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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 (Filed September 1, 2015)

RESPONSE OF THE UTILITY REFORM NETWORK TO PETITION FOR MODIFICATION OF DECISION 17-05-013 OF PACIFIC GAS AND ELECTRIC COMPANY TO REFLECT TAX CHANGES

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RESPONSE OF THE UTILITY REFORM NETWORK

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

On March 30, 2018, Pacific Gas and Electric Company (PG&E) served its petition for modification of Decision (D.) 17-05-013 in order to revise its 2018 and 2019 authorized revenue requirements to incorporate the effects of the federal Tax Cuts and Jobs Act of 2017 (Tax Act) and, in particular, the reduction of the corporate income tax rate from 35% to 21%. Pursuant to Rule 16.4(f) of the Commission's Rules of Practice and Procedure, The Utility Reform Network (TURN) submits this response.

PG&E's general rate case (GRC) was for a 2017 test year, with 2018 and 2019 as attrition years. In its proposed adjustment to its attrition Results of Operation (RO) model for 2018 and 2019, PG&E determined changes resulting from the Tax Act that would reduce the authorized revenue requirement by $267 million in 2018, and $296 million in 2019.[1]

I. Context: Protected and Unprotected Excess Accumulated Deferred Income Taxes (ADIT).

The Commission's review of PG&E's proposal and TURN's recommendation must occur in the context of the different types of excess Accumulated Deferred Income Taxes (ADIT). ADIT arises when the utility has collected more money for payment of taxes than it paid the taxing authorities in past years for accelerated depreciaiton and other items. With the reduction

[1] PG&E calculates 2018 revenue requirement reductions of $186 million for Electric Distribution and $99 million for Electric Generation, but an increase of $18 million for Gas Distribution. For 2019, the utility calculates reductions of $198 million for Electric Distribution and $101 million for Electric Generation, and an increase of $3 million for Gas Distribution. PG&E Petition, Attachment B, p. 2.

in federal taxes from 35% to 21%, approximately 40% of federal ADIT on the books at the end of 2017 immediately became excess ADIT (money that PG&E had collected but will not need to pay for future federal taxes).

With its petition, PG&E has begun the process of identifying the amounts of excess ADIT associated with the federal tax rate change, for purposes of returning those amounts to customers. However, in TURN's view the utility has not provided a complete or appropriate method for identifying and returning Excess ADIT.

The bulk of the Excess ADIT relates to accelerated depreciation on plant. The rules for these assets, known as "protected assets," are quite prescriptive. IRS regulations require the difference between tax and book depreciation to be normalized and prescribe that utilities must return the excess ADIT to ratepayers using the Average Rate Assumption Method (ARAM). The ARAM prescribes that excess ADIT be returned to customers in years when book depreciation exceeds tax depreciation and in proportion to the amount by which book depreciation exceeds tax depreciation. This method has the effect of returning the excess ADIT over the life of the assets that are subject to ADIT, but on a basis that <u>**returns more money in the distant future than at present**</u> (a "back-loaded" return).[2]

In contrast, PG&E, and thus the Commission, have discretion in the method of returning the deferred tax related to "unprotected" assets and liabilities. These include plant-related ADIT arising from causes other than accelerated depreciation (e.g., cost of removal, equity and debt AFUDC) as well as ADIT assets that are not related to plant at all (e.g., vacation pay).

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[2] Even where ARAM is prescribed, there are potential differences in interpretation, one of which warrants seeking guidance from the Internal Revenue service, which we will discuss in a section below.

Throughout its petition for modification PG&E intimates that ARAM is the way to return all deferred tax assets, particularly all plant-based assets. As discussed below, we believe that the Commission not only has discretion for non-protected assets but should use it.

II. The Commission Should Direct PG&E To Obtain An IRS Letter Ruling Regarding The Correct Treatment of Cost of Removal For The ARAM Calculations Used To Determine The Revenue Requirement Impacts Of The Tax Act.

PG&E states that the Tax Act provided the Average Rate Assumption Method (ARAM) as the mandatory method for returning excess tax reserves to customers.[3]

PG&E's circumstances here present the same question of interpretation as to the definition of depreciation that TURN recently raised in the tax update hearings regarding Southern California Edison Company's (SCE) test year 2018 GRC (A.16-09-001). PG&E's approach reflects an interpretation that may not necessarily be compelled under the Tax Act or other applicable tax law or regulation. 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 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. While TURN has not had an opportunity to determine the impact of the different approaches for PG&E, we expect that it is a material difference.[4]

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[3] PG&E Petition, Attachment B, p. 3.

[4] For SCE, which addressed its implementation of the Tax Act in testimony served earlier in this year in its test year 2018 GRC, the revenue requirement impact was approximately $37 million in 2018 alone, meaning the $107 million revenue requirement reduction that SCE calculated using an approach similar to SCE's here would have been a $144 million reduction had cost of removal been included. *See*, Ex. TURN-15 (Marcus Update Testimony) in A.16-09-001, served March 5, 2018.

PG&E provided no information that would establish that its interpretation of ARAM as set forth in its testimony is the only appropriate interpretation. There are no citations to Internal Revenue Service regulations or rulings that support its position that only book depreciation should be included. PG&E also provided no information regarding whether its approach here is consistent with the approach taken since 1986 to implement ARAM (after the corporate tax rate was reduced from 46% to 35% at that time).

However, TURN also understands and agrees with PG&E that it is important to implement these changes in a manner that will not be found to be a normalization violation by the Internal Revenue Service (IRS), given the severe consequences a normalization violation could have on PG&E's ratepayers.[5] Therefore, TURN makes the same recommendation here that we made in SCE's GRC: PG&E should pursue a letter ruling from the IRS to resolve the uncertainty regarding whether "book depreciation" for the purposes of ARAM should include cost of removal as well as the recovery of the cost of the original plant investment. The Commission can and should adopt on an interim basis the revenue requirement changes as set forth in PG&E's petition (as modified based on TURN's other arguments), so long as it preserves the opportunity to implement a further revenue requirement reduction should the IRS indicate that ARAM may be defined based on the entirety of book depreciation. To this end, TURN recommends a two-step process:

1) The Commission should order PG&E to develop a request for a private letter ruling 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. TURN recommends a process similar to that taken in SCE's test year 2015 GRC

[5] PG&E Petition, Attachment B, p. 11, footnote 13.

when the question was the appropriate treatment of issues related to the repair allowance vis-à-vis normalization rules.[6]

2) The Commission should direct that PG&E track the difference between the use of ARAM as set forth in its Attachment B report and ARAM as defined using the entirety of depreciation including net salvage, or alternatively preserve that issue by requiring that it be tracked as part of the tax memorandum account established pursuant to D.17-05-013.

III. The Accumulated Deferred Income Taxes (ADIT) That PG&E Deems "Unprotected" Should Be Identified By Different Categories, And Parties Given A Further Opportunity To Address Whether The Proposed Treatment of Each Category is Appropriate.

PG&E's petition for modification does not distinguish between unprotected excess ADIT and protected excess ADIT for purposes of analyzing whether ARAM is appropriate in each case. As a result, TURN submits that the Commission does not have enough information to make a final decision on how to deal with unprotected ADIT based on the information presented in PG&E's petition.

TURN suggests that the Commission direct PG&E to provide the following information, divided into individual elements of ADIT. Specifically, PG&E should provide a list of all individual components of accumulated deferred tax assets and liabilities, excluding those for disallowed capital spending in the gas transmission area. For each individual component, the utility should provide the following information.

a. The amount included in rate base in each of 2016 recorded, 2017, 2018, and 2019 forecast. If the answer is zero, PG&E should explain why. PG&E should include and separately identify any components where a deferred tax asset or liability is netted against a corresponding liability or asset within the cash working capital exhibit rather than included in rate base in the rate base exhibit.

[6] D.15-11-021, Section 22.2.4, pp. 452.

b. Identify the FERC Account (190, 282, and 283) associated with each of the components.

c. Identify whether the component is protected and subject to mandatory ARAM (lives and methods of depreciation) or unprotected (basis adjustments to plant or non-plant ADIT).

d. Provide ADIT calculated as of the end of 2017 at a 35% federal tax rate and the excess ADIT (caused by the reduction in the federal tax rate from 35% to 21%).

e. Provide the amount of excess ADIT forecast to be returned to ratepayers in each of 2018, 2019, 2020, and 2021.

f. Provide the method by which PG&E proposes to return excess ADIT to ratepayers for each individual component (e.g., ARAM, spread over a fixed number of years, etc.)

To the extent any component has a deferred tax asset or liability netted within the utility's cash working capital calculations, it should be included and separately identified.

Once 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.

IV. If Cost of Removal Is Treated As Part of "Unprotected" ADIT, The Associated Liability Should Be Charged to Ratepayers Following ARAM; A Shorter Period Is Likely to Be Appropriate For Other Elements of "Unprotected" ADIT.

The tax treatment of the **cost of removal** results in a deferred tax liability, which would cause rates to increase as the excess ADIT is unwound. It is appropriate for PG&E to apply the same ARAM-based treatment to this liability as for protected assets (regardless of and independent of determining whether depreciation is defined for purposes of ARAM as including or excluding negative net salvage). Since the reduction in current revenue requirement for excess ADIT must be refunded over an extremely long period of time on a back-loaded basis for protected assets, then the increase in customer rates for tax deferrals for cost of removal should be charged to customers over a similarly long period of time, partially offsetting the return of excess ADIT from protected assets, rather than being accelerated.

For other plant-based unprotected assets, a reasonable principle would be to return Unprotected Plant-based ADIT to ratepayers over a relatively long period of time, though less than the useful life of the plant, rather using the back-loaded ARAM which is not required. This would balance intertemporal issues by not refunding the money extremely quickly while providing more rate relief to ratepayers than PG&E proposes. Alternative methods of returning unprotected plant-based Excess ADIT could range from 10 years to the life of the asset without back-loading and might vary depending on the specific asset.

PG&E proposed to normalize the deferred tax positon of its generation assets in 2002, and was ultimately given a 10-year period of higher rates to collect the tax liability from its customers.[7] Now that the shoe is on the other foot, PG&E is attempting to spread out non-protected assets over the longest possible back-loaded period.

For non-plant-based Excess ADIT, the return period should be even shorter, and some of these amounts may be returned through the reversal of tax allowances on cash working capital items. This treatment of deferred taxes on cash working capital reduced rate base by about $38 million (assuming SCE's working capital forecast) in the SCE rate case.[8] Any similar items should be addressed by PG&E.

In sum, PG&E should be required to provide information to enable interested parties and the Commission to investigate the treatment of Unprotected Excess ADIT. The Commission should provide additional time for further comments (and even limited hearings, if necessary).

[7] Decision 04-05-055 in A. 02-11-017, page 75, citing Decisions 02-04-016 and 97-11-074.

[8] A. 16-09-001, TURN-15, pp. 4-6; SCE agreed with TURN's forecast in SCE-61, p. 3.

TURN is confident that the presentation and review of this more detailed information could be achieved and still result in a decision before the end of 2018, consistent with PG&E's proposed timeline for dealing with the 2019 revenue requirement revisions associated with the Tax Act.[9] The Commission may wish to explore an interim revenue requirement and rate reduction in order to provide near-term rate relief as early as possible, with further review of additional information aimed at determining if the amount of the reduction should be increased due to some or all of the issues TURN has identified here.

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Respectfully submitted,

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[9] PG&E Petition, Attachment B, p. 17. The utility proposed less-specific timing for the 2018 revenue requirement revisions, suggesting they may be linked to requested increases such as the billion-dollar CEMA application the utility filed concurrently with this petition.