STATE OF CALIFORNIA EDMUND G. BROWN JR., *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

FILED
07/12/19
12:05 PM

July 12, 2019

Agenda ID #17574
Ratesetting

TO PARTIES OF RECORD IN APPLICATION 15-09-001:

This is the proposed decision of Administrative Law Judge Stephen C. Roscow. Until and unless the Commission hears the item and votes to approve it, the proposed decision has no legal effect. This item may be heard, at the earliest, at the Commission's August 15, 2019 Business Meeting. To confirm when the item will be heard, please see the Business Meeting agenda, which is posted on the Commission's website 10 days before each Business Meeting.

Parties of record may file comments on the proposed decision as provided in Rule 14.3 of the Commission's Rules of Practice and Procedure.

The Commission may hold a Ratesetting Deliberative Meeting to consider this item in closed session in advance of the Business Meeting at which the item will be heard. In such event, notice of the Ratesetting Deliberative Meeting will appear in the Daily Calendar, which is posted on the Commission's website. If a Ratesetting Deliberative Meeting is scheduled, ex parte communications are prohibited pursuant to Rule 8.2(c)(4)(B).

/s/ MICHELLE COOKE for
Anne E. Simon
Chief Administrative Law Judge

AES:avs
Attachment

Decision **PROPOSED DECISION OF ALJ ROSCOW (Mailed 7/12/2019)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company for Authority, Among Other Things, to Increase Rates and Charges for Electric and Gas Service Effective on January 1, 2017 (U39M).	Application 15-09-001

DECISION GRANTING PETITION FOR MODIFICATION OF DECISION 17-05-013 TO REFLECT TAX REDUCTIONS FOR PACIFIC GAS AND ELECTRIC COMPANY

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DECISION GRANTING PETITION FOR MODIFICATION OF DECISION 17-05-013 TO REFLECT TAX REDUCTIONS FOR PACIFIC GAS AND ELECTRIC COMPANY

Summary

This decision grants the Petition for Modification of Decision 17-05-013 filed by Pacific Gas and Electric Company (PG&E), to the extent adopted herein, for revision of its 2018 and 2019 attrition-year revenue requirements to reflect the effects of the Tax Cuts and Jobs Act of 2017.

PG&E requested Commission approval of reductions of the attrition-year revenue requirements authorized in Decision 17-05-013, by $267 million for 2018 and by $296 million for 2019, to reflect the effects of the new legislation. Although we find PG&E's methods of calculating these reductions appropriate for the most part, we direct PG&E to modify its calculations in several instances. PG&E is ordered to revise its calculations accordingly so that the finalized reductions may be passed on to customers later this year.

1. Procedural Background

On May 11, 2017, the Commission issued Decision (D.) 17-05-013, adopting General Rate Case (GRC) revenue requirements for Pacific Gas and Electric Company's (PG&E) electric generation, electric distribution system and gas distribution system for Test Year 2017 and attrition years 2018 and 2019. The authorized revenue requirements include PG&E's estimated federal income tax obligations, which PG&E calculated using the corporate income tax rates in effect at that time. On December 22, 2017 the Tax Cuts and Jobs Act of 2017 (TCJA) was signed into law. The TCJA introduced new federal tax laws and made changes to the Internal Revenue Code (IRC) that substantially impacted PG&E beginning in the 2018 tax year. In particular, the TCJA provided for a reduction in PG&E's corporate federal income tax rate from 35% to 21%.

PG&E sent a letter to the Commission's Executive Director on January 5, 2018 proposing to submit a filing by March 31, 2018 to request a reduction in its authorized revenue requirements, as well as an implementation plan to reflect the TCJA reductions in retail customers' rates. The Director of the Commission's Energy Division sent a letter to PG&E on March 2, 2018, stating instead that "PG&E should file a Petition to Modify D.17-05-013 [PFM] by March 31, 2018 in order to present testimony, a revised RO [results of operations] model, and new revenue requirements for attrition years 2018 and 2019 incorporating the effects of the TCJA."

2. PG&E's Petition for Modification

PG&E filed its PFM on April 2, 2018. PG&E requested authority to revise its 2018 and 2019 authorized GRC revenue requirements to incorporate the effects of the lower corporate tax rate and other changes required by the TCJA. Attachment B to the PFM provides PG&E's "Report of Pacific Gas and Electric Company on Revenue Requirement Revisions from the Tax Cut and Jobs Act of 2017 on the 2017 General Rate Case" (PG&E Report). PG&E also provided, as Attachment C to the PFM, the sworn declaration of Mark T. Caron, Vice President of Tax for PG&E Corporation and PG&E.

PG&E's Report and Mr. Caron's declaration state that D.17-05-013 requires modification due to four major tax law changes that have significant impacts on PG&E's estimated tax expense and rate base for 2018 and 2019:

1. The TCJA reduced the corporate income tax rate from 35 percent to 21 percent, effective January 1, 2018;[1]
2. The TCJA adopted what PG&E considers to be a mandatory methodology to return excess tax reserves to customers (Average Rate Assumption Method (ARAM));[2]
3. The TCJA required public utilities to use Modified Accelerated Cost Recovery System (MACRS) depreciation after September 27, 2017;[3] and
4. The TCJA repealed the IRC Section 199 Manufacturing Tax Deduction, effective January 1, 2018.[4]

Based on these changes, PG&E updated its post-test year revenue requirements relating to federal tax expense in two ways. First, PG&E re-calculated its federal tax expense and deferred federal tax liabilities to directly incorporate the four changes listed above. Second, PG&E re-calculated its total rate base to reflect the indirect effect of the same changes on rate base. PG&E's approach to these calculations results in reductions to the revenue requirements authorized in D.17-05-013 totaling $267 million for 2018 and $296 million for 2019. The table below summarizes the distribution of those changes across each of PG&E's GRC-funded lines of business (we note here that the TCJA has the effect of increasing PG&E's gas distribution revenue requirements for 2018 and 2019).[5]

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[1] Section 13001 of Pub L. No. 115-97 amending IRC Section 11.

[2] *Ibid.*

[3] Section 13201(d)(9)(A) of Pub L. No. 115-97 amending IRC Section 168 (k).

[4] Section 13305 of Pub L. No. 115-97 repealing IRC Section 199.

[5] PG&E Report at 2, Table 1, "Revenue Requirement Changes by Functional Area."

PG&E Estimates of Changes in Revenue Requirements Due to the Tax Cuts and Jobs Act of 2017 Increase/(Decrease) $ in Millions		
Line of Business	**2018**	**2019**
Electric Distribution	(186)	(198)
Electric Generation	(99)	(101)
Gas Distribution	18	3
Total	(267)	(296)

The bulk of PG&E's report presents a second set of calculations that itemize the total reductions shown above according to their source in the TCJA. PG&E's summary of the results of those calculations is presented in Table 1 below.[6] For ease of presentation, we will use this table as the outline for our review of each of PG&E's proposed changes in the remainder of this decision.

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6 *Id.*, at 14, Table 9, "Summary of Revenue Requirement Changes in 2018 & 2019 Due to the Tax Act, Total General Rate Case."

Footnote continued on next page

Table 1
PG&E's Proposed
Revenue Requirement Changes
Due to The Tax Cuts and Jobs Act of 2017
($000)

Line No.	Change in Revenue Requirement	Increase/(Decrease) 2018	Increase/(Decrease) 2019
1	Decrease due to lower taxes on equity return on rate base [7]	(486,041)	(504,221)
2	Increase due to lower taxes on flow-through tax deductions [8]	280,595	273,216
3	Increase due to lower taxes on tax credits [9]	2,887	2,887
4	Decrease due to amortization of excess deferred taxes (ARAM)[10]	(81,591)	(106,937)
5	Increase due to higher rate base [11]	19,910	42,398
6	Franchise and Uncollectibles and miscellaneous differences	(2,934)	(3,324)
7	Total Changes due to the Tax Act	(267,174)	(295,981)

3. Positions of Parties

On April 30, 2018 one party in this proceeding, The Utility Reform Network (TURN), filed a response to PG&E's PFM. TURN disputes PG&E's assertion that the TCJA mandates the use of the Average Rate Assumption Method to return excess tax reserves to customers (*see* line 4 in Table 1 above, "Decrease due to amortization of excess deferred taxes"). Apart from this

[7] PG&E Report at 5, Table 2, "2018 Equity ROR-Related Revenue Requirement Reduction, Total General Rate Case."

[8] PG&E Report at 9, Table 5, "2018 Revenue Requirement Change To Flow-Through Under New Tax Rate, Total General Rate Case."

[9] PG&E Report at 9, Table 6, "2018 Revenue Requirements Related To Tax Credits Under New And Old Tax Rate, Total General Rate Case."

[10] PG&E Report at 12, Table 7, "2018 Revenue Requirements Related To ARAM, Total General Rate Case."

[11] PG&E Report at 13, Table 8, "2018 Revenue Requirement Related To Changes in 2018 Rate Base, Total General Rate Case."

dispute, TURN also contends that PG&E has not provided sufficient information to allow the Commission to render a fully informed decision on PG&E's proposals. TURN recommends that the Commission take the following actions in response to PG&E's PFM:

1. Adopt the revenue requirement changes as set forth in PG&E's petition on an interim basis (as modified based on TURN's other arguments), subject to further reduction after the IRS clarifies the proper use of ARAM to return excess tax reserves to customers.
2. Direct PG&E to obtain an IRS Letter Ruling regarding the proper use of ARAM.
3. Require PG&E to provide additional information that TURN believes is necessary to fully analyze the various categories of PG&E's Accumulated Deferred Income Taxes (ADIT), and provide parties a further opportunity to address whether the proposed treatment of each category is appropriate.

Today's decision is based on consideration of the written pleadings of PG&E and TURN.

4. Discussion

In the sections that follow, we address PG&E's estimated TCJA-related revenue requirement changes, as presented in Table 1 above.

4.1. Decrease in Revenue Requirements Due to Lower Taxes on Equity Return on Rate Base

The first item listed in Table 1 above is a significant reduction of the revenue requirement necessary to fund PG&E's authorized return on common equity. Although offset by other increases, as shown on Line 1 of Table 1 this reduction accounts for a $486 million ratepayer benefit in 2018 and a $504 million benefit in 2019.

PG&E's Commission-authorized rate of return (ROR) on its rate base is 7.69%, which is the sum of the weighted cost of its authorized return on long-term debt, preferred stock, and common equity. The calculation shown below reflects the method adopted by the Commission in D.12-12-034; since that time, PG&E made Commission-authorized filings that reduced the weighted cost of its authorized return on common equity from the 5.39% used in PG&E's PFM calculations, to the current value of 5.33%.

PG&E's Authorized Cost of Capital and Authorized Return on Rate Base for its Electric and Gas Operations[12]

		Cost Factor	Capital Ratio	Weighted Cost
Line No.		**(a)**	**(b)**	**= (a) x (b)**
1	Long-term Debt	4.89%	47.0%	2.30%
2	Preferred Stock	5.60%	1.0%	.06%
3	Common Equity	10.25%	52.0%	5.33%
4	Authorized Return on Rate Base			7.69%

PG&E explains in its PFM that its return on common equity represents the Company's net earnings and as such is subject to income taxes.[13] This estimated tax expense, in turn, is a standard item included in every GRC revenue requirement, to be collected from ratepayers as part of the rates they pay for electricity and natural gas.

Pursuant to standard cost-of-service ratemaking practices, federal and state income tax expenses are incorporated into the GRC revenue requirement by means of a factor based on expected income tax rates (the "Income Tax Gross-Up"). PG&E's calculations show that the TCJA's reduction in the federal

[12] D.12-12-034, Ordering Paragraph 4, updated by PG&E in Advice Letter 3887-G/5148-E.

[13] PG&E PFM, Attachment B at 4. PG&E further explains that the debt-related ROR is financed by interest expense, which is tax deductible and therefore does not require a tax recovery or a gross-up. The TCJA did not change the tax deduction for interest expense for public utilities. (*Id.* at 5.)

income tax rate results in a corresponding reduction in the income tax gross-up from roughly 1.78 to roughly 1.42. The use of the lower factor directly reduces the amount by which PG&E's revenue requirement must be increased to account for taxes.

Table 2 below reproduces PG&E's calculation of the isolated impact of the TCJA on PG&E's ROR in 2018 due to the lower corporate income tax rate (*i.e.,* this calculation intentionally ignores the additional effects on rate base due to the TCJA, which we discuss in a later section of this decision).[14] The $486 million decrease in revenue requirement shown in Table 2 results from both the lower income tax gross-up (Line 4) and lower combined tax rates (Line 6).

The methodology used by PG&E in its calculation is undisputed. Based on our own review, we find it to be reasonable. PG&E should use the same method in any revisions made to this line item in compliance with this decision.

Table 2
2018 Equity ROR-Related Revenue Requirement Reduction
($000)

Line No.	Revenue Requirement Calculation	New Tax Rate	Old Tax Rate	(Decrease)
1	Total rate base adopted in D.17-05-013	25,378,933	25,378,933	
2	Rate of return on common equity	5.39%	5.39%	
3	Equity-related return on rate base	1,367,924	1,367,924	
4	Income tax gross-up	1.425313	1.780627	
5	Grossed-up revenue requirement	1,949,721	2,435,762	
6	Combined tax rate	29.84%	43.84%	
7	Revenue requirement attributable to income taxes	581,797	1,067,838	
8	Revenue requirement reduction resulting from lower tax rate			(486,041)

14 PG&E calculated the 2019 tax year impacts in the same manner; those results are summarized in Table 1 above and Table 9 of PG&E's Report.

4.2. Increase in Revenue Requirements Due to Lower Taxes on Flow-Through Tax Deductions

The second item listed in Table 1 above is an increase to PG&E's tax-related revenue requirement due to the effect of the lower tax rate on flow-through tax deductions. As shown in Line 2 of Table 1 the result is a $280 million increase in 2018 and a $273 million increase in 2019.

PG&E uses the flow-through accounting method to reflect certain tax deductions in its GRC revenue requirement. Under this approach, PG&E simply estimates its expected test year tax return deductions and includes those benefits in its final calculation of the revenue requirement. The tax benefit reflected in the revenue requirement is equal to the forecasted cash savings.[15] When tax rates are reduced, this reduces the forecasted tax benefit and increases the forecasted income tax expense, resulting in a higher revenue requirement. However, the future tax expense when a flowed-through tax benefit is reversed (flowed-back) will also be at the lower tax rate. This will reduce the future revenue requirement, which PG&E considers a long-term future benefit to customers.

PG&E has three types of net flow-through tax adjustments, which must be calculated separately because the applicable income tax rates are different: (1) tax deductions where the federal and state amounts are the same, (2) federal-only tax deductions, and (3) state-only tax deductions. We present Tables 3, 4 and 5 together on the following page to show how PG&E developed the estimated change in its 2018 revenue requirement. First, Table 3 calculates PG&E's revenue requirement under the old tax rate. Second, Table 4 calculates PG&E's revenue requirement under the new tax rate. Lastly, Table 5 compares the old and new revenue requirements, which shows a net $280 million

[15] Exhibit PG&E-10, Chapter 12 at 12-3.

reduction in the tax benefit from the amount included in the 2018 revenue requirement authorized in D.17-05-013. PG&E's 2018 revenue requirement must now be increased by that amount.

The methodology used by PG&E in its calculations is undisputed. Based on our own review, we find this approach to be reasonable. PG&E should use the same method in any revisions made to this line item in compliance with this decision.

Table 3
2018 Revenue Requirements Related To
Flow-Through Under Old Tax Rate
Total General Rate Case
($000)

Line No.	Item	Federal and State	Federal Only	State Only	Total
1	Tax deductions	1,058,558	(201,995)	(496,582)	
2	Income tax rate	43.84%	35.00%	8.84%	
3	Income tax change	464,072	(70,698)	(43,898)	
4	Income tax gross-up	1.780627	1.780627	1.780627	
5	Revenue requirement change from flow-through tax deductions	826,339	(125,887)	(78,166)	622,286

Table 4
2018 Revenue Requirements Related to
Flow-Through Under New Tax Rate
($000)

Line No.	Item	Federal and State	Federal Only	State Only	Total
1	Tax deductions	1,058,558	(153,549)	(496,582)	
2	Income tax rate	29.84%	21.00%	8.84%	
3	Income tax change	315,874	(32,245)	(43,898)	
4	Income tax gross-up	1.425313	1.425313	1.425313	
5	Revenue requirement change from flow-through tax deductions	450,219	(45,960)	(62,568)	341,691

Table 5
2018 Revenue Requirement Change To
Flow-Through Under New Tax Rate
($000)

Source	Revenue Requirement	Federal and State	Federal Only	State Only	Total
Table 3, line 5	Revenue requirement reduction from flow-through tax deductions using **old** tax rate	826,339	(125,887)	(78,166)	662,286
Table 4, line 5	Revenue requirement reduction from flow-through tax deductions using **new** tax rate	450,219	(45,960)	(62,568)	341,691
Total change in revenue requirements ("old" minus "new")		376,120	(79,928)	(15,598)	280,595

4.3. Increases in Revenue Requirements Due to Lower Taxes on Tax Credits

The third line in Table 1 above shows an increase in PG&E's post-TCJA revenue requirement that is related to federal and state tax credits, equal to $2.887 million annually in 2018 and 2019 (Table 1, Line 3). PG&E explains that although the reduction in the federal corporate income tax rate does not decrease the tax benefit from such tax credits, the lower tax rate does reduce the tax gross-up factor. This has the indirect effect of increasing the revenue requirement related to tax credits because the lower factor reduces the size of the grossed-up credit that offsets the GRC revenue requirement. This calculation is shown in Table 6 below.

The methodology used by PG&E in its calculation is undisputed. Based on our own review, we find this approach to be reasonable. PG&E should use the same method in any revisions made to this line item in compliance with this decision.

Table 6
2018 Revenue Requirements Related to Tax Credits Under New and Old Tax Rate
($000)

Line No.	Item	New Tax Rate	Old Tax Rate	Difference
1	Federal/State Tax Credits	(8,125)	(8,125)	0
2	Income Tax Gross-Up	1.425313	1.780627	
3	Revenue Requirement Impact of Tax Credit	(11,581)	(14,468)	2,887

4.4. Decreases in Revenue Requirements Due to Amortization of Excess Accumulated Deferred Income Taxes

The fourth line in Table 1 above shows PG&E's estimates of the decrease in its revenue requirements due to the method PG&E proposes to apply to amortize the excess of deferred taxes that have been created by the lower tax rate. PG&E proposes reductions equal to $81.591 million in 2018 and $106.937 million in 2019 (*see* Line 4 of Table 1). PG&E's calculation of the 2018 value is shown in Table 7 below.

Table 7
2018 Revenue Requirements Related to ARAM
($000)

Line No.	Item	New Tax Rate
1	Federal ARAM Adjustment	(57,244)
2	Income Tax Gross-Up	1.425314
3	Revenue Requirement Impact of ARAM	(81,591)

TURN challenges PG&E's choice of methodology for these calculations, and the resulting proposed reductions, contending that "the utility has not provided a complete or appropriate method for identifying and returning Excess ADIT."[16] We turn to that discussion now.

4.4.1. Background

TURN's disagreement with PG&E has to do with the interaction between the utility's depreciation practices and the tax benefits associated with those practices. Like all utilities regulated by this Commission, PG&E accounts for depreciation expenses using one method for ratemaking purposes (straight-line depreciation) and a different method for tax purposes (accelerated depreciation). While straight-line depreciation reduces the value of an asset by the same annual amount over the life of the asset, accelerated depreciation allows a utility to reduce that value by larger amounts early in the life of the asset, and lower amounts in later years. Because depreciation is an expense, using the accelerated method will reduce a utility's net income more in those earlier years than would

[16] TURN Comments at 2.

be the case if straight-line depreciation were used. The lower net income, in turn, reduces the utility's income tax obligation. However, this benefit "reverses" in later years of the life of an asset, when the asset is fully depreciated for tax purposes, leaving no depreciation expenses to offset net income.

Under normal cost-of-service ratemaking principles, regulatory commissions would pass the tax savings that result from accelerated depreciation straight through to ratepayers in the form of a reduced revenue requirement and lower rates. However, Congress adopted accelerated depreciation in order to stimulate investment, and discouraged regulatory commissions from passing along the savings by requiring that utilities using accelerated depreciation for an asset for tax purposes must also comply with "normalization" rules that require that, for ratemaking purposes, the same asset be depreciated over the entire useful life of the asset, via straight-line depreciation.

As a result of the normalization requirement, customer rates collect more taxes than the utility actually pays the IRS in the early years of the underlying asset, but less taxes than are necessary in later years. The utility establishes a "deferred tax reserve account" to record the difference between the straight-line depreciation expense and the accelerated depreciation expense. These funds are labeled Accumulated Deferred Income Taxes (ADIT). The utility then draws down that reserve as the accelerated depreciation benefits for a particular asset reverse.

4.4.2. The Impact of the TCJA on Excess ADIT

The use of normalized accounting is viewed as a means of "protecting" the funds made available by accelerated depreciation--which Congress intended to stimulate additional investment spending--from the reach of regulatory commissions intent on flowing these excess funds back to ratepayers. Instead, the ADIT associated with these "protected" assets must be returned to ratepayers according to an amortization schedule determined by the IRC. This methodology is known as the Average Rate Assumption Method (ARAM). Congress also directed that failure to use the ARAM where it is required is considered a "normalization violation" that the IRS penalizes by withdrawing the option for the utility to take advantage of accelerated depreciation in the future.[17]

Turning now to the impact of the TCJA on these accounting practices, TURN succinctly explains in its comments that "with the reduction in federal taxes from 35% to 21%, approximately 40% of federal ADIT on [PG&E's] books at the end of 2017 immediately became <u>excess</u> ADIT (money that PG&E had collected but will not need to pay for future federal taxes)."[18] TURN and PG&E do not disagree that excess ADIT should be returned to ratepayers, but they do disagree over how the excess amount should be calculated, and how quickly that amount should be repaid. These disagreements are based on each party's interpretation of the IRC regarding these questions.

PG&E calculated the value to be returned to ratepayers in 2018 (the $81.591 million shown in Table 7 above, and on line 4 of Table 1 above) based on its assumption that the TCJA now requires all excess ADIT to be returned according to the ARAM. TURN agrees with PG&E that excess ADIT that is subject to ARAM requirements must be amortized on a schedule that avoids a

[17] The ARAM requires that excess ADIT be reversed as the book/tax difference reverses, meaning that a normalization violation occurs if the excess ADIT is used to reduce rates <u>more rapidly</u> than the corresponding reversal of the book/tax difference turnaround takes place.

[18] TURN Comments at 1-2, emphasis added.

normalization violation, but TURN disagrees with PG&E regarding whether all excess ADIT is really subject to those requirements. TURN contends that the Commission has discretion regarding how it may direct PG&E to return certain categories of excess ADIT to ratepayers. TURN identifies three categories for the Commission's consideration.

4.4.3. The Three Categories of Excess ADIT

The first category of excess ADIT has its source in protected assets, as we described above. TURN acknowledges that most of the excess ADIT that PG&E identifies in its PFM is the result of accelerated depreciation, and is thus a "protected" asset; TURN agrees with PG&E that this category of excess ADIT must be returned to ratepayers using the ARAM. However, TURN also notes that where excess ADIT arose for reasons unrelated to accelerated depreciation, it is considered "unprotected" by the IRC and is therefore not subject to ARAM. Thus, a second category of ADIT may also be plant-related, but is considered "unprotected" by the IRC because it is categorized by provisions of the IRC unrelated to accelerated depreciation. Finally, a third category of excess ADIT derives from assets that are not related to utility plant at all (*e.g.,* vacation pay).[19]

In past GRCs this Commission approved the application of normalization rules to unprotected assets, even though that was not required by the IRC, to ensure that all ratepayers served by the asset over its useful life are treated equally. This is consistent with Public Utilities Code § 454.8, which provides guidance to this Commission regarding proper recovery from ratepayers of the costs of new utility construction:

> In any decision establishing rates for an electrical or gas corporation reflecting the reasonable and prudent costs of the

[19] TURN Comments at 2.

> new construction of any addition to or extension of the corporation's plant, when the commission has found and determined that the addition or extension is used and useful, the commission shall consider a method for the recovery of these costs which would be constant in real economic terms over the useful life of the facilities, so that ratepayers in a given year will not pay for the benefits received in other years.

That said, although we agree that the <u>benefit</u> of deferred taxes should be normalized so that ratepayers are treated equally over time, we do not agree with deferring the <u>return of excess funds</u> if this is not required by statute or regulation. We prefer that such funds be returned to ratepayers now. Unlike requiring all ratepayers to share equally in the expense of an asset over its useful life, returning excess funds to current ratepayers does not impose a greater burden on future ratepayers. Rather, repayment now returns the excess funds to ratepayers who are the closest in time to the recent ratepayers who contributed those funds to these accounts.

The problem before us with respect to our review of PG&E's estimated reduction of $81.591 million is that PG&E calculated this value based on its assumption that all excess ADIT is protected, and therefore subject to the ARAM. As TURN points out in its comments, PG&E's PFM does not distinguish between protected excess ADIT and unprotected excess ADIT and provides no analysis of where the use of ARAM is required and where it is not. TURN therefore contends that the Commission does not have enough information to make a final decision on how to identify unprotected ADIT, and how to return those amounts to ratepayers quickly.[20] We address TURN's contention at the end of this section of this decision.

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[20] TURN Comments at 5.

4.4.3.1. Excess ADIT Related to Cost of Removal

TURN's comments also highlight a separate issue within the debate over excess ADIT, a matter this Commission recently addressed in its decision on Southern California Edison's GRC application (D.19-05-020 in A.16-09-001).[21] This issue is the proper treatment of "cost of removal" in these calculations. Textbooks define depreciation expense as equal to the initial cost of an asset, minus whatever value can be recovered at the end of the asset's useful life after it is fully depreciated (its salvage or "scrap" value). For example, if the cost of the asset is $10,000 and the firm expects its salvage value to be $1,000 then the depreciation expense is $9,000. However, utility assets are typically considered to have negative salvage value because the "cost of removal" (or COR) is expected to exceed any scrap value that may exist. In the example just given, if the cost of the asset is $10,000 but the expected salvage value is $0 and the expected COR is $1,000 then the depreciation expense is $11,000.

PG&E has historically included COR when it calculates its total book depreciation expense, which means that part of the excess ADIT resulting from the TCJA is the COR that ratepayers have been funding over the years. However, PG&E changed its historical practice in its PFM, and excludes COR from book depreciation when it applies the ARAM to calculate the amount of excess ADIT that it recommends be returned to ratepayers. As TURN explains,

> When comparing book depreciation and tax depreciation for purposes of ARAM, the inclusion of the entire amount of depreciation (including both recovery of the original cost of capital investments and the future cost of removal) has a

[21] D.19-05-020 in A.16-09-001.

Footnote continued on next page

> material effect on the outcome. By including only the amount of depreciation associated with recovery of the original cost of capital investments, PG&E's calculations result in a smaller near-term adjustment.[22]

TURN states that it has not estimated the impact of the two possible treatments of COR, but expects that it is a material difference because that was the case in SCE's GRC proceeding.[23]

TURN cites the importance of avoiding normalization violations, and recommends that the Commission approve PG&E's estimated revenue requirement reductions (as modified based on TURN's other arguments), but also order PG&E to (1) request a private letter ruling (PLR) from the IRS as to whether the use of the entirety of book depreciation is appropriate for computing ARAM, or only the portion excluding net salvage; and (2) track the difference between the use of (i) ARAM as set forth in its PFM calculations and (ii) ARAM as defined using the entirety of depreciation, including net salvage.[24]

TURN made its recommendations before we addressed the same issue in our decision on SCE's GRC application. There, we took TURN's recommendations a step further and directed SCE to reduce its revenue requirements immediately in its post-decision rate change, rather than waiting until receiving a PLR from the IRS on the COR question. Our directives were supported by the following Conclusions of Law in D.19-05-020, which state in relevant part:

- The benefits of the TCJA should flow to the ratepayers (*see*, COL 194).

[22] TURN Comments at 3.

[23] *Ibid.*

[24] TURN Comments at 4-5.

- Ratepayers should begin receiving the benefit of the TCJA now and continuing through the remainder of SCE's 2018-2020 GRC cycle (*see*, COL 195).
- SCE should normalize the benefits of the TCJA including deferred taxes reflected on SCE's regulatory books of account based on the differences between SCE's regulatory tax liability, including Cost of Removal, and its actual tax liability, as calculated on its actual depreciable basis (*see*, COL 189).[25]
- The net excess deferred taxes relating to unprotected assets should be returned to ratepayers. Consistent with the return of other funds due to implementation of the TCJA, these funds should be returned on an amortized basis over the remainder of SCE's 2018-2020 GRC cycle (*see*, COL 190).

We intend to apply the same policies to PG&E's PFM proposals as we did in D.19-05-020. PG&E has consistently normalized the benefits of accelerated depreciation derived from its depreciable basis and it is our intention that PG&E continues to normalize the benefits of the TCJA.[26] Historically, PG&E has included COR in its calculation of ADIT. To change now and exclude COR from the ARAM calculation would increase the tax expense for current customers in excess of the benefit they received from the asset: the result is the COR is no longer normalized, despite it being a cost which should be shared equally by all ratepayers. Therefore, we believe it is consistent with the IRC normalization

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[25] In D.19-05-020 the Commission notes that this is consistent with IRC Section 168(i)(9)(A)(i) and Treasury Regulation § 1.167(l) 1(h)(1)(iii). *See*, COL 189 in full and discussion at 294-297.

[26] We repeat our reference from D.19-05-020 at page 296, footnote 680: Taxpayers have a duty to treat items consistently. See *Unvert v. Commissioner*, 72 T.C. 807, 814 (T.C. 1979) ("'there is a duty of consistency as to [tax] treatment, and one should be held to the consequences of the initial treatment.'").

rules for us to require PG&E to continue to include COR in its calculation of excess ADIT when calculating ARAM.

In reaching this determination, we fully intend that PG&E continue to comply with applicable normalization rules. We believe we have reached the correct result, and (as TURN observes at page 4 of its Comments) PG&E has not cited to any written determination, case, regulation, or statute to support its position. Nevertheless, just as we did in D.19-05-020 for SCE, we acknowledge that PG&E may request a PLR from the IRS on this question. In the event that PG&E requests a PLR and subsequently receives an IRS ruling stating normalization rules do not apply to COR in the ARAM calculation for the return of excess deferred taxes to ratepayers, PG&E shall comply with the IRS's interpretation of the applicable tax laws by filing a Tier 2 advice letter with this Commission to seek an appropriate adjustment to its revenue requirement and/or rate base. In the meantime, we agree with TURN that PG&E should use the tax memorandum account established pursuant to D.17-05-013 to track the difference that results from (i) the use of ARAM as set forth in its Attachment B report and (ii) ARAM as defined using the entirety of depreciation including net salvage.

4.4.2. Next Steps Regarding Excess ADIT

We concluded our discussion above regarding the three categories of excess ADIT by echoing TURN's observation that PG&E's PFM does not distinguish between protected excess ADIT and unprotected excess ADIT and provides no analysis of where the use of ARAM is required and where it is not. We face the same problem with respect to PG&E's treatment of COR in its calculations. At the same time, we intend that the benefits of the TCJA be returned quickly to PG&E's ratepayers where it is allowed by the IRC. TURN recommends that the Commission require PG&E to essentially go back to the drawing board and provide a list of all individual components of accumulated deferred tax assets and liabilities, along with extensive additional information for each component. At that point, TURN suggests "[o]nce this information is made available to the parties, the Commission can determine the appropriate method for returning to customers the Tax Act reductions associated with specific assets and accounts."[27] TURN's analysis of the problem facing us is excellent, but we do not believe the solution necessitates that we order PG&E to produce additional data. We did not require this of SCE, and we are also intent on closing out PG&E's PFM now, so that PG&E's customers can begin receiving the benefits of the TCJA to which they are entitled. We discuss our preferred solution below in the "ratemaking implementation" section of this decision.

4.5. Increases in Revenue Requirements Due to Higher Rate Base

The fifth and final material item listed in Table 1 above is PG&E's estimate of the increase in its post-TCJA revenue requirement due to higher rate base. As shown on line 5 of Table 1, PG&E estimates its revenue requirement will increase by $19.91 million in 2018 and $42.398 million in 2019. This is due to four direct impacts of the TCJA on PG&E's rate base:

1) lower deferred federal income taxes from applying MACRS instead of bonus depreciation (the TCJA ended the option to use bonus depreciation);
2) new deferred taxes accruing at the lower tax rate;
3) the ARAM amortization of protected and unprotected excess tax reserves; and
4) working cash.

[27] TURN Comments at 5.

The details of PG&E's estimates are shown in Table 8 below.

First, the combined impacts of PG&E's items (1) through (3) are shown on Line 1, "Deferred Income Taxes." Since deferred taxes are an offset credit against rate base, reductions in deferred tax amounts will increase rate base in the three ways listed by PG&E: applying MACRS instead of bonus depreciation for most of the asset additions after September 27, 2017 reduces deferred taxes. In addition, new tax timing differences arising after 2017 are tax-affected at the lower 21% tax rate, which results in lower new deferred taxes. Finally, ARAM amortization of excess tax reserves also acts to increase rate base when the amortized amounts reduce revenue requirements.

Second, the impact of PG&E's item (4) is shown on Line 2 of Table 8, "Working Cash." Although the ARAM amortization of excess tax reserves acts to increase rate base, this also affects the Working Cash calculation within the RO model; Working Cash is adjusted for changes in Income Taxes, Deferred Taxes and Other Expense Items, and these adjustments made to Working Cash to conform with the Tax Act result in decreases to rate base.

Table 8
2018 Revenue Requirement Related to 2018 Rate Base Changes
($000)

Line No.	Item	Debt Return	Equity Return	Total
1	Deferred Income Taxes	222,000		
2	Working Cash	(22,551)		
3	Total Rate Base Changes	199,449	199,449	199,449
4	Rate of Return	2.30%	5.39%	7.69%
5	Return on Rate Base	4,587	10,750	15,338
6	Income Tax Gross-Up	1.0000	1.425313	
7	Revenue Requirement	4,587	15,323	19,910
8	Income Tax Rate		29.84%	
9	Revenue Requirement Attributable to Income Taxes		4,572	4,572

The methodology used by PG&E in its calculations is undisputed. Based on our own review, we find this approach to be reasonable and PG&E should use the same method in any revisions made to this line item in compliance with this decision.

5. Ratemaking Implementation

As we discussed above, consistent with our approach in D.19-05-020 for SCE, we intend that where the TCJA created benefits that can be passed on immediately to its customers, PG&E provide this rate relief as soon as possible. However, in the SCE proceeding we were able to implement our modifications to SCE's proposal immediately, as part of the overall RO modeling as we prepared D.19-05-020, which incorporated all of our determinations regarding SCE's GRC application, including our decisions regarding the TCJA. The situation is somewhat different for PG&E.

Although PG&E's PFM provided precise estimates of the effects of the TCJA on its 2018 and 2019 post-test year revenue requirements, in this decision we determine that PG&E should revise those estimates in two ways:

i. PG&E should revise its estimated revenue requirement reductions to quantify the amount of unprotected excess ADIT, which can be returned to ratepayers without following ARAM.

ii. PG&E should revise its calculation of the revenue requirement impact of the use of ARAM where it is required (line 4 in Table 1 of this decision) so that the Cost of Removal is included in book depreciation when calculating the amount of protected excess ADIT which can be returned to ratepayers.

TURN has demonstrated that PG&E's calculations—though quite detailed—were not prepared in a way that would allow this Commission, or TURN and other parties, to revise PG&E's estimates in the two ways listed above without PG&E's

assistance. Therefore, we will take the approach to implementing the post-TCJA reductions described below.

In its PFM, PG&E proposes to work collaboratively with the Commission's Energy Division to determine the appropriate timing for providing the revenue requirement revisions authorized in this decision to its customers, with consideration of possible impacts on customer rates due to other factors. We find this approach appropriate, with some additional guidance regarding the Energy Division's role.

First, PG&E should revise its calculations of the post-TCJA revenue requirement reductions in 2018 and 2019 according to our instructions listed above. Staff from the Commission's Energy Division should be consulted by PG&E as these revisions are prepared, and PG&E should provide workpapers with its revised calculations for review by parties in this proceeding, as part of the Advice Letter filing described below.

Second, PG&E should work collaboratively with the Energy Division to determine a recommended length of time over which the revised reductions should be amortized in rates. We note that in the SCE proceeding, we set this period equal to the remainder of the SCE GRC cycle then in progress, approximately 18 months. For PG&E, its current GRC cycle ends at the end of 2019 and we recognize that the optimal period for returning excess funds to PG&E's customers may be longer. That said, we expect these funds to be returned to ratepayers over as short a period of time as possible. The proposal PG&E develops in collaboration with the Energy Division should fully explain how the return of these funds interacts with other upcoming rate changes contemplated by PG&E. As with its revised revenue requirement reductions, this proposal should also be supported by detailed workpapers that will enable other parties in this proceeding to review and comment on PG&E's proposed amortization period.

PG&E should file the revised revenue requirement reductions and the associated amortization proposal in a Tier 2 Advice Letter, as instructed in the Ordering Paragraphs of this decision.

6. Comments on Proposed Decision

The proposed decision of ALJ Roscow in this matter was mailed to parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on ________________.

7. Assignment of Proceeding

Michael Picker is the assigned Commissioner and Stephen C. Roscow is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. On May 11, 2017, the Commission issued D.17-05-013, adopting GRC revenue requirements for PG&E for Test Year 2017 and attrition years 2018 and 2019.

2. The revenue requirements authorized in D.17-05-013 were based upon corporate income tax rates in effect at the time the Commission adopted that decision in May 2017.

3. On December 22, 2017, Public Law 115-97, the Tax Cuts and Jobs Act (TCJA) was signed into law, enacting new federal tax laws and making changes to the Internal Revenue Code (IRC) that substantially impact PG&E beginning in the tax year 2018. These impacts were not incorporated into the 2018 and 2019 GRC attrition year revenue requirements authorized in D.17-05-013.

4. Pursuant to its Petition for Modification (PFM) of D.17-05-013, PG&E calculated the changes resulting from the Tax Act, yielding (a) 2018 GRC attrition year revenue requirement reductions of $186 million for Electric Distribution and $99 million for Electric Generation and an increase in revenue requirement of $18 million for Gas Distribution; and (b) 2019 GRC attrition year revenue requirement reductions of $198 million for Electric Distribution and $101 million for Electric Generation and an increase of $3 million for Gas Distribution.

5. The deferred income taxes reflected on PG&E's regulatory books of account are based on the differences between PG&E's regulatory income tax liability and its actual income tax liability, calculated on its actual depreciable basis and consistent with IRC requirements.

6. The Average Rate Assumption Method (ARAM) requires that excess income tax reserves be refunded to customers based on a normalization method, so that they are returned over the regulated book life of the underlying plant that generated the original reserves.

7. In its GRC application, PG&E included Cost of Removal (COR) in book depreciation when calculating the deferred income tax reserve accrued <u>through</u> December 31, 2017. Conversely, in this PFM PG&E's ARAM amortization calculation does not include new COR accrued for book purposes <u>after</u> December 31, 2017. The difference created by removing COR when calculating the ARAM is likely to have a material impact on the amount of funds that are returned to PG&E's customers.

8. Certain utility assets are not subject to normalization rules. These assets are typically referred to as "unprotected" assets.

Conclusions of Law

1. The Petition for Modification of Decision 17-05-013 should be granted in accordance with the ordering paragraphs below.

2. The reductions to PG&E's 2018 and 2019 GRC revenue requirements due to the TCJA should be passed on immediately to PG&E's customers, to the extent allowed by law.

3. PG&E's proposal to apply ARAM to amortize unprotected excess deferred taxes is not required by law.

4. It is reasonable to require that the net excess deferred taxes relating to unprotected assets be returned to current ratepayers.

5. PG&E should revise its estimated 2018 and 2019 revenue requirement reductions to quantify the amount of unprotected excess Accumulated Deferred Income Taxes (ADIT) which can be returned to ratepayers without following ARAM.

6. PG&E should revise its calculation of the revenue requirement impact of the use of ARAM where its use is required so that the Cost of Removal is included in book depreciation when calculating the amount of protected excess ADIT which can be returned to ratepayers.

7. Returning excess deferred income taxes to current ratepayers does not impose a greater burden on future ratepayers. Rather, repayment now returns excess deferred taxes to ratepayers who are the closest in time to the ratepayers who contributed the funds to these accounts.

8. Any changes to PG&E's post-TCJA revenue requirements should be implemented in a manner that will not be found to be a normalization violation by the Internal Revenue Service (IRS).

9. In the event that PG&E requests a private letter ruling from the IRS and subsequently receives an IRS ruling stating normalization rules do not apply to COR in the ARAM calculation for the return of excess deferred taxes to ratepayers, PG&E shall comply with the IRS's interpretation of the applicable tax laws as described in the Ordering Paragraphs of this decision.

O R D E R

IT IS ORDERED that:

1. The Petition for Modification of Decision 17-05-013, filed by Pacific Gas and Electric Company, is hereby granted in accordance with the ordering paragraphs of this decision.

2. Ordering Paragraph 7 of Decision 17-05-013 is modified to add the following language as additional text at the end of the paragraph:

> In order to reflect the changes in the Tax Cuts and Jobs Act (TCJA) of 2017, the 2018 and 2019 attrition amounts authorized herein shall be reduced in a manner consistent with the new requirements of the TCJA, as calculated by PG&E and submitted in a Tier 2 Advice Letter that shall take effect after approval by the Commission's Energy Division.

3. Pacific Gas and Electric Company (PG&E) shall ensure that its calculations of the revenue requirement reductions due to the Tax Cuts and Jobs Act (TCJA) of 2017 comply with the following instructions:

   i. PG&E's estimated revenue requirement reductions shall quantify the amount of unprotected excess Accumulated Deferred Income Taxes (ADIT), which can be returned to ratepayers without following the Average Rate Assumption Method (ARAM); and

   ii. PG&E's estimated revenue requirement reductions shall quantify the use of ARAM where it is required such that the Cost of Removal is included in book depreciation when calculating the amount of protected excess ADIT which can be returned to ratepayers.

4. Pacific Gas and Electric Company shall consult with the Commission's Energy Division as part of its compliance with Ordering Paragraph 3 of this decision and shall also work collaboratively with the Energy Division to determine a recommended length of time over which the estimated revenue requirement reductions should be amortized in rates.

5. Within 30 days of the effective date of this decision, Pacific Gas and Electric Company shall file the results of its compliance with Ordering Paragraphs 3 and 4 of this decision as a Tier 2 advice letter.

6. If Pacific Gas and Electric Company requests a private letter ruling from the Internal Revenue Service (IRS) concerning application or interpretation of the Tax Cut and Jobs Act, it shall file and serve a copy of its intended request as a Tier 1 Advice Letter at least 30 days before sending the request to the IRS.

7. Any request by Pacific Gas and Electric Company for a private letter ruling concerning application or interpretation of the Tax Cut and Jobs Act shall seek a response to the question, "Is including Cost of Removal/Negative Net Salvage in the Average Rate Assumption Method calculation for the return of excess deferred taxes to ratepayers inconsistent with normalization requirements?"

8. If Pacific Gas and Electric Company (PG&E) requests a private letter ruling from the Internal Revenue Service (IRS) and subsequently receives an IRS ruling stating normalization rules do not apply to Cost of Removal/Negative Net Salvage in the Average Rate Assumption Method calculation for the return of excess deferred taxes to ratepayers, PG&E shall comply with the IRS's interpretation of the applicable tax laws by filing a Tier 2 advice letter with this

Commission to seek an appropriate adjustment to its revenue requirement and/or rate base.

9. Application 15-09-001 remains open.

This order is effective today.

Dated ____________________________, at San Francisco, California.