum account, rather than awaiting the approval of an application; (ii) the kinds of investments it intends to make and why those investments should be made promptly; (iii) the amount of additional investments it intends to make and the impact that will have on its revenue requirement; and (iv) how this proposed investment will in fact be funded with money made available by the bonus depreciation provisions of the New Tax Laws or money that otherwise might be refunded to ratepayers by means of the memorandum account created by this resolution. In addition to investment not yet made, a utility may request to include in its separate memorandum account the ongoing revenue requirement effects of investments already made, so long as they were funded with money made available by the bonus depreciation provisions of the New Tax Laws.

[5] Under a two-way memorandum account, the amount of additional investment revenue requirement that could thus be recovered would no longer be limited to the amount of revenue requirement savings during the period covered by the memorandum account.

SB_GT&S_0237336

Which utilities should be exempt from having memorandum accounts:

In general, it is appropriate to establish this kind of a memorandum account for all utilities that have their rates set on a cost–of-service basis. As noted above, these generally include water and sewer system corporations, small LECs, gas and electrical corporations, pipeline corporations, and heat corporations. However, we conclude that Class C and D water and sewer corporations should be exempt from this memorandum account requirement. There are two main considerations underlying this conclusion. First, many of these utilities have their rates set using a "rate of margin" (ROM), rather than a rate of return. Because rate of return is not a factor in setting the rates of these ROM utilities, their rates do not change when there is change in rate base. Similarly, a deduction of a deferred tax reserve from rate base would likewise have no impact on rates. Indeed, most of the items that would be tracked in the memorandum account are not relevant to these ROM utilities. Second, Class C and D water and sewer utilities are very small utilities for whom the administrative burden of keeping track of the necessary accounting entries would be an excessive burden, even for those whose rates are set on a rate-of-return basis.

In comments on the Second Draft Resolution, Mountain Utilities requested that it be exempted from the memorandum account requirement. Mountain Utilities is organized for the purpose of providing sole-source generation, distribution, and sale of electricity exclusively to a customer base of fewer than 2,000 customers and therefore is an "electric microutility" pursuant to Public Utilities (PU) Code section 2780. More specifically, Mountain Utilities serves approximately 700 customers. Thus, it is similar in size to a Class C water utility (which has between 500 and 2,000 service connections). Also, like a Class C water utility, the administrative burden of keeping track of the necessary accounting entries would likely be excessive. Accordingly, we will exempt Mountain Utilities from the requirement to establish a memorandum account. We note that section 2780.1 does not technically apply here (because this is not *hearing* in a proceeding to which Mountain Utilities is a *respondent*), nevertheless the principle behind that section (namely not to impose unnecessary regulatory costs on a microutility) is relevant here. Alpine Natural Gas Operating Company No. 1, LLC (Alpine Natural Gas) also requested an exemption in comments on the Third Draft Resolution. Alpine is small natural gas company with 1,200 service connections. We conclude that, like Mountain Utilities, Alpine should be exempted from the operation of this resolution due to its small size.

In comments on the Second Draft Resolution, NRG Energy Center San Francisco LLC (NRG Energy Center) also requested an exemption from the memorandum account requirement. The rates of NRG Energy Center are not currently set using a rate of return. Furthermore, it does not currently have regular general rate cases; indeed it has not had one for many years. Accordingly, NRG Energy Center should also be exempted from the memo account requirement.

SB_GT&S_0237337

In their comments on the Third Draft Resolution, the Small LECs argue that they all should be exempt from this resolution because they are all similar to class C and D water utilities. This contention does not withstand scrutiny. First, none of the small LECs have their rates set using a rate of margin; all of them have their rates set using a rate-of-return methodology. Second, it is our experience that all of the small LECs have sufficient accounting and ratemaking expertise available to them to set up and make entries into the memorandum account. This contrasts with some of the small water companies who struggle to deal with accounting issues. Third, unlike the small water companies, or the small energy utilities that are being exempted from the memorandum account, the small LECs have available to them subsidies from the California High Cost Fund A. This makes their ratemaking situation entirely unlike those of the small water and energy utilities. Finally, none of the small water companies that are exempted from the memorandum account have more than 2,000 service connections, while the Small LECs seek to exempt companies with as many as 20,000 customers.

Some utilities with 2012 test year GRCs argue that they should be exempted from the memorandum account requirement. In support of this argument they point out that the Tax Relief Act will not have any effect on their cash flow until late 2011. However, these utilities' rates are set on an accrual, not a cash, basis, and the benefits of the Tax Relief Act have already begun accruing or will accrue later during 2011[6]. Because this exemption request would prevent ratepayers from sharing in the benefits of the New Tax Laws that accrue during the remainder of 2011, we deny this request for exemption.

The details of the memorandum account:

This resolution will establish for each cost-of-service rate-regulated utility, except for Class C and D water and sewer utilities, and except for Mountain Utilities, Alpine Natural Gas, and NRG Energy Center, (collectively the Covered Utilities) a memorandum account to reflect, on a CPUC-jurisdictional, revenue requirement basis, impacts from the New Tax Laws.

The memorandum account will be used to determine whether any future rate changes are appropriate to reflect impacts of the New Tax Laws for the period from the date of this resolution until the effective date of revenue requirement changes in each Covered Utility's next GRC ("Memo Account Period"). The memorandum account will be used by each Covered Utility to track the revenue requirement impacts of the New Tax Laws

[6] In their comments on the Third Draft Resolution, the Sempra Utilities argue that they have not yet begun to accrue any deferred income tax liabilities because they have also created an offsetting income tax receivable. By referencing the possibility that the tax benefits may begin to accrue sometime during 2011, we do not agree, or disagree, with this contention of the Sempra Utilities. We only note that even under their view of the tax impacts, benefits will begin to accrue "sometime in 2011." (Sempra Utilities Comments, March 4, 2011, p. 5.)

SB_GT&S_0237338

during the Memo Account Period, reflecting on a CPUC-jurisdictional, revenue requirement basis the effects of the New Tax Laws not otherwise reflected in rates. In determining an appropriate revenue requirement adjustment, if any, for the Memo Account Period, the Commission will take into account, and each Covered Utility will record:[7] (a) decreases in its revenue requirement resulting from increases in its deferred tax reserve; and (b) other direct changes in revenue requirement resulting from each utility's taking advantage of the New Tax Laws. In their comments on the drafts of this resolution, the utilities have established that, depending on the utility involved, there may be impacts from a decrease in, or elimination of, the Section 199 deduction resulting from bonus depreciation taken, changes in working cash, and, for energy utilities, changes in CIAC calculations. Other impacts may be possible.[8]

In each Covered Utility's next GRC, or at such other time as ordered in that GRC decision, the Commission will address the disposition of amounts (a) recorded in the memorandum account and (b) forecast for the remainder of the Memo Account Period, and may reflect any net revenue requirement change in prospective rates.

This memorandum account will be a two-way memorandum account, i.e., it will be available for the Commission to consider whether utility rates should be reduced or increased to reflect the tax impacts of the New Tax Laws during the Memo Account Period

The following paragraphs describe in further detail some of the wording we have used above in describing the memorandum account.

Amounts in the memorandum account will be recorded on a "revenue requirement basis." This means that each utility will be tracking the revenue requirement impact of each change resulting from the New Tax Laws. This is important, because, consistent with the Internal Revenue Code, the tax savings from accelerated depreciation are not passed through directly to ratepayers, but instead, as explained above, ratepayers benefit through the process of normalization and the creation of a deferred tax reserve that is deducted from rate base. We also ensure that all amounts recorded in the memorandum account will be recorded on a consistent basis by requiring that they all be recorded on a revenue requirement basis.

---

[7] Although this resolution refers to amounts "recorded" in the memorandum account, because this is a memorandum account, and not a balancing account, the amounts tracked or recorded in the memorandum account are not recorded in the utilities' financial statements, e.g., in the balance sheet.

[8] In its comments on the Third Draft Resolution, PG&E suggests that the memorandum account may need to reflect the treatment of net operating losses, but does not spell out why that is the case, or what kind of adjustment may be required. The need for such an adjustment may be discussed with Commission staff before PG&E files its advice letter containing specific language for its memorandum account.

SB_GT&S_0237339

We refer to amounts not otherwise reflected (or recovered) in rates. We use this terminology to exclude costs and expenses recovered through previously authorized rates, e.g., rates set in a prior GRC. We also use it to exclude costs or expenses recovered through rates set after the date of this resolution, e.g., through a balancing account or another memorandum account, or a formal proceeding prior to the utility's next GRC.

In their comments on the Original Draft Resolution, the energy utilities pointed out that the bonus depreciation afforded by the New Tax Laws will decrease their taxable income, and therefore may decrease, or eliminate, the Internal Revenue Code Section 199 Manufacturer's tax deduction that they are entitled to, which is already reflected in their revenue requirements. The utilities also pointed out that the New Tax Laws will have impacts on their working cash, an item that is a component of their rate base and therefore also reflected in their revenue requirements. We agree that each of these items can properly be reflected in the memorandum account. The energy utilities also argued that the New Tax Laws will impact their CIAC (contributions-in-aid-of-construction) revenues. Energy utilities are taxed on plant contributed by others, such as real estate developers. Accordingly, when such entities contribute plant to the utility they must also contribute an amount to cover the tax impacts (the tax component of CIAC). We agree that the New Tax Laws are likely to have a revenue requirement impact relating to energy utility CIAC. The energy utilities are authorized to include these CIAC impacts in their memorandum accounts on a revenue requirement basis and consistent with any requirements of the Internal Revenue Code.

In its comments on the Second Draft Resolution, the California Water Association (CWA) raised concerns about how the requirement to establish the memorandum account will apply to multi-district water utilities. Accordingly, we provide the following guidance here. Each district whose rates are separately set will need a separate memorandum account, with a separate Memo Account Period. However, only those districts that have plant placed into service and benefiting from bonus depreciation under either of the New Tax Laws prior to their next GRC will need to record any entries in their memorandum accounts. Where plant benefits more than one district, the revenue requirement impacts shall be proportionally allocated among districts according to previously adopted methodologies, according to benefit received, or as determined in the next GRC.

In its comments on the Second Draft Resolution, SCE suggested that the memorandum account should include "all other changes to SCE's 2011 cost of service due to the New Tax Law". All direct changes in revenue requirement resulting from a utility's taking advantage of the New Tax Laws may be reflected in that utility's memorandum account, whether or not they are specifically mentioned in this resolution. The specific categories of revenue requirement impact that each utility wishes to include in its memorandum account should be spelled out in the advice letter it files pursuant to this resolution. For kinds of revenue requirement impact not specifically mentioned in this resolution, the

SB_GT&S_0237340

utility will need to provide some justification in its advice letter. The utilities are encouraged to discuss with staff, prior to filing their advice letters, the appropriateness of including kinds of revenue requirement impacts not mentioned in this resolution.

What it means when we establish a memorandum account:

The establishment of a memorandum account does not change rates, nor guarantee that rates will be changed in the future. This mechanism simply allows the Commission to determine at a future date whether rates should be changed, without the impediment of claims of retroactive ratemaking. Thus, all we are determining here is that it may be desirable to adjust the rates of the Covered Utilities to more fully reflect the tax impacts, if any, that these utilities realize from the New Tax Laws, while avoiding any issue of retroactive ratemaking.

When advice letters should be filed:

It will be necessary for the each Covered Utility to file an advice letter to incorporate the memorandum account into its tariffs. The proposed tariff language should describe in detail the kinds of revenue requirement impacts that are to be entered into the memorandum account. For kinds of revenue requirement impacts not specifically mentioned in this resolution, the utility will need to provide some justification in its advice letter. We will allow all Covered Utilities 60 days to file the required advice letters. This should provide ample time for the utilities to develop tariff language and for discussions with staff.[9] This uniform 60 day period should not be problematic because the memorandum accounts are effective for all Covered Utilities as of the date of this resolution.

[9] The necessary tariff language will be simpler than what would have been required by the Second and Third Draft Resolutions, as the memorandum account established by this resolution no longer includes impacts of any increased investment.

SB_GT&S_0237341

COMMENTS ON DRAFT RESOLUTION

The Original Draft Resolution

Public Utilities Code section 311(g)(1) generally requires draft resolutions to be issued for comment at least 30 days before being voted on by the Commission. However, pursuant to PU Code section 311(g)(3), the Commission has adopted Rule 14.6(c)(9) of its Rules of Practice and Procedure which permitted a reduction in the comment period here. More specifically, Rule 14.6(c)(9) permits the Commission to reduce the 30-day period for public review and comment in circumstances where the public interest in the Commission adopting a resolution before expiration of the 30-day review and comment period clearly outweighs the public interest in having the full 30-day period for review and comment. This resolution does not change utility rates, nor determine that utility rates ought to be changed. It only permits the Commission to consider those issues at a future date, while avoiding retroactive ratemaking concerns. On the other hand, delaying issuance of this resolution to allow for the full 30-day comment period might extend the period of time during which retroactive ratemaking could be a concern. Accordingly, the public interest in adopting this resolution before expiration of a 30 day public comment period clearly outweighs the public interest in allowing for the full 30 day comment period. The Original Draft Resolution was issued for comment on December 30, 2010 and served on all persons on the service list attached to it. Consistent with Rule 14.6(c)(9), there was a reduced comment period with comments due on January 7, 2011.

Comments were submitted by Pacific Gas and Electric (PG&E), TURN, SCE, CWA, the City of Visalia, jointly by Southern California Gas (SoCal Gas) and San Diego Gas and Electric (SDG&E) (collectively the "Sempra Utilities") and collectively by the small local exchange carriers, (the "Small LECs"). Most of these comments have been addressed above, or rendered irrelevant in light of our elimination of the "subject to refund" language.

The Second Draft Resolution

In light of the major changes made, a Second Draft Resolution was issued for public comment on February 7, 2011, although an additional comment period was not legally required. The Second Draft Resolution was served on all persons served with the Original Draft Resolution. Comments were due by 10 a.m. on February 14, 2011. Comments were received from PG&E, TURN, SCE, CWA, the Sempra Utilities, the Small LECs, Mountain Utilities, NRG Energy Center, and PacifiCorp.

SB_GT&S_0237342

The Third Draft Resolution

A Third Draft of this Resolution was issued for public comment on February 25, 2011, although an additional comment period was not legally required. Comments were limited to language not included in the Second Draft Resolution and were due by Friday, March 4, 2011. Comments were received from PG&E, SCE, CWA, the Sempra Utilities, the Small LECs, and Alpine Natural Gas.

Given that there have now been three separate opportunities to comment on drafts of this resolution, the public interest in having an opportunity to comment on the draft resolution has been amply respected.

Additional Responses to Comments

There are a number of comments, not addressed above, that we wish to address here.

There were comments to the effect that the Commission had not previously taken action to reduce rates when the Internal Revenue Code was revised to provide for bonus depreciation. We note that utilities often request memo accounts for unexpected increases in expenses between GRCs. These requests, and the resulting memorandum accounts, typically do not include any possibility of decreasing rates. Rather, they allow for the possibility that rates may increase or stay the same. Utilities do not come to us requesting memorandum accounts or rate decreases when there has been a large and unexpected decrease in expenses between rate cases. We believe that an even-handed approach to regulation requires us to consider, when there has been a large and unexpected decrease in expenses between rate cases, whether it is appropriate to establish a memorandum account to allow for a future decrease in rates. Here, the impacts of the New Tax Laws are so large, that a number of the major energy utilities have informed the Commission that they expect to pay no federal income tax for at least one year. For the reasons noted above, this memorandum account will also allow for a future increase in rates where the direct revenue requirement impact of the New Tax Laws during the Memo Account Period is an increase in revenue requirement.

In comments on the Original Draft Resolution, there was some concern expressed about a need to recalculate the entirety of the utilities' deferred tax reserve. However, there is no need to do so. The bonus depreciation provisions of the New Tax Laws only apply to property placed into service beginning with the 2010 Tax Year. Therefore, only the increase in deferred tax reserve resulting from property placed into service beginning January 1, 2010 needs to be calculated.

In its comments on the Second Draft Resolution, SCE suggested that the revenue requirement impacts to be recorded in its memorandum account should be based on its "2011 weighted average Commission-jurisdictional rate base". We agree that only

SB_GT&S_0237343

CPUC-jurisdictional impacts should be tracked. Based on its comments on the Third Draft Resolution, it appears that SCE is proposing to determine the revenue requirement impacts based on the forecast amount of plant in service during 2011 submitted in its 2012 GRC. While this would avoid the difficult task of determining an amount of 2011 plant in service contemplated by its 2009 GRC, it is not clear what the effects of using this particular methodology would be. Accordingly, this issue will need to be addressed in SCE's GRC. SCE will need to address the impact of adopting this methodology, as opposed to other possible methodologies, in detail at that time.[10]

Several comments argue that the resolution tries to justify impermissible retroactive ratemaking. It does not do so. Although the memorandum account tracks the revenue requirement effects of property placed into service during and after the 2010 tax year, it tracks only those revenue requirement effects occurring after the date of the resolution. Therefore the effect of the resolution is entirely prospective.

In its comments on the Second Draft Resolution, PacifiCorp requests that the Commission allow flexibility so that the Commission can consider other important factors not addressed in the draft resolution, such as a covered utility's financial health, in determining whether any balance in the memorandum account should benefit ratepayers. While we do not include in the Ordering Paragraphs the specific language that PacifiCorp has requested, we do agree with PacifiCorp that it, and other utilities, and parties to their rate cases may present to the Commission whatever factors they believe are relevant to the Commission's ultimate decision as to what, if anything, to do with any balance in the memorandum account. In this connection, we note that this resolution creates a memorandum account, and not a balancing account. As noted above, this resolution does not change utility rates, nor determine that utility rates ought to be changed. It only permits the Commission to consider those issues at a future date, while avoiding retroactive ratemaking concerns.

In its comments on the Second Draft Resolution, TURN requests that we return to the "subject to refund" approach of the Original Draft Resolution, and that we require advance review of additional capital investments, rather than relying on after-the-fact reasonableness review. We have explained above why we are adopting a memorandum

[10] In its comments on the Second and Third Draft Resolutions, SCE also requests to use its 2012 Test Year Results of Operations (RO) Model submitted in its pending GRC, to calculate the amounts to be entered into the memorandum account. As a general matter, it would seem appropriate to use an RO model to calculate revenue requirement impacts. However, this particular RO Model has not yet been fully vetted in the current GRC.

In their comments on the Third Draft Resolution, the Sempra Utilities refer to SCE's proposed proxy and argue that different utilities may need to use different proxies for calculating 2011 plant in service where there has been no express figure adopted for the utility. We agree that the appropriate proxy to be used by each utility that needs one is not a matter that should be determined on a generic basis at this time.

SB_GT&S_0237344

account, rather than the subject-to-refund approach. A key consideration in that regard is that the subject-to-refund approach would likely deter the utilities from increasing capital spending, while the New Tax Laws were intended to stimulate additional capital spending in the short term. For the reasons explained above, we are no longer allowing the revenue requirement associated with additional utility infrastructure investment to be recorded in the memorandum account required by this resolution. On the other hand, we will be allowing covered utilities to file advice letters for separate memorandum accounts if they can demonstrate a need to use the tax savings generated by the New Tax Laws for additional utility infrastructure investment before it is feasible to process a formal application. This will require more of an advance showing before utilities are allowed to recover the costs of additional infrastructure investment in memorandum accounts, and will also require the filing of a formal application where that is feasible. The use of advice letters to request such additional memorandum accounts should avoid our interfering with the goal of the New Tax Laws to promptly stimulate the economy.

PG&E argues that the revenue requirement impacts of the bonus depreciation provision of the Small Business Act, from and after the date of this resolution, should not be included in this resolution because PG&E cannot now adequately reflect those impacts in its "future spending and budget process" (PG&E's comments on the Third Draft Resolution, March 4, 2011, at page 4).[11] In making this argument, PG&E stresses that the Small Business Act only impacted property placed into service during 2010, while ignoring the fact that the Small Business Act was not enacted until September 27, 2010, late in the year and less than three months before the Tax Relief Act was enacted. Thus, there has been little time during which the impacts of the Small Business Act might have affected PG&E's capital planning. Furthermore, this resolution authorizes PG&E to seek recovery, through a separate memorandum account, of increases to its revenue requirement resulting from additional, needed utility infrastructure investment using funds made available by the bonus depreciation provision of the Small Business Act. Accordingly, we conclude that inclusion of the impacts of the Small Business Act in the memorandum account established by this resolution (i) should not unduly interfere with PG&E's spending and budget process, and (ii) does not preclude PG&E from seeking recovery of the revenue requirement associated with additional capital expenditures made possible by the bonus depreciation provisions of the Small Business Act. Therefore, we are not removing the Small Business Act from the scope of this resolution.

In its comments on the Third Draft Resolution, SCE argues that, although this memorandum account is not being established as a Z-factor, the memorandum account should be subject to the $10 million threshold applicable to *its* Z-factor. However, not all utilities have Z-factors. This resolution establishes a generic memorandum account for all Covered Utilities. Arguments about whether the amount recorded in the memorandum account of a specific utility should later be reflected in rates should be

[11] SCE makes a similar argument in its comments on the Third Draft Resolution.

SB_GT&S_0237345

litigated later. SCE also seeks to broaden the scope of the memorandum account to include an extraneous issue, namely an alleged error in SCE's authorized 2011 revenues. The purpose of a memorandum account is to track a particular area of utility expense that is, at the time of the account's authorization, expected to vary independently from other utility costs. A memorandum account is not intended to be a substitute for a GRC, an application for rehearing, or a petition to modify. SCE also argues that establishing a memorandum account here is inconsistent with the policy stated in our 1984 decision *Re: Income Tax Expense for Ratemaking Purposes* (D.84-05-026, 15 CPUC 2d 42). SCE focuses on the portion of the decision describing the Commission's reliance on forecast ratemaking. We simply note that in the past nearly 27 years our ratemaking policies for energy utilities have departed in many respects from the kind of forecast ratemaking we engaged in at that time.[12]

FINDINGS AND CONCLUSIONS

1. President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 ("Tax Relief Act") on December 17, 2010.
2. The Tax Relief Act may provide tax relief to the utilities regulated by this Commission. Among other provisions, this law provides for 100% bonus depreciation on certain business property put into service after September 8, 2010 and before January 1, 2012, with 50% bonus depreciation for at least a year thereafter.
3. President Obama signed the Small Business Job Act of 2010 (Small Business Act), on September 27, 2010, which authorized 50% bonus depreciation for certain property placed into service during 2010.
4. This resolution refers to the Tax Relief Act together with the bonus depreciation provision of the Small Business Act as the "New Tax Laws".
5. The benefits of bonus or accelerated depreciation are generally reflected in rates through "normalization" and the use of a deferred tax reserve.
6. While existing ratemaking mechanisms likely will result in ratepayers benefiting from a portion of the tax benefits utilities receive under the New Tax Laws, it is not clear that all of the tax benefits resulting from these new laws will have an impact on rates under current mechanisms, because the general rates of utilities are typically reviewed only once every three years.
7. The Commission should allow for the possibility of revising the rates of the utilities whose rates are set on a cost-of-service basis, so that some or all of the benefits of the New Tax Laws not otherwise reflected in rates may accrue to ratepayers, while avoiding issues of retroactive ratemaking.

[12] PG&E makes a similar argument in its comments on the Third Draft Resolution.

SB_GT&S_0237346

8. Because the immediate impacts of the New Tax Laws on some utilities may be a revenue requirement increase, the Commission should also allow for the possibility of increasing utility rates to reflect the impacts of the New Tax Laws not otherwise reflected in rates, while avoiding issues of retroactive ratemaking.
9. The appropriate method for preserving the opportunity to consider, at a later time, whether some or all of the impacts of the New Tax Laws not otherwise reflected in rates should be reflected in rates is to establish a memorandum account.
10. The memorandum account should reflect not only the tax benefits of the New Tax Laws, but other direct changes in revenue requirement resulting from each utility's taking advantage of the New Tax Laws. Such changes may include, but are not limited to, impacts on Section 199 deductions, working cash, and contributions in aid of construction.
11. An even-handed approach to regulation requires the Commission to consider, when there has been a large and unexpected decrease in expenses between rate cases, to consider establishing a memorandum account to allow for a future decrease in rates. It also requires the Commission to consider whether a two-way memorandum account should be authorized where the expected impacts may be both revenue requirement decreases and revenue requirement increases.
12. Many Class C and D water and sewer utilities have their rates set based on a rate-of-margin basis, rather than a rate-of-return basis, such that rate base, and therefore deferred tax reserve, do not have an impact on rates.
13. Class C and D water and sewer utilities are very small utilities for whom the administrative burden of keeping track of the necessary accounting entries would be an excessive burden, even if their rates are set on a rate-of-return basis.
14. Class C and D water and sewer utilities should be exempted from the establishment of this memorandum account.
15. Mountain Utilities and Alpine Natural Gas Operating Company No. 1, LLC should be exempted from the establishment of this memorandum account because they are also very small utilities.
16. NRG Energy Center San Francisco LLC should be exempted from the establishment of this memorandum account because its rates are not currently set on a rate-of-return basis and because it does not have regularly scheduled General Rate Cases.
17. Small LECs are not similarly situated to Class C and D water utilities, nor to the energy utilities that are being exempted from the establishment of this memorandum account.
18. This resolution does not change utility rates, nor determine that utility rates ought to be changed. It only permits the Commission to consider, at a future date, the issue of whether utility rates should be changed as a result of the New Tax Laws, while avoiding retroactive ratemaking concerns.

SB_GT&S_0237347

19. Delaying issuance of this resolution to allow for a full 30-day comment period might extend the time during which retroactive ratemaking could be a concern.
20. The public interest in adopting this resolution before expiration of a 30 day public comment period clearly outweighs the public interest in allowing for the full 30 day comment period.
21. Three rounds of comments have been allowed on drafts of this resolution.
22. Although the memorandum account tracks the revenue requirement effects of property placed into service during and after the 2010 tax year, it tracks only those revenue requirement effects occurring after the date of the resolution. Therefore the effect of this resolution is entirely prospective.

ORDER

1. There is hereby established for each cost-of-service rate-regulated utility, with the exception of Class C and D water and sewer utilities, and with the exception of Mountain Utilities, of Alpine Natural Gas Operating Company No. 1, LLC, and of NRG Energy Center San Francisco LLC, (collectively the Covered Utilities) a memorandum account to reflect, on a CPUC-jurisdictional, revenue requirement basis, impacts from the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 and the bonus depreciation provision of the Small Business Job Act of 2010 (collectively "The New Tax Laws").
2. This memorandum account shall track on a CPUC-jurisdictional, revenue requirement basis the impacts of the New Tax Laws not otherwise reflected in rates during the period starting on the date of this resolution until the effective date of revenue requirement changes in each Covered Utility's next General Rate Case ("Memo Account Period"). Each Covered Utility shall record in this memorandum account: (a) decreases in its revenue requirement resulting from increases in its deferred tax reserve; (b) other direct changes in revenue requirement resulting from each utility's taking advantage of the New Tax Laws.
3. This memorandum account shall be used in determining whether any future rate adjustment is appropriate to reflect impacts of the New Tax Laws during the Memo Account Period for each Covered Utility.
4. In each Covered Utility's next General Rate Case (GRC), or at such other time as ordered in that GRC decision, the Commission shall address the disposition of amounts (a) recorded in the memorandum account and (b) forecast for the remainder of the MemoAccount Period, and may reflect any net revenue requirement impact in prospective rates.
5. Within 60 days of the date of this resolution, each Covered Utility shall file an advice letter to add a memorandum account to its tariffs consistent with the requirements of

SB_GT&S_0237348

Ordering Paragraphs 1 and 2, above. The proposed tariff language shall describe in detail the kinds of revenue requirement impacts that are to be entered into the memorandum account. Any utility that wants to include in its memorandum account a revenue requirement impact of the New Tax Laws not specifically mentioned in this resolution should justify the inclusion of each such category of impact in its advice letter.

6. All of the memorandum accounts established pursuant to Ordering Paragraphs 1 and 2 of this resolution shall be effective as of the date of this resolution.
7. Any Covered Utility that wishes to use savings from the New Tax Laws to invest in additional, needed utility infrastructure, not otherwise funded in rates, within a time frame shorter than would be practicable through the formal application process may file an advice letter requesting establishment of a separate memorandum account into which to record the revenue requirement associated with such additional capital investment. In this advice letter the utility should explain, in addition to any other relevant points: (i) why the additional revenue requirement should be recorded in a memorandum account, rather than awaiting the approval of an application; (ii) the kinds of investments it intends to make and why those investments should be made promptly; (iii) the amount of additional investments it intends to make and the impact that will have on its revenue requirement; and (iv) how this proposed investment will in fact be funded with money made available by the bonus depreciation provisions of the New Tax Laws or money that otherwise might be refunded to ratepayers by means of the memorandum account created by this resolution. In addition to investment not yet made, a utility may request to include in its separate memorandum account the ongoing revenue requirement effects of investments already made, so long as they were funded with money made available by the bonus depreciation provisions of the New Tax Laws. The advice letters filed pursuant to this ordering paragraph will require Commission action before they are put into effect.
8. The Legal Division shall serve a copy of this resolution, by mail or e-mail, on all cost-of-service rate-regulated utilities and any additional persons who submitted comments on the draft resolution.
9. The effective date of this order is today.

I certify that this Resolution was adopted by the California Public Utilities Commission at its regular meeting of March 10, 2011, and that the following Commissioners approved it:

PAUL CLANON
Executive Director

SB_GT&S_0237349

Lower bills. Livable planet.

115 Sansome Street, Suite 900
San Francisco, CA 94104
415-929-8876 • www.turn.org
Robert Finkelstein, Legal Director

April 5, 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: Draft Resolution L-411 Establishing a Memorandum Account for all Cost-of-Service Rate-Regulated Utilities To Reflect The Benefits Of Recent Federal Tax Legislation

Dear Commissioners:

Last week Commissioners Sandoval and Ferron convened an all-party meeting regarding Draft Resolution L-411 and the appropriate ratemaking treatment of the benefits from the New Tax Laws. At the conclusion of the meeting Commissioner Sandoval invited the parties to consider alternatives that might prove to be acceptable approaches to capturing the benefits. TURN wishes to put one such alternative approach on the table. Rather than requiring an application or advice letter for any proposed capital expenditure using the tax benefits, the Commission could adopt a two-track approach. To the extent a utility's additional expenditures associated with the tax benefits go to infrastructure replacement (based on criteria the Commission would set forth in the Resolution), there would be no need for a before-the-fact application or advice letter. Only if a utility seeks to use the tax benefits to support capital expenditures in areas not tied to infrastructure replacement would it need to first seek approval through the application or advice letter process. The approach is described in further detail below.

This alternative approach is premised on the Commission retaining several key elements of the latest circulated version of the Draft Resolution. First, it is essential that the Commission retain the central feature set forth in the most recent version of the Draft Resolution: The benefits of the New Tax Laws must either fund necessary capital expenditures for utility plant, or flow to benefit ratepayers. TURN submits that, all else equal, if the choice facing utility management is to make capital expenditures or have unspent funds go to ratepayers, there is a greater likelihood that the utility will make the capital additions than if the choice is to either make the capital expenditures or keep unspent funds. While the most recent utility positions seem geared toward using the benefits to fund further necessary capital expenditures for utility plant, on their own such statements of good intentions do not provide sufficient ratepayer protection.

Second, the fact that a utility can spend more money does not necessarily mean that it should, or that the incremental expenditure would be reasonable.[1] It is therefore important for the Commission to address up front whether the proposed additional spending through use of the tax benefits would serve not only the near-term goal of increasing capital expenditures in California, but also the longer-term interests of utility ratepayers.

The alternative TURN puts forward seeks to relieve the tension between the utilities' stated desire to expeditiously invest the tax benefits in utility plant and the need for Commission review of such spending proposals to ensure that they are a reasonable and appropriate use of funds that, if not so invested, should flow to ratepayers. The Draft Resolution would require an application as the preferred means of review or, where that approach is not feasible, an advice letter that addresses the need for the new spending. The utilities have complained that such an approach would impede their ability to make capital investments to the betterment of California's economy.[2]

TURN offers the following alternative approach. Instead of requiring a pre-spending application or advice letter for all projects funded by the tax benefits, the final version of Resolution L-411 could establish clear guidelines of the types of capital expenditures the Commission seeks to encourage with this source of funds. To the extent a utility stays within these guidelines, it would not need to seek pre-approval of the spending (although reasonableness would still be subject to review in a subsequent GRC). Should a utility determine that the tax benefits would be best invested in some area outside of the Resolution's guidelines, it would need to file an application or advice letter seeking Commission approval in order to go forward with the investment.

The guidelines should steer the capital spending into infrastructure replacement. The Commission often hears that service reliability will deteriorate unless a utility increases its capital expenditures in order to address system deficiencies and aging infrastructure. To the extent the tax benefits get spent on such projects, the Commission would accelerate the pace of infrastructure replacement.

---

[1] As a recent example, consider PG&E's Distribution Reliability Improvement Program. The utility was prepared to spend nearly $2 billion to achieve certain distribution reliability improvements. Upon review, the Commission scaled the proposed spending back to $357 million, and noted that spending 16% of the utility's proposed amount would achieve 68% of the quantifiable reliability improvement benefits. (D.10-06-048, p. 2.) PG&E now contends that it could spend $400 to $600 million per year over the next two years on projects enabled by the tax benefits, without any specificity regarding what that spending would achieve.

[2] In TURN's view, these complaints are overwrought. The Commission has adopted and operated under expedited processes when circumstances warranted, achieving timely outcomes without sacrificing its oversight role or opportunities for public input in the process. However, TURN also recognizes that this is an area in which perception may matter as much as substance, and the utilities could successfully create a perception that requiring even a pre-spending advice letter would scale back the additional capital investment and job creation benefits that might ensue.

TURN submits the following criteria the Commission should adopt to guide the spending into the appropriate areas:

- The Commission should identify the types of infrastructure replacement projects that it most wants to encourage, which would typically be the types of projects included in GRC applications. For example, for the electric utilities, projects would include proactive replacement of poles and underground cables, replacement of existing substation transformers that are over 50 years old, and work to improve the reliability of the worst-performing distribution circuits on their system.[3] For gas utilities, projects would include accelerating existing programs of distribution pipeline replacement, replacement of the riskiest gas transmission lines, and installing "smart pigs" in gas transmission lines.

- The property that the investment is made in must be CPUC-jurisdictional (i.e., no electric utility can spend the money on FERC jurisdictional transmission).

- For dual-fuel utilities, the investment amount must not exceed the tax benefits associated with the specific electric or gas functions (i.e., SDG&E and PG&E cannot spend electric system tax benefits to invest in their gas systems).

- The property that the investment is made in must itself be eligible for bonus depreciation.[4]

- The property that the investment is made in must have a tax depreciable life of at least 15 years (to ensure the spending is on assets where accelerated depreciation has the most value to ratepayers).

- The spending must not provide generation capacity at a new plant.[5]

TURN does not suggest that these represent the entire universe of appropriate criteria. And while the examples are described in terms that are clearly energy-centric, nearly all the regulated cost-of-service utilities have raised concerns about their ability to achieve necessary levels of infrastructure replacement in the near term. TURN submits that such criteria seeking to direct the tax benefits to infrastructure replacement will provide the Commission some assurance that the benefits are being put to good purpose if used for capital expenditures rather than rate reductions.

---

[3] Costs associated with hooking up new customers or serving increasing customer demand in the normal course of business would not be within this category. Such spending is not "infrastructure replacement" but rather "infrastructure additions."

[4] This criterion is intended to prevent the tax benefits from being spent on real estate or software.

[5] PG&E has a number of small hydroelectric generation projects that are controversial and, in TURN's view, should not be funded with the tax benefits. Both this provision and the 15-year minimum would also prevent additions to utility photovoltaic programs previously approved in separate applications.

SB_GT&S_0237352

Finally, several utilities have stated concerns regarding the potential adverse effect that any sort of "subject to refund" provision might have on their ability to use the tax benefits to fund additional capital expenditures, and the difficulty of determining what level of expenditures would be "incremental" to GRC-authorized funding levels. To the extent such concerns are valid, TURN submits that the Reliability Investment Incentive Mechanism (RIIM) currently in place for SCE provides a structure that would sufficiently mitigate both these concerns.[6]

Subject to Refund: In SCE's current GRC cycle (covering 2009-2011), the utility has approximately $3.378 billion of authorized RIIM capital expenditures. If SCE spends a total RIIM amount over the three-year period that is less than the authorized amount, then SCE will return the difference to ratepayers as a one-time event.[7] The language in SCE's tariffs implementing this potential return to ratepayers is very straightforward: "If an overcollection in revenue requirement is determined from (1) the authorized reliability-related capital additions being greater than recorded adjusted capital additions . . . these amounts shall be refunded to customers."[8] This potential refund to customers has not appeared to hinder SCE's RIIM capital expenditures, as the utility seems to be on course to spend the full amount authorized over the three-year period. Thus the Commission should reject claims that a "subject to refund" element here would be counter-productive, and instead direct that any tax benefits not spent on approved capital projects will be returned to ratepayers.

Incremental: The SCE GRC decision (D.09-03-025) adopted capital expenditure forecasts for 2009, but not for 2010 or 2011. In Resolution E-4313, the Commission adopted SCE's proposed approach for calculating RIIM capital expenditures in 2010 and 2011, by escalating the level adopted for 2009 by the escalation factors adopted for attrition purposes (4.25% for 2010, and 4.35% for 2011). Again, the Commission could use a similar approach here to determine a proxy for the authorized capital expenditure level in 2010, 2011 or 2012, even where there is no specific authorized capital expenditure level for that year. Applying the adopted attrition increase on a percentage basis to the capital expenditures authorized for the most recent test year would provide the proxy, and the Commission could deem amounts spent above that level to be "incremental" to the capital expenditures already provided for in the most recently approved GRC revenue requirement.

TURN concludes with a reminder that time is of the essence here. As the latest version of the Draft Resolution correctly explains, "there could be substantial amounts in deferred tax reserves that do not get reflected in rates unless the Commission takes

---

[6] The RIIM example is particularly of interest in that the mechanism seeks to encourage capital expenditures in areas that "preserve long-term electric service reliability" and specifically includes items such as distribution and substation infrastructure replacement. Res. E-4313, p. 2.

[7] Res. E-4313, p. 8 (http://docs.cpuc.ca.gov/word_pdf/FINAL_RESOLUTION/119977.pdf).

[8] The language appears in Section LL of SCE's preliminary statement. http://www.sce.com/NR/sc3/tm2/pdf/ce291.pdf

SB_GT&S_0237353

action." (Draft Resolution, p. 3.) And for so long as the Commission defers taking action, the utilities continue to have the option of flowing these "substantial amounts" to their shareholders. To the extent the Commission seeks to limit the available options to investment in necessary capital expenditures or decreases in the authorized revenue requirement (and, all else equal, lower rates), it needs to issue the Resolution and thereby create the memorandum account. Now that we are three months into 2011, the "substantial amounts" from 25% of this year are already unlikely to be subject to the memorandum account. You need to act before that figure grows any larger.

As always, we thank you for your consideration of these matters. Please let me know if you have any questions regarding this proposal or TURN's position on the New Tax Laws.

Yours truly,

/s/

Robert Finkelstein
Legal Director

cc: Marzia Zafar, CPUC
Paul Clanon, CPUC Executive Director
Frank Lindh, CPUC General Counsel
Joel Perlstein, CPUC Legal Division
Michael Galvin, CPUC

Brian K. Cherry
Vice President
Regulatory Relations

Pacific Gas and Electric Company
77 Beale St., Mail Code B10C
P.O. Box 770000
San Francisco, CA 94177

415.973.4977
Fax: 415.973.7226

VIA EMAIL

April 8, 2011

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

Re: Draft Resolution L-411

Dear Commission President Peevey, and Commissioners Ferron, Florio, Sandoval and Simon:

I am writing on behalf of Pacific Gas and Electric Company (PG&E) as a follow-up to the All-Party Meeting on Draft Resolution L-411 held by Commissioners Sandoval and Ferron on March 30, 2011. We greatly appreciate the Commissioners' willingness to host this very important meeting of constituent groups to consider how the Commission should respond to this proposed resolution.

Tax Savings Estimates. At the All-Party meeting, Commissioner Sandoval directed the larger utilities to submit letters addressing their expected tax savings, as well as any offsets, as a result of bonus depreciation in Tax Years 2010 and 2011 and any tax years prior to the effective date of each utility's next GRC.

Attached as Appendix A to this letter is PG&E's s very preliminary estimate of the CPUC jurisdictional revenue requirements impacts of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (New Tax Law), should a memorandum account be established to track tax consequences under pre-existing spending assumptions.[1]

PG&E Supports TURN's April 5 Proposal, With Minor Modifications And Two Specific Reservations. On April 5, TURN sent a letter to the Commissioners proposing an

---

1 As PG&E Corporation's Chief Financial Officer Kent Harvey explained at the All-Party Meeting, the tax benefits from the September 2010 bonus depreciation law (Small Business Act) are offset by already incurred additional capital spending above levels reflected in our most recent GRC. Therefore, Appendix A includes only the benefits of the New Tax Law and not the Small Business Act.

SB_GT&S_0237355

alternative approach to the memorandum accounts set forth in Draft Resolution L-411. PG&E supports TURN's proposal, with certain minor modifications shown in Appendix B to this letter.

PG&E and TURN have discussed but not reached agreement on whether capital spending to improve the reliability of electric generating facilities should be included among the types of infrastructure replacement projects expressly authorized by the Commission for inclusion in the memorandum account, nor have they reached agreement on how to address PG&E's concerns about the Small Business Act and 2009 and 2010 capital investments (see discussion below). However, both PG&E and TURN remain willing and interested in resolving these issues on a reasonable basis as expeditiously as possible.

PG&E appreciates TURN's recognition of its concerns with the Draft Resolution's advice letter and application process and supports the establishment of up-front guidelines for additional capital spending. PG&E's modifications – which PG&E shared with TURN and which TURN supports as consistent with the general principles of the criteria as originally proposed in TURN's letter – are intended to provide utilities with adequate flexibility to make investments to the benefit of their customers while recognizing TURN's interest in ensuring that such investments are necessary and prudent.

The Commission Must Remove The Small Business Act from the Scope of the Draft Resolution. PG&E reiterates its strong opposition to including the Small Business Act within the scope of the Draft Resolution. As PG&E has explained, the Draft Resolution unfairly seeks to capture the tax benefits of the Small Business Act without making compensating adjustments to recognize that utilities such as PG&E made additional capital investments in 2009 and 2010 to take advantage of bonus depreciation laws passed in 2008 and 2009 – additional investments that are not reflected in PG&E's 2011 rate base.

If the Draft Resolution continues to include the Small Business Act, with benefits clawed back to the beginning of 2010, PG&E may be unable to implement its current budget of capital and other spending, let alone engage in additional spending – resulting in the exact opposite of the intent of the New Tax Law. Therefore, PG&E strongly urges the Commission to delete the Small Business Act from the scope of the Draft Resolution, or, as a lesser alternative, to allow PG&E to include both the tax benefits of the Small Business Act and the additional capital investments in 2009 and 2010 made as a result of prior bonus depreciation laws.

Time is of the Essence. As TURN acknowledges, "time is of the essence here." The longer the Commission allows there to be uncertainty about the impact of the New Tax Law, the longer the Commission undermines the intent of the law and the benefits that customers can receive through added utility infrastructure investment. PG&E has estimated that a 100% deduction of capital costs for Federal tax purposes can save customers nearly 20% on a present value ratemaking basis, and a 50% deduction can save customers nearly 10%. This means that PG&E can do more for customers at a lower customer cost. PG&E must act quickly to implement this increased spending so such spending can take place efficiently and effectively before the end of 2011, when the 100% deduction generally ends, and 2012, when all benefits are planned to expire.

Conclusion. For the foregoing reasons, PG&E urges the Commissioners to indicate at the Commission's next public meeting their concurrence that, should a memorandum account ultimately be established, that utilities at least can be assured that additional spending on the investments agreed upon so far between TURN and PG&E will qualify as offsets without the need for an advice filing or application. This expression of the Commissioners' opinions will enable utilities to immediately initiate planning and implementation of incremental spending, at least on the items thus far agreed upon between TURN and PG&E.

PG&E further asks the Commission to specifically request TURN, PG&E and the other interested participants to act as expeditiously as possible to reach concurrence on their remaining issues, and if not, propose a list of unresolved issues that should be addressed and decided by the Commission.

Very truly yours,

Brian K. Cherry
VP, Regulatory Relations
Pacific Gas and Electric Company

cc : Mark S. Wetzell
Philip Weismehl
Paul Phillips
Angela Minkin
Carol Brown
Paul Clanon, CPUC Executive Director
Karen Clopton, Chief ALJ
Rami Kahlon, Director, CPUC Division of Water and Audits
Marzia Zafar, CPUC Division of Water and Audits
Michael Galvin
Frank R. Lindh, CPUC General Counsel
Joel Perlstein, Esq., CPUC Legal Division
Service List for Draft Resolution L-411

SB_GT&S_0237357

PG&E Letter to Commissioners on Draft Resolution L-411
(Dated April 8, 2011)

APPENDIX B

PG&E's Edits to TURN's Alternative Approach Criteria

- The Commission should identify the types of infrastructure replacement projects that it most wants to encourage, which would typically be the types of projects included in general rate case-type (*e.g.,* GRC or GT&S) applications. For example, for the electric utilities, projects would include proactive replacement of poles and underground cables, replacement of existing substation transformers that are over 50 years old or that otherwise require replacement based on reasonable engineering assessments, and work to improve the reliability of the worst-performing or highest priority distribution circuits on their system based on reasonable engineering assessments.[3] For gas utilities, projects would include accelerating existing programs of distribution pipeline replacement, replacement of the riskiest or highest priority gas transmission lines based on reasonable engineering assessments, and installing "smart pigs" in gas transmission lines.
- The property that the investment is made in must be CPUC-jurisdictional (i.e., no electric utility can spend the money on FERC jurisdictional transmission).
- For ~~dual-fuel~~ utilities that provide both gas and electric services, at least 90% of the incremental investment amount must ~~not exceed~~ be attributable to the tax benefits associated with ~~the specific electric or gas~~ that particular service function (i.e., SDG&E and PG&E ~~cannot~~ must generally use ~~spend~~ electric system tax benefits to invest in their electric systems and gas system tax benefits to invest in their gas systems).

[3] Costs associated with hooking up new customers or serving increasing customer demand in the normal course of business would not be within this category. Such spending is not "infrastructure replacement" but rather "infrastructure additions."

SB_GT&S_0237358

- The property that the investment is made in must itself be eligible for bonus depreciation (determination of whether an investment is eligible for bonus depreciation shall be made based on the same criteria as determination of whether tax benefits are the result of bonus depreciation, and will be based on IRS guidance).[4] [5]
- At least 90% of ~~The property that~~ the investment ~~is made in~~ must have a tax depreciable life of at least 15 years (to ensure most of the spending is on assets where accelerated depreciation has the most value to ratepayers), and any remaining investments must be ancillary to such investments.
- The spending must not provide generation capacity at a new plant.[6]

---

[4] This means that a type of investment is not to be treated as an incremental investment unless it is also treated as the type of item that generates a bonus depreciation tax benefit.

[5] This criterion is intended to prevent the tax benefits form being spent on real estate or software, except as permitted under the 10% cap for "ancillary" investments.

[6] PG&E has a number of small hydroelectric generation projects that are controversial and, in TURN's view, should not be funded with the tax benefits. Both this provision and the 15-year minimum would also prevent additions to utility photovoltaic programs previously approved in separate applications.

SB_GT&S_0237359

Lower bills. Livable planet.

115 Sansome Street, Suite 900
San Francisco, CA 94104
415-929-8876 • www.turn.org
Robert Finkelstein, Legal Director

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

[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.

SB_GT&S_0237361

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.

[5] *Id.*

[6] *Id.*

SB_GT&S_0237362

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 increase 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 reduction of $10 million, of which 90% would be allocated to CPUC-jurisdictional operations. This is a far cry different from an $11 million increase.

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

[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 Relief 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." SCE 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.

SB_GT&S_0237363

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

[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 Additions" 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 Commissioners 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.

SB_GT&S_0237364

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.

SB_GT&S_0237365

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/

Robert Finkelstein
Legal Director

cc: Marzia Zafar, CPUC
Paul Clanon, CPUC Executive Director
Frank Lindh, CPUC General Counsel
Joel Perlstein, CPUC Legal Division
Michael Galvin, CPUC

[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.

STATE OF CALIFORNIA EDMUND G. BROWN JR., Governor

Public Utilities Commission
505 Van Ness Avenue
San Francisco, Ca 94102-3298

May 19, 2011

Draft Resolution L-411A
Agenda ID #10418

TO: All Interested Persons

The Legal Division has issued for comment Draft Resolution L-411A to correct internal inconsistencies and other errors in Resolution L-411 approved at the Commission's April 14, 2011 business meeting. Resolution L-411 established a memorandum account for Pacific Gas and Electric Company and all other non-exempted cost-of-service energy and Class A and B water and sewer utilities that will not be addressing the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 in a 2011 or 2012 test year general rate case.

On May 19, 2011, the draft resolution was mailed to the attached service list, pursuant to California Public Utilities Code § 311(g) and Rule 14.2(c)(2) of the Commission's Rules of Practice and Procedure. Interested person may submit comments no later than June 8, 2011.

Comments are limited to discussing whether the changes made in Resolution L-411A correctly resolve the internal inconsistencies, correct other errors and clarify the Ordering Paragraphs of the original resolution, consistent with the Commission's intent in approving Resolution L-411. Comments may also address any other errors or inconsistencies that should be, but have not been, addressed in this Draft Resolution L-411A. Comments should not reargue issues resolved in Resolution L-411, and comments that do so will not be addressed.

Comments should be submitted to Joel Perlstein at one of the addresses below. E-mail submission is preferred.

Joel Perlstein's e-mail address is: jtp@cpuc.ca.gov

Alternatively, an original and two copies of the comments, may be mailed to:

Joel Perlstein, Legal Division
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

The date of submission is the date the comments are received by the Commission.

451373

SB_GT&S_0237367

Persons interested in comments of others may e-mail or write to Margarita Lezcano at mal@cpuc.ca.gov or the address below, or telephone her at (415) 703-1931.

Margarita Lezcano, Legal Division
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Draft Resolution L-411A will be placed on the Commission's June 23, 2011 agenda. The Commission may act then on this draft resolution or it may postpone action until later.

When the Commission acts on a draft resolution, the Commission may adopt all or part of the draft resolution, as written, or amend or modify the draft resolution; or the Commission may set the draft resolution aside and prepare a different resolution. Only when the Commission acts does the resolution become binding.

/s/ FRANK LINDH
Frank Lindh

General Counsel, Legal Division

Encl. Draft Resolution L-411A
Service List

451373

DRAFT Agenda ID #10418

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Legal Division

San Francisco, California
Date: June 23, 2011
Resolution No.: L-411A

RESOLUTION

REVISED RESOLUTION ON THE COMMISSION'S OWN MOTION ESTABLISHING A MEMORANDUM ACCOUNT FOR ALL COST-OF-SERVICE RATE-REGULATED UTILITIES, EXCEPT FOR: CLASS C AND D WATER AND SEWER UTILITIES, MOUNTAIN UTILITIES, ALPINE NATURAL GAS, NRG ENERGY CENTER, SMALL LOCAL EXCHANGE CARRIER TELEPHONE CORPORATIONS AND THOSE ENERGY AND WATER UTILITIES THAT WILL BE ADDRESSING THE TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOB CREATION ACT OF 2010 IN A 2011 OR 2012 TEST YEAR GENERAL RATE CASE, TO ALLOW THE COMMISSION TO CONSIDER REVISING RATES TO REFLECT THE TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOB CREATION ACT OF 2010

SUMMARY

It has come to the Commission's attention that Resolution L-411, as approved by the Commission on April 14, 2011, contained a number of internal inconsistencies and other similar errors. Accordingly, we are issuing this revised Resolution L-411A to remove the inconsistencies, correct the errors, and clarify the Ordering Paragraphs of the original resolution. The effective date of the memorandum account established by the resolution remains April 14, 2011.

This resolution establishes a one-way memorandum account for all cost-of-service rate regulated utilities that do not address the New Tax Law in a 2011or 2012 test year General Rate Case proceeding, to track the impacts of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 ("New Tax Law" or "Tax Relief Act"). By its terms, however, this resolution exempts all Class C and D water and sewer utilities, Mountain Utilities, Alpine Natural Gas, NRG Energy Center, and small

local exchange carrier telephone corporations. More specifically, the memorandum account established by this resolution will track on a CPUC-jurisdictional, revenue requirement basis: (a) decreases in each impacted utility's revenue requirement resulting from increases in its deferred tax reserve; and (b) other direct changes in revenue requirement resulting from taking advantage of the New Tax Law. This resolution also authorizes impacted utilities to use savings from this new tax law to invest in certain additional, needed utility infrastructure, not otherwise funded in rates, within a time frame shorter than would be practicable through the formal application or advice letter processes. The establishment of a memorandum account does not change rates, nor guarantee that rates will be changed in the future. This mechanism simply allows the Commission to determine at a future date whether rates should be changed, without having to be concerned with issues of retroactive ratemaking.

BACKGROUND

On December 17, 2010, President Obama signed the Tax Relief Act. It has come to the attention of the Commission that this law may provide tax relief to the utilities regulated by this Commission. Provisions in the Tax Relief Act may reduce the utilities' costs of providing service. Many of the utilities regulated by this Commission have their rates set on a cost-of-service basis. These utilities include, without limitation: water and sewer system corporations, small local exchange carrier telephone corporations (Small LECs), gas and electrical corporations, pipeline corporations, and heat corporations.

Among other provisions, the Tax Relief Act provides for 100% bonus depreciation on certain business property put into service after September 8, 2010 and before January 1, 2012. The Tax Relief Act also provides for 50% bonus depreciation for property placed into service thereafter and before January 1, 2013 and for property placed into service in 2013 where construction begins prior to January 1, 2013.

Consistent with the Internal Revenue Code, the Commission's ratemaking procedures do not reflect in rates the full reduction in tax expense in the year in which accelerated depreciation is taken for tax purposes. Rather, rates are set as if depreciation for tax purposes were being calculated on the straight line method over the projected life of the asset (the same depreciation method used for setting rates). Thus, the utility collects in rates taxes that will not need to be paid until a later time, if at all.[1] Nevertheless, ratepayers do get a benefit from the accelerated depreciation. This is accomplished through "normalization" and the use of a "deferred tax reserve". The deferred tax reserve for any particular asset reflects the amount of depreciation taken for tax purposes that

[1] See *City of Los Angeles v. Public Utilities Commission*, 15 Cal. 3d 680, 686 (1975) (for an enterprise that is either expanding or stable, accelerated depreciation does not merely defer taxes, but eliminates them entirely).

SB_GT&S_0237370

exceeds the amount used in setting rates. This difference is then multiplied by a tax rate to yield the amount of deferred tax reserve. Thus, for example, assume a utility puts into service a new capital asset costing $100,000 with a 10-year service life and takes 100% bonus depreciation and the federal tax rate is 40%, the corresponding deferred federal tax reserve at the end of a year will be $36,000 (i.e. the $100,000 depreciation taken for tax purposes, minus the $10,000 taken for ratemaking purposes times 40%.) The combined deferred tax reserve on all of the utility's assets is, in turn, deducted from rate base in calculating the utility's revenue requirement, thus reducing rates.

However, the general rates of cost-of-service utilities are typically reviewed only once every three years. When they are reviewed, the actual amount of the deferred tax reserve is generally reflected in setting new rates. Unless a utility's rates are adjusted for the years between general rate cases (GRCs) in a way that takes account of the actual amount of the deferred tax reserve, the increase in the deferred tax reserve caused by the Tax Relief Act would not be reflected in rates until the rates set in the utility's next GRC take effect. Because the Tax Relief Act provides for 100% bonus depreciation on qualifying assets put into service after September 8, 2010 and before January 1, 2012 (with 50% bonus depreciation thereafter), and because it may be some time before all of the cost-of-service rate-regulated utilities have their rates adjusted to reflect the amounts actually recorded in their deferred tax reserves, there could be substantial amounts in deferred tax reserves that do not get reflected in rates unless the Commission takes action.

In comments on drafts of this resolution, The Utility Reform Network (TURN) requested that the scope of the resolution be broadened to cover the effects of the Small Business Job Act of 2010 (Small Business Act), HR 5297, signed on September 27, 2010. TURN noted that the Small Business Act authorized 50% bonus depreciation for certain property placed into service during 2010, thus having an impact on deferred tax reserves like that of the Tax Relief Act. However, we decline to do so because the Small Business Act is a re-authorization of four previous bonus depreciation laws enacted since 2002, none of which triggered any adjustment to rates other than in test years.

DISCUSSION

The purpose of this resolution:

The purpose of this resolution is to preserve the opportunity for the Commission to decide at a future date whether some of the impacts of the Tax Relief Act (or New Tax Law), not otherwise reflected in rates, ought to be reflected in future rates, without having to be concerned with issues of retroactive ratemaking.

SB_GT&S_0237371

When a utility begins to experience a large and unexpected increase in costs, it sometimes requests authority from the Commission to establish a memorandum account. As we said in D.10-04-031:

> A memorandum account allows a utility to track costs arising from events that were not reasonably foreseen in the utility's last general rate case. By tracking these costs in a memorandum account, a utility preserves the opportunity to seek recovery of these costs at a later date without raising retroactive ratemaking issues. However, when the Commission authorizes a memorandum account, it has not yet determined whether recovery of booked costs is appropriate, unless so specified.

Here we face the possibility of large and unexpected *decreases* in tax expense. Due to the timing of rate cases, benefits of the tax decrease may not accrue to ratepayers in the same way they would if the tax decrease had been expected. We wish to preserve the opportunity to consider whether some or all of the tax impacts not otherwise reflected in rates should benefit ratepayers, without having to face issues of retroactive ratemaking.

At the same time, we recognize that taking bonus depreciation under the New Tax Law may have impacts on components of a utility's revenue requirement other than the deferred tax reserve. In particular, there is likely to be an impact on (i) working cash calculations, and there may be (ii) a reduction in, or elimination of, the Section 199 deduction available due to taking bonus depreciation, and (iii) impacts involving contributions-in-aid-of-construction (CIAC). Other impacts are also possible. Some of these impacts result in revenue requirement increases primarily in the year(s) in which bonus depreciation is taken, while the revenue requirement reduction resulting from the increase in the deferred tax reserve is spread over a longer period. Thus, although the overall revenue requirement impact of taking bonus depreciation benefits ratepayers, the revenue requirement impact in the years in which bonus depreciation is taken may actually be a revenue requirement increase.[2]

---

[2] This point was illustrated by figures provided by Southern California Edison (SCE) in its comments on the Second Draft Resolution. Three different versions of this resolution have previously been issued for public comment. The Original Draft Resolution bore the number Resolution W-4867 and was issued for comment on December 30, 2010. A substantially revised Second Draft Resolution was issued for comment on February 7, 2011, and then re-numbered as Resolution L-411. A Third Draft Resolution was issued for comment on February 25, 2011.

SB_GT&S_0237372

The approach the Commission should adopt to achieve this purpose:

The Original Draft Resolution[3] proposed to accomplish the above purpose by making the rates of all cost-of-service rate regulated utilities subject to refund for the limited purpose of allowing ratepayers to benefit, to the extent, if any, the Commission finds reasonable, from tax benefits resulting from the Tax Relief Act.

In their comments and discussions with Commission staff, the utilities pointed out several disadvantages of this approach, primarily the uncertainty created by the "subject to refund" language. The utilities noted that the purpose of the bonus depreciation provisions of the New Tax Law is to encourage additional capital investment, thereby stimulating employment and the economy. The utilities could use tax savings realized under the New Tax Law to fund additional, needed utility infrastructure investment not otherwise funded by rates. This may be an opportune time to increase capital investment, given decreases in construction costs and the availability of bonus depreciation for plant put into service before 2013. At least some of the utilities intend to use tax savings from the New Tax Law to fund additional, needed utility infrastructure investment. However, the utilities informed staff that they would be reluctant to do so if some unknown amount of the tax savings were instead needed to fund rate reductions.

In light of these factors, this resolution has been revised to eliminate the subject to refund language. Instead, this resolution uses a memorandum account to track the various benefits and costs of the New Tax Law. This approach still permits the Commission to determine at a later date whether some of the impacts of the New Tax Law should be reflected in rates, without having to be concerned about retroactive ratemaking issues. However, this approach replaces the uncertainty of "subject to refund" language with specific calculations that will be contained in a memorandum account. As a result, this resolution should not impede the capital investment that the New Tax Law is intended to encourage.

The second and third drafts of this resolution accommodated the desire of some utilities to use the tax savings realized under the New Tax Law to fund additional, needed utility infrastructure investment not otherwise funded in rates, by allowing the revenue requirement impacts of such additional investment enabled by the bonus depreciation provisions of the New Tax Law to be tracked as an offset to the memorandum account. This resolution authorizes such an offset. This resolution also establishes that this memorandum account will be a one-way memorandum account. This means that this memorandum account shall not be used to recover any net revenue requirement increase. If, at the end of the period covered by the memorandum account, the account reflects a

[3] See immediately preceding footnote.

SB_GT&S_0237373

net revenue requirement increase, the memorandum account shall be terminated without any impact on rates.

Southern California Edison (SCE) has demonstrated that it may well have a revenue requirement increase due to the New Tax Law during 2011, while the revenue requirement decreases will be fully reflected in rates for its 2012 GRC test year and the years thereafter.

If this were a two-way memorandum account, the revenue requirement associated with additional, needed utility infrastructure enabled by the bonus depreciation provisions of the New Tax Law, could allow even larger, unidentified, and unreviewed additional capital investments to be made, and their costs recovered from ratepayers (subject only to after-the-fact reasonableness review).[4]

For the foregoing reasons we are establishing that the memorandum account shall be a one-way memorandum account and instead of requiring a pre-spending application or advice letter for all projects funded by the tax benefits, we are establishing guidelines for the utilities to follow. To the extent a utility stays within these guidelines, it would not need to seek pre-approval of the spending (although reasonableness would still be subject to review in a subsequent GRC). Should a utility determine that the tax benefits would be best invested in some area outside of this resolution's guidelines, it would need to file an application or advice letter seeking Commission approval in order to go forward with the investment.

Accordingly, for a utility that wishes to use savings form the New Tax Law to invest in additional needed utility infrastructure, not otherwise funded in rates, the following guidelines should be followed. Allowable types of infrastructure replacement projects would include the following typical types of projects included in general rate case type applications. For the electric utilities, projects include proactive replacement of poles and underground cables, replacement of existing substation transformers that are over 50 years old or that otherwise require replacement based on reasonable engineering assessments, and work to improve the reliability of the worst-performing or highest priority distribution circuits on their system based on reasonable engineering assessments. The spending must not provide generation capacity at a new plant. For gas utilities, projects include accelerating existing programs of distribution pipeline replacement, replacement of the riskiest or highest priority gas transmissions based on reasonable engineering assessments, and installing "smart pig" and associated plant in gas transmission lines. For water utilities, allowable types of infrastructure replacement projects would include distribution systems, storage, pipeline, and pumping facilities.

[4] Under a two-way memorandum account, the amount of additional investment revenue requirement that could thus be recovered would no longer be limited to the amount of revenue requirement savings during the period covered by the memorandum account.

SB_GT&S_0237374

The property that the investment is made in must be Commission-jurisdictional. The property that the investment is made in must itself be eligible for bonus depreciation. At least 90% of the investment must have a tax depreciable life of at least 15 years, and any remaining investments must be ancillary to such investments.

Which utilities should be exempt from having memorandum accounts?

In general, it is appropriate to establish this kind of a memorandum account for all utilities that have their rates set on a cost–of-service basis. As noted above, these generally include water and sewer system corporations, Small LECs, gas and electrical corporations, pipeline corporations, and heat corporations. However, we conclude that Class C and D water and sewer corporations should be exempt from this memorandum account requirement. There are two main considerations underlying this conclusion. First, many of these utilities have their rates set using a "rate of margin" (ROM), rather than a rate of return. Because rate of return is not a factor in setting the rates of these ROM utilities, their rates do not change when there is change in rate base. Similarly, a deduction of a deferred tax reserve from rate base would likewise have no impact on rates. Indeed, most of the items that would be tracked in the memorandum account are not relevant to these ROM utilities. Second, Class C and D water and sewer utilities are very small utilities for which the administrative burden of keeping track of the necessary accounting entries would be an excessive burden, even for those whose rates are set on a rate-of-return basis.

In comments on the Second Draft Resolution, Mountain Utilities requested that it be exempted from the memorandum account requirement. Mountain Utilities is organized for the purpose of providing sole-source generation, distribution, and sale of electricity exclusively to a customer base of fewer than 2,000 customers and therefore is an "electric microutility" pursuant to Public Utilities (PU) Code section 2780. More specifically, Mountain Utilities serves approximately 700 customers. Thus, it is similar in size to a Class C water utility (which has between 500 and 2,000 service connections). Also, like a Class C water utility, the administrative burden of keeping track of the necessary accounting entries would likely be excessive. Accordingly, we will exempt Mountain Utilities from the requirement to establish a memorandum account. We note that section 2780.1 does not technically apply here (because this is not *hearing* in a proceeding to which Mountain Utilities is a *respondent*), nevertheless the principle behind that section (namely not to impose unnecessary regulatory costs on a microutility) is relevant here. Alpine Natural Gas Operating Company No. 1, LLC (Alpine) also requested an exemption in comments on the Third Draft Resolution. Alpine is a small natural gas company with 1,200 service connections. We conclude that, like Mountain Utilities, Alpine should be exempted from the operation of this resolution due to its small size.

In comments on the Second Draft Resolution, NRG Energy Center San Francisco LLC (NRG Energy Center) also requested an exemption from the memorandum account

SB_GT&S_0237375

requirement. The rates of NRG Energy Center are not currently set using a rate of return. Furthermore, it does not currently have regular general rate cases; indeed it has not had one for many years. Accordingly, NRG Energy Center should also be exempted from the memo account requirement.

In their comments on the Third Draft Resolution, the Small LECs argue that they all should be exempt from this resolution because they are all similar to Class C and D water utilities, a disproportionate cost of complying with the requirement, and the application of the annual means test in the California High Cost Fund-A (CHFC-A) mechanism which serves to limit the draws of those who receive CHFC-A funding to their authorized earnings levels. We concur that the cost of compliance and the limitations of the CHFC-A justify an exemption for the Small LECs

SCE and the Sempra Utilities (San Diego Gas & Electric Company and Southern California Gas Company) argue that since their GRC will be heard in 2012, their capital spending motivated by the 2010 Tax Act would be captured and appropriately treated in the GRC. We concur and will exempt SCE and the Sempra Utilities. To the extent that other cost of service utilities will be addressing the 2010 Tax Act in a 2011 or 2012 test year GRC they should be similarly exempted from the memorandum account requirement.

Pacific Gas and Electric Company (PG&E) appears to be in a unique position of having filed a settlement in its GRC with the Commission in late 2010 before the New Tax Law was signed into law in December. Because it will not be addressing impacts of the New Tax Law until its next GRC filing, PG&E is not exempted from the memorandum account.

The details of the memorandum account:

This resolution will establish for each cost-of-service rate-regulated utility, except for those exempted above, (collectively the Covered Utilities) a memorandum account to reflect, on a CPUC-jurisdictional, revenue requirement basis, impacts from the New Tax Law.

The memorandum account will be used to determine whether any future rate changes are appropriate to reflect impacts of the New Tax Law for the period from the date of this resolution until the effective date of revenue requirement changes in each Covered Utility's next GRC ("Memo Account Period"). The memorandum account will be used by each Covered Utility to track the revenue requirement impacts of the New Tax Law during the Memo Account Period, reflecting on a CPUC-jurisdictional, revenue requirement basis the effects of the New Tax Law not otherwise reflected in rates. In determining an appropriate revenue requirement adjustment, if any, for the Memo Account Period, the Commission will take into account, and each Covered Utility will

SB_GT&S_0237376

record:[5] (a) decreases in its revenue requirement resulting from increases in its deferred tax reserve; and (b) other direct changes in revenue requirement resulting from each utility's taking advantage of the New Tax Law. In their comments on the drafts of this resolution, the utilities have established that, depending on the utility involved, there may be impacts from a decrease in, or elimination of, the Section 199 deduction resulting from bonus depreciation taken, changes in working cash, and, for energy utilities, changes in CIAC calculations. Other impacts may be possible.[6]

In each Covered Utility's next GRC, or at such other time as ordered in that GRC decision, the Commission will address the disposition of amounts (a) recorded in the memorandum account and (b) forecast for the remainder of the Memo Account Period, and may reflect any net revenue requirement decrease in prospective rates.

This memorandum account will be a one-way memorandum account. The following paragraphs describe in further detail some of the wording we have used above in describing the memorandum account.

Amounts in the memorandum account will be recorded on a "revenue requirement basis." This means that each utility will be tracking the revenue requirement impact of each change resulting from the New Tax Law. This is important, because, consistent with the Internal Revenue Code, the tax savings from accelerated depreciation are not passed through directly to ratepayers, but instead, as explained above, ratepayers benefit through the process of normalization and the creation of a deferred tax reserve that is deducted from rate base. We also ensure that all amounts recorded in the memorandum account will be recorded on a consistent basis by requiring that they all be recorded on a revenue requirement basis.

We refer to amounts not otherwise reflected (or recovered) in rates. We use this terminology to exclude costs and expenses recovered through previously authorized rates, e.g., rates set in a prior GRC. We also use it to exclude costs or expenses recovered through rates set after the date of this resolution, e.g., through a balancing account or another memorandum account, or a formal proceeding prior to the utility's next GRC.

In their comments on the Original Draft Resolution, the energy utilities pointed out that the bonus depreciation afforded by the New Tax Law will decrease their taxable income, and therefore may decrease, or eliminate, the Internal Revenue Code Section 199

[5] Although this resolution refers to amounts "recorded" in the memorandum account, because this is a memorandum account, and not a balancing account, the amounts tracked or recorded in the memorandum account are not recorded in the utilities' financial statements, e.g., in the balance sheet.

[6] In its comments on the Third Draft Resolution, PG&E suggests that the memorandum account may need to reflect the treatment of net operating losses, but does not spell out why that is the case, or what kind of adjustment may be required. The need for such an adjustment may be discussed with Commission staff before PG&E files its advice letter containing specific language for its memorandum account.

SB_GT&S_0237377

Manufacturer's tax deduction that they are entitled to, which is already reflected in their revenue requirements. The utilities also pointed out that the New Tax Law will have impacts on their working cash, an item that is a component of their rate base and therefore also reflected in their revenue requirements. We agree that each of these items can properly be reflected in the memorandum account. The energy utilities also argued that the New Tax Law will impact their CIAC (contributions-in-aid-of-construction) revenues. Energy utilities are taxed on plant contributed by others, such as real estate developers. Accordingly, when such entities contribute plant to the utility they must also contribute an amount to cover the tax impacts (the tax component of CIAC). We agree that the New Tax Law is likely to have a revenue requirement impact relating to energy utility CIAC. The energy utilities are authorized to include these CIAC impacts in their memorandum accounts on a revenue requirement basis and consistent with any requirements of the Internal Revenue Code.

In its comments on the Second Draft Resolution, the California Water Association (CWA) raised concerns about how the requirement to establish the memorandum account will apply to multi-district water utilities. Accordingly, we provide the following guidance here. Each district whose rates are separately set will need a separate memorandum account, with a separate Memo Account Period. However, only those districts that have plant placed into service and benefiting from bonus depreciation under the New Tax Law prior to their next GRC will need to record any entries in their memorandum accounts. Where plant benefits more than one district, the revenue requirement impacts shall be proportionally allocated among districts according to previously adopted methodologies, according to benefit received, or as determined in the next GRC.

In its comments on the Second Draft Resolution, SCE suggested that the memorandum account should include "all other changes to SCE's 2011 cost of service due to the New Tax Law". All direct changes in revenue requirement resulting from a utility's taking advantage of the New Tax Law may be reflected in that utility's memorandum account, whether or not they are specifically mentioned in this resolution. The specific categories of revenue requirement impact that each utility wishes to include in its memorandum account should be spelled out in the advice letter it files pursuant to this resolution. For kinds of revenue requirement impact not specifically mentioned in this resolution, the utility will need to provide some justification in its advice letter. The utilities are encouraged to discuss with staff, prior to filing their advice letters, the appropriateness of including kinds of revenue requirement impacts not mentioned in this resolution.

What it means when we establish a memorandum account:

The establishment of a memorandum account does not change rates, nor guarantee that rates will be changed in the future. This mechanism simply allows the Commission to determine at a future date whether rates should be changed, without the impediment of

SB_GT&S_0237378

claims of retroactive ratemaking. Thus, all we are determining here is that it may be desirable to adjust the rates of the Covered Utilities to more fully reflect the tax impacts, if any, that these utilities realize from the New Tax Law, while avoiding any issue of retroactive ratemaking.

When advice letters should be filed:

It will be necessary for each Covered Utility to file an advice letter to incorporate the memorandum account into its tariffs. The proposed tariff language should describe in detail the kinds of revenue requirement impacts that are to be entered into the memorandum account. For kinds of revenue requirement impacts not specifically mentioned in this resolution, the utility will need to provide some justification in its advice letter. We will allow all Covered Utilities until June 30, 2011 to file the required advice letters. This should provide ample time for the utilities to develop tariff language and for discussions with staff. This period should not be problematic because the memorandum accounts are effective for all Covered Utilities as of the date of the original Resolution L-411.

COMMENTS ON DRAFT RESOLUTION

The Original Draft Resolution

Public Utilities Code section 311(g)(1) generally requires draft resolutions to be issued for comment at least 30 days before being voted on by the Commission. However, pursuant to PU Code section 311(g)(3), the Commission has adopted Rule 14.6(c)(9) of its Rules of Practice and Procedure which permitted a reduction in the comment period here. More specifically, Rule 14.6(c)(9) permits the Commission to reduce the 30-day period for public review and comment in circumstances where the public interest in the Commission adopting a resolution before expiration of the 30-day review and comment period clearly outweighs the public interest in having the full 30-day period for review and comment. This resolution does not change utility rates, nor determine that utility rates ought to be changed. It only permits the Commission to consider those issues at a future date, while avoiding retroactive ratemaking concerns. On the other hand, delaying issuance of this resolution to allow for the full 30-day comment period might extend the period of time during which retroactive ratemaking could be a concern. Accordingly, the public interest in adopting this resolution before expiration of a 30 day public comment period clearly outweighs the public interest in allowing for the full 30 day comment period. The Original Draft Resolution was issued for comment on December 30, 2010 and served on all persons on the service list attached to it. Consistent with Rule 14.6(c)(9), there was a reduced comment period with comments due on January 7, 2011.

SB_GT&S_0237379

Comments were submitted by PG&E, TURN, SCE, CWA, the City of Visalia, jointly by Southern California Gas (SoCal Gas) and San Diego Gas and Electric (SDG&E) (collectively the "Sempra Utilities") and collectively by the Small LECs. Most of these comments have been addressed above, or rendered irrelevant in light of our elimination of the "subject to refund" language.

The Second Draft Resolution

In light of the major changes made, a Second Draft Resolution was issued for public comment on February 7, 2011, although an additional comment period was not legally required. The Second Draft Resolution was served on all persons served with the Original Draft Resolution. Comments were due by 10 a.m. on February 14, 2011. Comments were received from PG&E, TURN, SCE, CWA, the Sempra Utilities, the Small LECs, Mountain Utilities, NRG Energy Center, and PacifiCorp.

The Third Draft Resolution

A Third Draft of this Resolution was issued for public comment on February 25, 2011, although an additional comment period was not legally required. Comments were limited to language not included in the Second Draft Resolution and were due by Friday, March 4, 2011. Comments were received from PG&E, SCE, CWA, the Sempra Utilities, the Small LECs, and Alpine.

Given that there have now been three separate opportunities to comment on drafts of this resolution, the public interest in having an opportunity to comment on the draft resolution has been amply respected.

Additional Responses to Comments

There are a number of comments, not addressed above, that we wish to address here.

There were comments to the effect that the Commission had not previously taken action to reduce rates when the Internal Revenue Code was revised to provide for bonus depreciation. We note that utilities often request memo accounts for unexpected increases in expenses between GRCs. These requests, and the resulting memorandum accounts, typically do not include any possibility of decreasing rates. Rather, they allow for the possibility that rates may increase or stay the same. Utilities do not come to us requesting memorandum accounts or rate decreases when there has been a large and unexpected decrease in expenses between rate cases. We believe that an even-handed approach to regulation requires us to consider, when there has been a large and unexpected decrease in expenses between rate cases, whether it is appropriate to establish a memorandum account to allow for a future decrease in rates. Here, the impacts of the

New Tax Law are so large that a number of the major energy utilities have informed the Commission that they expect to pay no federal income tax for at least one year.

There was also some concern expressed about a need to recalculate the entirety of the utilities' deferred tax reserve. However, there is no need to do so. The bonus depreciation provisions of the New Tax Law only apply to property placed into service beginning September 9, 2010. Therefore, only the increase in deferred tax reserve resulting from property placed into service beginning September 9, 2010 needs to be calculated.

Some utilities have expressed concerns regarding the potential complexity of refund mechanisms and the need for prompt resolution so they can initiate desired incremental infrastructure spending. We recognize that attempting to precisely reflect all incremental impacts from the New Tax Law and additional infrastructure spending may create unwarranted complexity and controversy. We, therefore, reiterate our overall intent that this memorandum account should not impede the additional capital spending that the New Tax Law was intended to encourage. We understand that this memorandum account will be implemented on a revenue requirement basis using a mixture of forecasted and actual data and will not be a traditional balancing account matching revenues and expense. While we wish to reflect the incremental effects of the New Tax Law and additional spending on infrastructure for ratemaking purposes, we also understand that estimates and simplifying assumptions will be necessary, some of which have been discussed herein. We encourage Commission staff to support additional practicable and workable solutions for memorandum account implementation and to help facilitate expeditious implementation of these new accounts without engaging in a complex evaluation of the utilities' GRCs.

Several comments argue that the resolution tries to justify impermissible retroactive ratemaking. It does not do so. Although the memorandum account tracks the revenue requirement effects of property placed into service after September 8, 2010, it tracks only those revenue requirement effects occurring after the date of Resolution L-411. Therefore the effect of the resolution is entirely prospective.

In its comments on the Second Draft Resolution, PacifiCorp requests that the Commission allow flexibility so that the Commission can consider other important factors not addressed in the draft resolution, such as a Covered Utility's financial health, in determining whether any balance in the memorandum account should benefit ratepayers. While we do not include in the Ordering Paragraphs the specific language that PacifiCorp has requested, we do agree with PacifiCorp that it, and other utilities, and parties to their rate cases may present to the Commission whatever factors they believe are relevant to the Commission's ultimate decision as to what, if anything, to do with any balance in the memorandum account. In this connection, we note that this resolution creates a memorandum account, and not a balancing account. As noted above, this

SB_GT&S_0237381

resolution does not change utility rates, nor determine that utility rates ought to be changed. It only permits the Commission to consider those issues at a future date, while avoiding retroactive ratemaking concerns.

In its comments on the Second Draft Resolution, TURN requests that we return to the "subject to refund" approach of the Original Draft Resolution, and that we require advance review of additional capital investments, rather than relying on after-the-fact reasonableness review. We have explained above why we are adopting a memorandum account, rather than the subject-to-refund approach. A key consideration in that regard is that the subject-to-refund approach would likely deter the utilities from increasing capital spending, while the New Tax Law was intended to stimulate additional capital spending in the short term.

In its comments on the Third Draft Resolution, SCE argues that, although this memorandum account is not being established as a Z-factor, the memorandum account should be subject to the $10 million threshold applicable to *its* Z-factor. However, not all utilities have Z-factors. This resolution establishes a generic memorandum account for all Covered Utilities. Arguments about whether the amount recorded in the memorandum account of a specific utility should later be reflected in rates should be litigated later. SCE also argues that establishing a memorandum account here is inconsistent with the policy stated in our 1984 decision *Re: Income Tax Expense for Ratemaking Purposes* (D.84-05-026, 15 CPUC 2d 42). SCE focuses on the portion of the decision describing the Commission's reliance on forecast ratemaking. We simply note that in the past nearly 27 years our ratemaking policies for energy utilities have departed in many respects from the kind of forecast ratemaking we engaged in at that time.[7]

Draft Resolution L-411A

Draft Resolution L-411A was issued for comment on May 19, 2011 for a 20-day comment period. Comments were limited to discussing whether the changes made in Resolution L-411A correctly resolve the internal inconsistencies, correct other errors, and clarify the Ordering Paragraphs of the original resolution, consistent with the Commission's intent in approving Resolution L-411. Comments were also permitted to address any other errors or inconsistencies that should have been, but were not, addressed in Draft Resolution L-411. Comments were due on June 8, 2011. Comments were received from ______________________.

[7] PG&E makes a similar argument in its comments on the Third Draft Resolution.

FINDINGS AND CONCLUSIONS

1. President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 ("Tax Relief Act" or "New Tax Law") on December 17, 2010.
2. The Tax Relief Act may provide tax relief to the utilities regulated by this Commission. Among other provisions, this law provides for 100% bonus depreciation on certain business property put into service after September 8, 2010 and before January 1, 2012, with 50% bonus depreciation for at least a year thereafter.
3. The general rates of utilities are typically reviewed only once every three years.
4. The benefits of bonus or accelerated depreciation are generally reflected in rates through "normalization" and the use of a deferred tax reserve.
5. While existing ratemaking mechanisms likely will result in ratepayers benefiting from a portion of the tax benefits utilities receive under the New Tax Law, it is not clear that all of the tax benefits resulting from this new law will have an impact on rates under current mechanisms, because the general rates of utilities are typically reviewed only once every three years.
6. The Commission should allow for the possibility of revising the rates of the utilities whose rates are set on a cost-of-service basis, so that some or all of the benefits of the New Tax Law not otherwise reflected in rates may accrue to ratepayers, while avoiding issues of retroactive ratemaking.
7. The appropriate method for preserving the opportunity to consider, at a later time, whether some or all of the impacts of the New Tax Law not otherwise reflected in rates should be reflected in rates is to establish a memorandum account.
8. The memorandum account should reflect not only the tax benefits of the New Tax Law, but other direct changes in revenue requirement resulting from each utility's taking advantage of the New Tax Law. Such changes may include, but are not limited to, impacts on Section 199 deductions, working cash, and contributions in aid of construction.
9. So as not to discourage utilities from using the tax savings resulting from the New Tax Law for investment in additional, needed infrastructure, the costs and expenses of that infrastructure not otherwise reflected in rates should also be reflected in the memorandum account, to the extent allowed by the guidelines spelled out in this resolution.
10. Many Class C and D water and sewer utilities have their rates set based on a rate-of-margin basis, rather than a rate-of-return basis, such that rate base, and therefore deferred tax reserve, do not have an impact on rates.

SB_GT&S_0237383

11. Class C and D water and sewer utilities are very small utilities for which the administrative burden of keeping track of the necessary accounting entries would be an excessive burden, even if their rates are set on a rate-of-return basis.
12. Class C and D water and sewer utilities should be exempted from the establishment of this memorandum account.
13. Mountain Utilities and Alpine Natural Gas Operating Company No. 1, LLC should be exempted from the establishment of this memorandum account because they are also very small utilities.
14. NRG Energy Center San Francisco LLC should be exempted from the establishment of this memorandum account because its rates are not currently set on a rate-of-return basis and because it does not have regularly scheduled General Rate Cases.
15. Small LECs should be exempted from the establishment of this memorandum account because they will incur a disproportionate cost of complying with the requirement and the application of the annual means test in the CHCF-A mechanism serves to limit the draws of those who receive CHFC-A funding to their authorized earnings level.
16. Southern California Edison Company and the Sempra Utilities (San Diego Gas & Electric Company and Southern California Gas Company) should also be exempted from the memorandum account since their General Rate Cases will be heard in 2012. Further, to the extent that any other cost of service energy or water utilities will be addressing the New Tax Law in a 2011 or 2012 test year general rate case, they should also be exempted from the memorandum account.
17. This resolution does not change utility rates, nor determine that utility rates ought to be changed. It only permits the Commission to consider, at a future date, the issue of whether utility rates should be changed as a result of the New Tax Law, while avoiding retroactive ratemaking concerns.
18. The Commission's overall intent is that this memorandum account should not impede the additional capital spending that the New Tax Law was intended to encourage. Consistent with this intent, the Commission understands that estimates and simplifying assumptions will be necessary, some of which have been discussed herein, and encourages staff to support additional practicable and workable solutions for memorandum account implementation and to help facilitate expeditious implementation of these new accounts.
19. Three rounds of comments have been allowed on drafts of this resolution.
20. Although the memorandum account tracks the revenue requirement effects of property placed into service during and after the 2010 tax year, it tracks only those revenue requirement effects occurring after the date of Resolution L-411. Therefore, the effect of this resolution is entirely prospective.

SB_GT&S_0237384

ORDER

1. There is hereby established for the Covered Utilities described in Ordering Paragraph 2, effective April 14, 2011, a memorandum account to reflect, on a CPUC-jurisdictional, revenue requirement basis, impacts from the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 ("The New Tax Law").
2. The Covered Utilities are: Pacific Gas and Electric Company and other cost-of-service rate-regulated utilities except for: Class C and D Water and Sewer Corporations, Mountain Utilities, Alpine Natural Gas, NRG Energy Center LLC, small local exchange carrier telephone corporations, Southern California Edison Company, Sempra Utilities (San Diego Gas & Electric Company and Southern California Gas Company), and any other cost of service energy or water utilities that will be addressing the New Tax Law in a 2011 or 2012 test year general rate case.
3. This memorandum account shall track on a CPUC-jurisdictional, revenue requirement basis the impacts of the New Tax Law not otherwise reflected in rates during the period starting on the date of this resolution until the effective date of the revenue requirement changes in each Covered Utility's next General Rate Case ("Memo Account Period"). Each Covered Utility shall record in this memorandum account: (a) decreases in revenue requirement resulting from increases in deferred tax reserve; (b) offsets to reflect additional costs or expenses, not otherwise recovered in rates, incurred as a result of additional utility infrastructure investment enabled by the bonus depreciation provisions of the New Tax Law, to the extent allowed by the Guidelines in Ordering Paragraph 5; and (c) amounts to reflect the impacts of any decrease in Section 199 deductions resulting from bonus depreciation taken, changes in working cash resulting from the New Tax Law, any decrease in the tax component of contributions-in-aid-of-construction (CIAC) received due to changes in the tariffed tax component of CIAC to reflect the New Tax Law, and any other direct changes in revenue requirement resulting from the utility's taking advantage of the New Tax Law.
4. This memorandum account shall be used in determining whether any future rate adjustment is appropriate to reflect impacts of the New Tax Law during the Memo Account Period. This memorandum account shall not be used to recover any net revenue requirement increase recorded during the Memorandum Account Period. If, at the end of the Memo Account Period, this memorandum account reflects a net revenue requirement increase, the memorandum account shall be terminated without any impact on rates.
5. Guidelines limiting the additional utility infrastructure investments that may be tracked in the memorandum account are: (a) for the electric utilities, projects that include proactive replacement of poles and underground cables, replacement of existing substation transformers that are over 50 years old or that otherwise require

SB_GT&S_0237385

replacement based on reasonable engineering assessments, and work to improve the reliability of the worst-performing or highest priority distribution circuits on their system based on reasonable engineering assessments. The spending must not provide generation capacity at a new plant; (b) for gas utilities, projects include accelerating existing programs of distribution pipeline replacement, replacement of the riskiest or highest priority gas transmissions based on reasonable engineering assessments, and installing "smart pig" and associated plant in gas transmission lines; and (c) for water utilities, allowable types of infrastructure replacement projects include distribution systems, storage, pipeline, and pumping facilities. For all utilities: (d) the property that the investment is made in must be Commission-jurisdictional; (e) the property that the investment is made in must itself be eligible for bonus depreciation; and (f) at least 90% of the investment must have a tax depreciable life of at least 15 years, and any remaining investments must be ancillary to such investments.

6. In each Covered Utility's next General Rate Case (GRC), or at such other time as ordered in that GRC decision, the Commission shall address the disposition of amounts (a) recorded in the memorandum account and (b) forecast for the remainder of the Memo Account Period, and may reflect any net revenue requirement decrease in prospective rates.
7. No later than June 30, 2011, each Covered Utility shall file an advice letter to add a memorandum account to tariffs consistent with the requirements of Ordering Paragraphs 1, 3, 4, 5, and 6, above. The proposed tariff language shall describe in detail the debits and credits that are to be entered into the memorandum account.
8. The Legal Division shall serve a copy of this resolution, by mail or e-mail, on all cost-of-service rate-regulated utilities and any additional persons who submitted comments on the draft resolution.

SB_GT&S_0237386

9. The effective date of this order is June 23, 2011.

I certify that this Resolution was adopted by the California Public Utilities Commission at its regular meeting of June 23, 2011, and that the following Commissioners approved it:

____

PAUL CLANON
Executive Director

SB_GT&S_0237387

120

Lower bills. Livable planet.

115 Sansome Street, Suite 900
San Francisco, CA 94104
415-929-8876 • www.turn.org
Robert Finkelstein, Legal Director

June 8, 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 Comments on Draft Resolution L-411A To Correct Internal Inconsistencies and Other Errors in Resolution L-411

Dear Commissioners:

In Resolution L-411, issued at the April 14, 2011 meeting, the Commission established a memorandum account for certain cost-of-service rate regulated energy and water utilities to track the impacts of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 ("New Tax Law"). On May 19, 2011, the Legal Division issued for comment Draft Resolution L-411A to correct internal inconsistencies and other errors in Resolution L-411. The Utility Reform Network (TURN) submits these comments on the Draft Resolution L-411A.

TURN has carefully compared Resolution L-411 as adopted with the Draft Resolution L-411A. There are a small number of proposed changes that remedy items that TURN would agree represent internal inconsistencies or minor errors, or provide helpful clarifications. For example, the new sentences explaining how a one-way memorandum account would work (pages 5-6), and the addition of the phrase "If this were a two-way memorandum account" shortly thereafter (page 6) provide important clarification of the differences between these two approaches and could prevent confusion over which approach Resolution L-411 adopted. On a lesser but still helpful level, deleting the words "either of" before "the New Tax Law" (p. 10) would make Resolution L-411 consistent in terms of referring to a single New Tax Law (rather than the two New Tax Laws that some of the earlier versions of the draft of L-411 would have addressed).

But Draft Resolution L-411A would also make a change that seems to modify the outcome adopted in Resolution L-411. The Resolution as adopted had the Commission establish guidelines for the utilities to follow, and "[t]o the extent a utility stays within these guidelines, it would not need to seek pre-approval of the spending (although reasonableness would still be subject to review in a subsequent GRC)." Res. L-411, p. 6. The guidelines described relatively narrow categories of allowable types of infrastructure

SB_GT&S_0237388

replacement projects, with specified examples of projects that would fit within those categories. Draft Resolution L-411A would have the Commission edit the description of the guidelines so that what had been specified examples would now be the only types of projects for which pre-approval is not required.

The approach adopted in Resolution L-411 seems largely based on the proposal TURN described in our letter of April 5, 2011.[1] As TURN further explained in our letter of April 11, 2011, the proposal was not presented as a rigid set of final criteria.[2] Resolution L-411 as adopted is more consistent with such an approach. The Draft Resolution L-411A would instead limit the examples of projects not needing pre-approval to those specified in the text of the resolution. TURN assumes that the proposed revision is intended to address some identified problem or shortcoming of the approach embraced in Resolution L-411 as adopted. However, nothing in the Draft Resolution L-411A identifies such a problem or shortcoming or explains how the revised approach is better.

At this point two other parties have weighed in on the changes proposed in Draft Resolution L-411A. In a letter dated May 26, 2011, PG&E expressed strong opposition to even the issuance of the Draft Resolution. The utility claims that turning the examples of projects that would not need pre-approval into a list of the only types of projects that could go forward without pre-approval would upset its plans for additional spending based on the original guidelines. This suggests that PG&E has in mind using the tax benefits to support additional spending on projects <u>not</u> covered by the specific examples set forth in TURN's April 5 letter, even as modified in PG&E's edits attached as Appendix B to the utility's April 8 letter. PG&E could have identified the potential projects that would have met the pre-approval guidelines of Resolution L-411 as adopted, but not the tighter guidelines of Draft Resolution L-411A. Its failure to do so leaves the Commission to guess as to the effect, if any, that the tighter guidelines under the Draft Resolution L-411A would actually have on PG&E's spending plans.

The California Water Association (CWA) submitted comments to Draft Resolution L-411A on May 31, 2011. CWA seems to be suffering a type of regulatory lag, as the majority of issues it raises in the current comments could have and should have been raised in comments prior to the adoption of Resolution L-411. The cover letter to Draft Resolution L-411A states, "Comments should not reargue issues resolved in Resolution L-411, and comments will do so will not be addressed." On this basis, most of CWA's comments should not be addressed. However, on the off chance that the Commission does not follow through on the admonition included in the cover letter, TURN briefly addresses some of CWA's comments here.

CWA first calls for eliminating the "arbitrary and unjustified 'guideline'" that limits memorandum account treatment to "replacement" projects.[3] CWA even goes so far as to

[1] Compare the criteria set forth at page 3 of TURN's April 5, 2011 letter with the discussion of the allowable types of projects at page 6 of the Resolution.

[2] TURN's April 11, 2011 letter, page 3.

[3] CWA's May 31, 2011 letter, page 3.

SB_GT&S_0237389

suggest that a statement in an earlier TURN letter indicates TURN's willingness to respond flexibly to such a proposal. Let's be clear: TURN's earlier letter stated

> 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.**[4]

CWA does not seek to modify the criteria, but rather to eliminate them. This goes far beyond any reasonable modification, and seems more like a back door attempt to achieve the full exemption of the water utilities that CWA unsuccessfully sought in the lead up to Resolution L-411.

CWA then claims to find a "troubling ambiguity" in the Resolution L-411 discussion of the pre-approval needed before investing tax benefits in an area outside of the guidelines set forth in the Resolution.[5] The relevant language of Resolution L-411 has no such ambiguity:

> Should a utility determine that the tax benefits would be best invested in some area outside of the Resolution's guidelines, it would need to file an application or advice leter [sic] seeking Commission approval in order to go forward with the investment.[6]

While CWA suggests that the Resolution "would seem to impose a pre-approval requirement for utility investment decisions of unprecedented breadth,"[7] the actual language of the Resolution limits that requirement to the use of tax benefits (that would otherwise be used to reduce rates) and then only for investments outside the specified guidelines.

CWA then presents a new argument regarding the purportedly disparate treatment of water utilities with general rate cases likely to be "heard in 2012" and the energy utilities who were exempted from the memorandum account requirement because of their GRCs that would be "heard in 2012."[8] TURN submits that the relevant factor for the energy GRCs is not when the GRC is scheduled or even likely to be "heard," but rather the test year for each utility's GRC. TURN understood the exemption to apply to the energy utilities with a 2012 test year for their next GRC (the Sempra Utilities and SCE). If any

---

[4] TURN Letter April 11, 2011, page 3 (emphasis added).

[5] CWA Letter May 31, 2011, page 4.

[6] Resolution L-411, page 6. The misspelling of "letter" could also be corrected if the Commission issues Resolution L-411A.

[7] CWA Letter May 31, 2011, page 4.

[8] *Id.*, page 5.

SB_GT&S_0237390

water utility also has a 2012 test year, it would also be exempted.[9] The Commission may wish to avoid any further confusion on CWA's part by replacing the "will be heard in 2012" phrase with "are for a 2012 test year" on page 8 and in Finding and Conclusion 16 of Draft Resolution L-411A.

Once again, we thank you for your consideration of these matters.

Yours truly,

/s/

Robert Finkelstein
Legal Director

cc: Joel Perlstein, CPUC Legal Division
Paul Clanon, CPUC Executive Director
Frank Lindh, CPUC General Counsel
Michael Galvin, CPUC
Marzia Zafar, CPUC

[9] Resolution L-411, pp. 7-8, and Finding and Conclusion 17.

SB_GT&S_0237391