

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

Application of Pacific Gas And Electric Company for Approval of Valuation and Categorization of Non-Nuclear Generation-Related Sunk Costs Eligible for Recovery in the Competition Transition Charge.	)	
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	)	
	)	Application No. 96-08-001
	)	(Filed August 1, 1996)
(U 39 E)	)	
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	)	
And Consolidated Proceedings	)	A. 96-08-006
	)	A. 96-08-007
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	)	
Application of Pacific Gas and Electric Company To Establish the Competition Transition Charge	)	Application 96-08-070
	)	(Supplemented October 21,1996)
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(U 39 E)	)	
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	)	A. 96-08-071
And Consolidated Proceedings	)	A. 96-08-072
_____	)	

**CTC PHASE 2  
JOINT PROPOSAL AND EXHIBIT  
ON TAX RELATED ISSUES  
SPONSORED BY ORA, TURN, SCE, SDG&E AND PG&E**

1 Purpose

During Phase 2 of the CTC proceeding, it became apparent that many of the perceived tax disputes raised by parties in their testimony were in fact due to misinterpretations brought about by complex and technical tax jargon used differently by the different parties, rather than arising from any fundamental dispute.

Thus, the participants in this workshop have set out to produce this joint exhibit to highlight areas of agreement, and to draw from each utility's Competition Transition Charge (CTC) filing<sup>1</sup> to provide clear and concise numeric presentations<sup>2</sup> that demonstrate how, and to whom (ratepayers or utilities), tax costs or benefits should flow during the CTC period.

All involved hope that this exhibit will help to avoid time-consuming, expensive, and counterproductive litigation of tax issues in the CTC hearings, where other important issues exist to occupy the parties.

## 2 Workshop Record

Representatives from Pacific Gas & Electric (PG&E), Southern California Edison (SCE), and San Diego Gas & Electric (SDG&E) met with representatives from the Office of Ratepayer Advocates (ORA) and The Utility Reform Network (TURN). Meetings were held on May 16th, May 28th, June 4th, and June 9th of this year. In addition, phone conferences were held between various parties.

While not every representative participated in every session, the participants have all reached consensus on how taxes should be accounted for in the CTC process.

That accord is manifested solely in this document.

## 3 Consensus Regarding CTC Accounting for Taxes

### **Goals**

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<sup>1</sup> A.96-08-070, filed October 21, 1996 for PG&E; A.96-08-071, filed October 21, 1996, as revised February, 1997 for SCE; A.96-08-072, filed October 21, 1996 for SDG&E.

<sup>2</sup> From CTC workpapers; estimated balances as of January 1, 1998; these amounts were audited during the Sunk Cost Audit.

- 3.1 One of the goals inherent in the Preferred Policy Decision (PPD) and AB 1890 is the full satisfaction of all obligations between ratepayers and investor owned utilities during the CTC period, unless the obligation is specifically excluded, or recovery is statutorily limited.
- 3.2 To this end, the PPD and AB 1890 accelerate the recovery of remaining above market plant costs and other generation-related costs, including regulatory assets, during the four year CTC transition period, subject to the statutory limitations of a rate freeze and fixed recovery period. There should be an appropriate sharing of benefits and costs between ratepayers and utilities during the CTC period resulting in full satisfaction of non-excluded obligations, and a “clean slate” between ratepayers and utilities thereafter as utility generation competes in the competitive market.

**Guidance**

- 3.3 As noted above, the PPD and AB 1890 are the principal sources of authority to determine the industry restructuring goals and limitations that provide a backdrop for sharing tax benefits and tax costs between ratepayers and utilities. Decisions adopted by the Commission during the course of the CTC proceedings will implement the AB 1890 goals and limitations.
- 3.4 In addition, Internal Revenue Service (IRS) normalization rules contained in the Internal Revenue Code (IRC) should not be disregarded because the severe penalties that would be imposed by the IRS due to a violation would

significantly increase ratepayer costs during the transition period. Similarly, other IRC provisions and state tax laws are governing.

- 3.5 Finally, Financial Accounting Standards Board (FASB) pronouncements also provide guidance. Although the Commission is not bound by these accounting standards, the standards provide valuable direction because they represent the consensus conclusion of a panel of accounting experts reached after thorough and open debate. These conclusions provide a useful framework for recognizing costs and matching costs with benefits. In addition, the same tax-related FASB pronouncements bind non-regulated generators today and will bind the utilities in the same manner after the CTC transition period.

### **Stipulations**

- 3.6 This agreement addresses property-related taxes (including “tax-on-tax” gross-ups), PG&E’s vacation pay deferred tax asset, and SCE’s ad valorem lien date tax asset. This agreement does not address or govern any tax or accounting issues arising from other non-property related taxation, such as Post Retirement Benefits other than Pensions (PBOP’s) or Pensions.
- 3.7 The parties agree that CTC Tax Costs (Regulatory Tax Receivables) are fully eligible for recovery during the CTC transition period. Thus, the utilities will have the opportunity to receive full funding for CTC Tax Costs subject only to the statutory limitations (rate freeze and a fixed recovery

period) imposed by AB 1890. CTC Tax Costs for property related items are determined as follows<sup>3</sup>:

- A. ( + Net Book Value of generation-related plant  
- Net Tax Value)
  - \* Applicable Statutory Tax Rate [federal and state]
  - \* Net to Gross Multiplier for Taxes
- B. - (Deferred Tax Reserve for normalized property<sup>4</sup>,
  - \* Net to Gross Multiplier for Taxes).

3.8 The CTC Revenue Requirement will continue to be adjusted by the amount of revenue requirement associated with a return<sup>5</sup> computed on the Deferred Tax Reserve balance (before gross up) related to taxes on normalized property until the end of the CTC transition period.

3.9 As the CTC Tax Costs related to flow-through property are funded<sup>6</sup> during the CTC transition period, the CTC Revenue Requirement will be adjusted for the amount of revenue requirement associated with a return on the

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<sup>3</sup> This computation is demonstrated in the Appendices attached for each utility, and is incorporated herein by this reference.

<sup>4</sup> This provides ratepayers with a credit for Deferred Taxes previously funded by them.

<sup>5</sup> Return is determined by the appropriate rate of return times the base amount. The appropriate rate of return is either the utility's authorized rate of return, or the reduced rate of return provided for in AB 1890 when a utility accelerates recovery of uneconomic costs, as applicable.

<sup>6</sup> The Minkin Proposed Decision provides for ordering of recovery based on the rate-of-return earned by the various assets, while the Conlon Proposed Decision requires level amortization over 48 months. In either case, the Deferred Tax Reserve related to flow-through taxes will increase or decrease as a function of the pattern of amortization of the regulatory asset or liability and the level of current taxes paid to taxing authorities.

funded Deferred Tax Reserve balance (related to taxes on flow-through property) until the end of the CTC transition period<sup>7</sup>.

- 3.10 All property-related regulatory tax receivables and/or payables will be amortized to zero by the end of the CTC transition period. This will settle all property-related tax benefits or obligations between ratepayers and utilities. No further sharing of benefits or obligations will occur beyond the end of the CTC transition period, except as provided for in the decisions relating to the Diablo Canyon, Palo Verde, and San Onofre nuclear plants.
- 3.11 PG&E ratepayers will continue to receive a credit against the CTC Revenue Requirement for the amount of revenue requirement associated with a return on the Unamortized Investment Tax Credit (ITC) balance, as permitted by IRC Section 46(f)(1), during the CTC period.
- 3.12 SCE and SDG&E ratepayers will continue to receive a credit against the CTC Revenue Requirement for the amount of the revenue requirement associated with the amortization of ITC, as permitted by IRC Section 46(f)(2), during the CTC period.
- 3.13 SCE's Regulatory Tax Asset related to the Ad Valorem Lien Date Adjustment will be treated as follows:
- During the first three years of the CTC period, or until the property generating the ad valorem lien date adjustment is sold, whichever comes first, the ad valorem lien date regulatory receivable will be

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<sup>7</sup> Traditionally, the Regulatory Asset and the Deferred Tax Liability have been of equal but opposite amounts. During the CTC period, this relationship will be decoupled as the Regulatory Receivable will be recovered over the CTC period, but the Deferred Tax Liability will unwind naturally. This will have the effect of funding the deferred tax over the CTC period. This funded amount (Regulatory Receivable - Deferred Tax Liability) will earn or pay a return which will be included in the CTC Revenue Requirement.

adjusted annually using the method contained in SCE's CTC workpapers. That is, tax benefits for ad valorem taxes will continue to be flowed through to ratepayers in advance of payment of the tax. The cumulative amount of this benefit, which is reflected in the tax regulatory asset, will change annually based upon the property tax due and the benefits provided to ratepayers.

- If a plant is sold or divested, the ad valorem lien date regulatory tax asset related to that plant will be included in the gain on sale computation and will be fully recoverable from ratepayers at that time.
- To the extent the ad valorem lien date regulatory tax asset has not been recovered on or before January 1, 2001, it will be recoverable in full from ratepayers in that year or in the last year of the CTC period if that occurs earlier.

3.14 PG&E's Vacation Pay Deferred Tax Asset will not be amortized during the CTC transition period. However, PG&E will continue to increase the CTC Revenue Requirement for the amount of the revenue requirement associated with a return on the Vacation Pay Deferred Tax Asset, as adjusted for the impact of asset sales or market valuations.

3.15 This agreement formally and with finality concludes and resolves all property-related tax issues raised by and between the workshop participants<sup>8</sup>. The participants ask the Commission to give this document favorable weight in determining the outcome of these issues.

#### 4 Accounting Presentation from Each Utility

Attached are summaries of the plant and tax amounts, as of January 1, 1998, that will be recovered by each utility or credited to ratepayers, subject to Commission approval. Note that these are estimated amounts from each utility's CTC filing; actual amounts as of January 1, 1998, will be based on the books of

account of each utility and provisions of Commission decisions resolving disputed issues related to the CTC treatment of underlying property, and will likely be different from the forecast amounts. Also attached is an appendix containing definitions agreed upon by the participants.

5 Conclusion

The participants believe that the goals of the PPD and AB 1890 are met through the tax accounting detailed above. The accounting fairly shares benefits and costs during the CTC transition period, concludes obligations between ratepayers and utilities at the end of the CTC period, and at all times accommodates requirements imposed by taxing authorities and others.

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<sup>8</sup> The workshop participants included all who raised property-related tax issues during the CTC proceeding to date. In addition, ALJ Minkin announced the start of the workshop, and extended an invitation to all interested parties to attend.