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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

(U 39 M)

Application 15-09-001
(Filed September 1, 2015)

**PACIFIC GAS AND ELECTRIC COMPANY (U39M)
COMMENTS ON PROPOSED DECISION**

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SUMMARY OF RECOMMENDED CHANGES

- Anticipating industry-wide guidance on normalization from the Internal Revenue Service, PG&E asks that the Commission modify its Proposed Decision and order PG&E to immediately record \$267 million for 2018 and \$296 million for 2019 to the benefit of customers, and to adjust those benefit amounts upon receiving the industry-wide guidance.
- PG&E also seeks various minor clarifications and corrections to the Proposed Decision.

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I. INTRODUCTION

Pacific Gas and Electric Company (PG&E) submits these comments on the July 12, 2019 Proposed Decision Granting Petition for Modification of Decision 17-05-013 to Reflect Tax Reductions for Pacific Gas and Electric Company (Proposed Decision or PD). These comments are submitted in accordance with Rule 14.3 of the Rules of Practice and Procedure of the California Public Utilities Commission (Commission). Appendix A to these comments provides PG&E's recommended changes to the findings of fact and conclusions of law in the Proposed Decision.

In brief, PG&E recommends that the Proposed Decision be revised to account for pending guidance from the Internal Revenue Service (IRS) that is likely to supersede and render obsolete some of the Proposed Decision's discussion on disputed items. Pending the issuance of this guidance, PG&E proposes to promptly refund the amounts set forth in its Petition for Modification through a Tier 1 advice letter submitted within 15 days of the effective date of this decision. After the issuance of the IRS guidance, PG&E proposes to true-up any amounts impacted by the guidance. PG&E would submit this proposed true-up through a Tier 2 advice letter within 60 days of the guidance.

These recommended changes are discussed in Section III below. Section II reports on recent legal developments: in particular, the expected IRS guidance. Section IV identifies certain passages in the Proposed Decision that warrant clarification or correction.

II. RECENT LEGAL DEVELOPMENTS

The Tax Cut and Jobs Act of 2017 (TCJA) was signed into law on December 22, 2017 and reduced the federal tax rate from 35% to 21% effective January 1, 2018. This rate reduction created excess deferred taxes for the differential between 35% and 21%.

For regulated public utilities, the TCJA provided a methodology for returning the benefit of these excess deferred taxes to customers over time, if the return of the benefit adheres to the “normalization” rules.¹ This methodology is known as the Average Rate Assumption Method (ARAM) and it states: “The [ARAM] is the method under which the excess in the reserve for deferred taxes is reduced *over the remaining lives* of the property as used in its regulated books of account which gave rise to the reserve for deferred taxes.”² On March 30, 2018, PG&E submitted its petition for modification (PFM) that led to the Proposed Decision. In that PFM, PG&E presented its interpretation of certain provisions of the TJCA regarding ARAM implementation.³

While this PFM has been pending, utilities sought clarification from the IRS via requests for private letter rulings (PLRs) that would provide guidance on how to implement the ARAM. On at least one occasion, the IRS declined to rule on an individual-company-basis, explaining

¹ Pub. L. No. 115-97 (December 22, 2017), Section 13001(d)(1), as codified in Section 168 of the Internal Revenue Code.

² Id., Section 13001(d)(3)(B) (emphasis added).

³ Some of those assumptions were challenged by TURN, and are resolved in TURN’s favor in Section 4.4 of the Proposed Decision. Acknowledging some uncertainty, however, the Proposed Decision allows for revisions to be made if PG&E pursues a private letter ruling and the IRS clarifies its expectations.

that it was working on industry-wide guidance. (In this situation, PG&E has not sought, and has no plans to seek, a PLR on ARAM interpretation.)

Just recently, the IRS issued Notice 2019-33 on May 13, 2019, seeking comments from industry and interested parties with respect to the interpretation and application of normalization for public utilities by July 29, 2019.⁴ Section 1 of the Notice explains its purpose:

This notice announces that the Department of the Treasury (Treasury Department) and the [IRS] intend to issue guidance under § 168 of the Internal Revenue Code to clarify the normalization requirements for excess tax reserves resulting from the corporate tax rate decrease in the Tax Cuts and Jobs Act (TCJA), Pub. L. 115-97 (131 Stat 2054). This notice requests comments about ratemaking issues that have arisen or are anticipated due to the corporate tax rate decrease and the requirements of section 13001(d) of the TCJA.

It is expected that this guidance will resolve several open questions around implementation of the tax normalization rules, including the questions addressed in Section 4.4 of the Proposed Decision.

III. THE PROPOSED DECISION SHOULD BE MODIFIED TO ACCOUNT FOR THE PENDING IRS GUIDANCE

Given the pending IRS guidance and the IRS' apparent reluctance to issue taxpayer-specific rulings, PG&E recommends that the Proposed Decision be modified to take account of these developments.

A. The Pending IRS Guidance is Likely to Supersede the Discussion of the Disputed Calculations in Section 4.4

Section 4.4 of the Proposed Decision purports to resolve the debate on how to calculate Excess Accumulated Deferred Income Taxes (ADIT). The Proposed Decision follows an approach it took with Southern California Edison Company (SCE), and recommends changes to

⁴ <https://www.irs.gov/pub/irs-drop/n-19-33.pdf>.

PG&E's calculations in two areas.⁵ Acknowledging some uncertainty in this approach, however, the Proposed Decision allows for future revisions to the revenue requirement calculations through a Tier 2 advice letter *if PG&E were to seek a private letter ruling from the IRS*.⁶ As discussed in Section II of these comments, the IRS is reluctant to entertain any such PLRs on these topics. Instead, the IRS is expected to address the open issues in its upcoming guidance.

The approach recommended in the Proposed Decision is substantively unwise insofar as it presupposes an outcome currently under review before the IRS. Had the Commission been aware of the upcoming guidance – as explained above, the IRS only announced the notice two months ago – PG&E expects that Commission would have naturally deferred the resolution of these disputed calculations to the IRS instead of attempting to resolve them in Section 4.4. Now that the IRS' direction is apparent, the prudent course for the Commission would be to defer resolution of these issues to the IRS guidance.

B. The Proposed Decision Should Be Modified to Return the Previously Calculated Amounts Promptly to Customers, with a True-up to be Provided after IRS Guidance

PG&E supports the desire to “provide this rate relief as soon as possible.”⁷ Because PG&E is unable to predict the timing of the upcoming IRS guidance, PG&E recommends the Proposed Decision be revised to direct the prompt return of the revenue requirement calculated by PG&E in its PFM. This can be done faster than the relief called for in the Proposed Decision because no additional calculations are necessary. Thus, within 15 days of the effective date of the decision, PG&E proposes to file a Tier 1 advice letter developed in collaboration with the

⁵ PD, p. 25.

⁶ PD, p. 31 (Ordering Paragraph 8).

⁷ PD, p. 25.

Energy Division describing how the reductions will be amortized in rates and how the return of those funds will interact with other rate changes. This shortened process will help ensure timely processing with upcoming rate changes and submittals in other pending proceedings, e.g., PG&E's November Update of its 2020 ERRRA Forecast Application (Application 19-06-001).

Subsequently, once the IRS guidance issues, PG&E would file any necessary true-up through a Tier 2 advice letter developed in collaboration with Energy Division, within 60 days of the IRS guidance. In this way, customers can receive faster relief, and possible conflict with IRS guidance will be avoided.

C. PG&E's Proposed Approach Would be Faster, More Efficient and Less Confusing to Customers

Given the upcoming IRS guidance, the Proposed Decision's approach will potentially lead to a slower customer refund, create inefficiencies and could frustrate customers if a portion of the refund needs to be reversed upon issuance of the IRS guidance.

PG&E's approach would be faster because the refund can be implemented in a Tier 1 filing, not Tier 2, within 15 days, not 30, of the Commission's decision. PG&E's calculation is already made and ready-to-go. The calculation was set forth in PG&E's PFM.

PG&E's approach would also be more efficient. It would be laborious and burdensome for PG&E to prepare the revised revenue requirement calculations required by the Proposed Decision, just to have to do them again to calculate new revenue requirement calculations after the IRS guidance issues. These calculations are time-intensive and add to PG&E's administrative costs. Insofar as these calculations can be done just once (after the IRS guidance issues), not twice, the Commission and stakeholders would be wise to embrace this opportunity to find efficiencies and reduce PG&E costs.

Another advantage of PG&E's approach is that the rate changes (whether they be one or two) are likely to be in the same direction for customers. This should mitigate possible confusion. While PG&E acknowledges that the Proposed Decision has found against PG&E in its treatment of Cost of Removal (COR), PG&E remains confident that the upcoming IRS guidance will support PG&E's treatment. One of the reasons for this confidence is the parallel IRS guidance provided for normalization of Investment Tax Credit (ITC) that is discussed below in Section IV.B. If the upcoming IRS guidance follows its previous ITC guidance, then customers will have received the appropriate amount in the initial refund. If the upcoming IRS guidance follows instead the Commission's treatment in Section 4.4, then customers will receive an additional refund in the true-up, both of which should be received favorably by customers.

IV. CLARIFICATIONS AND CORRECTION OF ERRORS

There are a number of passages in the Proposed Decision that warrant clarification or correction. These issues are discussed below.

A. Excess Deferred Taxes (ADIT) Related to Cost of Removal Continues to be Normalized

The Proposed Decision states, "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."⁸ The underlined portion of the statement is inaccurate. As described in Commission Decision (D.) 88-01-061, PG&E normalizes post 1980 COR and will continue to normalize COR even after implementation of the TCJA.⁹

⁸ PD, p. 21 (emphasis added).

⁹ 27 CPUC2d 310, 325 ("Removal costs are incurred in the process of removing old plant facilities which have ended their useful life and replacing them with new plant facilities. These costs have been

B. Pending IRS Guidance, PG&E's Methodology is Consistent with Technical Guidance for Normalization of Tax Benefits

TCJA Section 13001(d) defines the ARAM as “the excess in the reserve for deferred taxes is reduced over the remaining lives of the property as used in its regulated books of account which gave rise to the reserve for deferred taxes.” (Emphasis added.) That provision further states that it would be a violation if the excess tax reserve were reduced more rapidly or to a greater extent than such reserve would be reduced under the ARAM. The Proposed Decision notes that for normalization purposes consistency is a requirement.¹⁰ PG&E believes its ARAM amortization meets this consistency requirement based upon current technical guidance.

The Internal Revenue Code (IRC) requires two items to be normalized by public utilities; (1) accelerated tax depreciation under IRC Section 168 and (2) investment tax credits (ITC) under the former IRC section 46.¹¹ The IRS uses PLRs to assist taxpayers on how to comply with normalization rules like ARAM. While the IRS has not provided guidance on how to determine the remaining life as used in its regulated books for ARAM purposes when the taxpayer calculates book depreciation including net salvage; the IRS has provided ample guidance on that issue for the amortization of ITC.

Former IRC section 46(f) and section 1.46-6 of the Income Tax regulations provide limitations on the use of tax credits by public utilities. Former section 46(f)(1) provides a

treated as currently deductible for ratemaking tax purposes for 1980 and prior flow-through property and normalized in the calculation of book depreciation rates (straight line) for 1981 and subsequent years plant additions.”).

¹⁰ PD, p. 21, footnotes 25 and 26.

¹¹ Although the normalization sections of IRC section 46(f) were repealed in 1990, the IRC section 46(f)(1) and (2) elections made by utility taxpayers like PG&E are lifetime elections and therefore, still binding on utility taxpayers.

general rule that disallows tax credits for “public utility property” if, for ratemaking purposes, such investment tax credit is used to reduce the taxpayer's cost of service faster than ratably over the property's useful life for ratemaking purposes.¹² Ratable is also defined in section 46(f)(6) as “the period of time used in computing depreciation expense for purposes of reflecting operating results in the taxpayer's regulated books of account...”

As noted, this language is substantially similar to the ARAM limitation of over the remaining lives of the property as used in its regulated books of account.

A number of PLRs address a taxpayer that calculates book depreciation including net salvage. They conclude that the regulatory life for ITC amortization excludes the depreciation attributable to net salvage in determining the regulatory life of the asset.¹³

For example, PLR 200933023 describes the taxpayer’s depreciation methodology as follows:

The composite annual percentage rate is based on an estimate of average useful life and net salvage. For the Taxpayer net salvage, the estimated value of the asset upon retirement reduced by the estimated cost to retire, remove, and dispose of the asset, is negative in the aggregate. The use of net salvage (where negative) in the composite annual percentage rate increases that rate and, because the composite annual percentage rates are also used in the calculation of the ITC amortization, increases the ITC amortization.

The IRS concluded that using a regulatory life that included negative net salvage in determining the remaining regulatory life resulted in a normalization violation.

For the periods during which Taxpayer included negative net salvage in its calculation of asset life for ITC purposes..., the effect of these actions was to flow the ITC to ratepayers more rapidly than if calculated without the negative net salvage... However, this was not the intent of either the Taxpayer or of any of the Commissions...

¹² PLR 200933023, available at <https://www.irs.gov/pub/irs-wd/0933023.pdf>.

¹³ See PLRs 200933023 (<https://www.irs.gov/pub/irs-wd/0933023.pdf>), 200802026 (<https://www.irs.gov/pub/irs-wd/0802026.pdf>), and 200802025 (<https://www.irs.gov/pub/irs-wd/0802025.pdf>).

The PLR went on to hold that the inadvertent error caused by using negative net salvage in the calculation of ITC amortization would not require sanctions since both the taxpayer and the Commission were unaware of the errors/violations.

PG&E has followed the guidance that appears in these rulings for amortization of its ITC. Based upon the similarity of the language in TCJA section 13001(d) to the language in section 46(f)(6), PG&E believes that consistency would dictate ignoring depreciation attributable to net salvage in the calculation of an asset's remaining regulatory life.¹⁴

C. Finding 7 Should be Corrected to Explain that Removing COR Does Not Affect the Total Funds Returned to Customers.

Finding of Fact 7 in the Proposed Decision states in part that “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 customers.”¹⁵ The statement implies that the absolute amount of excess deferred taxes to be returned to customers would change by excluding COR from ARAM. In fact, the act of including or excluding COR from ARAM would change the *annual* amount returned to customers, but not the *total*. Thus, PG&E recommends revisions to this Finding, as set forth in Appendix A.

D. PG&E Did, in Fact, Quantify Protected vs. Unprotected Assets

The Proposed Decision comments that “PG&E 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.”¹⁶ In fact, PG&E provided an analysis of protected vs.

¹⁴ See PLR 200811004 (<https://www.irs.gov/pub/irs-wd/0811004.pdf>) where the IRS found a taxpayer using the same life for regulatory depreciation, ITC amortization and ARAM was not a normalization violation.

¹⁵ PD, p. 28.

¹⁶ PD, p. 22.

unprotected assets, by category, in the April 11, 2018 workshop hosted by the Commission to discuss the PFM. PG&E's workshop materials, which included this analysis on page 11, were provided to the service list on April 11, 2018.

PG&E does not urge the Commission to take any action with respect to the analysis that PG&E provided, because the upcoming IRS guidance could well redefine some of these categories. Nonetheless, the statement in the Proposed Decision that PG&E did not provide this type of analysis is incorrect. PG&E recommends that it be corrected.

E. As a Point of Clarification, Any Change to Book Depreciation for ARAM Purposes Also Changes Flow-back

The Proposed Decision states that the method for calculating the impact on flow-back is reasonable, undisputed, and should be applied to any revisions.¹⁷ The PFM described the methodology in detail: "Second, in order to be consistent with the removal of cost of removal (COR) book depreciation in the ARAM calculation (see ARAM discussion below), PG&E also removed the COR book depreciation in the federal book flow-back depreciation calculation. This reduces the cost to customers."¹⁸

As a point of clarification, PG&E would like to make sure that it is understood that if the Commission proceeds with the requirement in the Proposed Decision to recalculate the refund due to customers with COR included in ARAM (as Section 4.4 currently provides), the parallel inclusion of COR in book depreciation will revise the federal flow-back amount. This would cause the amounts calculated for flow-back to differ from those shown in PG&E's PFM.

¹⁷ PD, 11 ("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 revision made to this line item in compliance with this decision.").

¹⁸ PFM, p. 7.

V. CONCLUSION

Based on the foregoing, PG&E respectfully requests the Proposed Decision be revised to account for pending guidance from the IRS and to be clarified and corrected for the various issues identified above.

Respectfully Submitted,

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APPENDIX A

PG&E'S PROPOSED CHANGES TO THE CONCLUSIONS OF LAW AND FINDINGS OF FACT

The passages below provide PG&E's recommended changes to the Findings of Fact and Conclusions of Law set forth in the Proposed Decision. PG&E's recommendation changes are shown in strike-out for proposed deletions and double-underlining for proposed additions.

* * * * *

Findings of Fact (Revised)

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. The Internal Revenue Service is expected to provide guidance regarding whether the normalization rules require the ARAM to include Cost of Removal (COR) accrual in the book depreciation.

7. In its GRC application, PG&E included Cost of Removal (COR) in book depreciation when calculating the deferred income tax reserve accrued through December 31, 2017. Conversely, in this PFM PG&E's ARAM amortization calculation does not include new COR accrued for book purposes after 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.~~ will not change the total amount of excess tax funds to be returned to PG&E's customers. It could change the amount returned per year, but that difference is compensated by offsetting changes to rate base.

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

9. PG&E, during the Commission's April 11, 2018 workshop, presented a schedule showing protected excess deferred taxes of \$2,809 million *due to* customers and \$774 million (including \$720 million of Cost of Removal) of unprotected excess *due from* customers.

10. The Internal Revenue Service (IRS) issued Notice 2019-33 on May 13, 2019, seeking comments from industry and interested parties with respect to the interpretation and application of normalization for public utilities.

Conclusions of Law (Revised)

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.~~ through a Tier 1 advice letter submitted within 15 days of this decision. Prior to filing of the Tier 1 advice letter, PG&E shall consult with the Commission's Energy Division on the filing. PG&E should file a Tier 2 advice letter within 60 days of Internal Revenue Service (IRS) guidance on the interpretation and application of normalization for public utilities. Prior to filing of the Tier 2 advice letter, PG&E shall consult with the Commission's Energy Division to determine the effects on the revenue requirement, if any, from the IRS guidance.

3. PG&E's proposal to apply ARAM to amortize unprotected excess deferred taxes is ~~not required by law.~~ expected to be clarified in upcoming Internal Revenue Service guidance.

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 or collected from 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: after

IRS guidance is issued clarifying that the Cost of Removal must be included in book depreciation when calculating the amount of protected excess ADIT to be returned to ratepayers.

7. Returning or collecting excess deferred income taxes to or from current ratepayers does not impose a greater benefit or 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). This can be achieved by waiting for IRS guidance before changing the Petition for Modification computation.

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,~~ When PG&E receives IRS guidance on ARAM normalization rules, PG&E shall comply with the IRS's interpretation of the applicable tax laws as described in the Ordering Paragraphs of this decision, and work collaboratively with Energy Division to submit a Tier 2 Advice Letter upon receiving such guidance.

* * * * *