

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Legal Division

San Francisco, California

Date: March 10, 2011

Resolution No. L-411

RESOLUTION

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

SUMMARY

This resolution establishes a two-way memorandum account for all cost-of-service rate regulated utilities, except for Class C and D water and sewer utilities, and except for Mountain Utilities and NRG Energy Center, to track the impacts of the Tax Relief, Unemployment Insurance Reauthorization, And Job Creation Act Of 2010 and the bonus depreciation provision of the Small Business Job Act Of 2010. More specifically, this account will track on a CPUC-jurisdictional, revenue requirement basis: (a) decreases in each covered utility's revenue requirement resulting from increases in its deferred tax reserve; and (b) other direct changes in revenue requirement resulting from each utility's taking advantage of the New Tax Laws. This resolution also authorizes any covered utility that wishes to use savings from these new tax laws to invest in additional, needed utility infrastructure, not otherwise funded in rates, within a time frame shorter than would be practicable through the formal application process, to file a Tier 3 advice letter requesting establishment of a separate memorandum account into which to record the revenue requirement associated with such additional capital investment.

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

BACKGROUND

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

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

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

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

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

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

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

DISCUSSION

The purpose of this resolution:

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

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

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

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

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

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

The approach the Commission should adopt to achieve this purpose:

The Original Draft Resolution³ proposed to accomplish the above purpose by making the rates of all cost-of-service rate regulated utilities subject to refund for the limited purpose of allowing ratepayers to benefit, to the extent, if any, the Commission finds reasonable, from tax benefits resulting from the Tax Relief Act.

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

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

³ See immediately preceding footnote.

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

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

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

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

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

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

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

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

Which utilities should be exempt from having memorandum accounts:

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

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

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

In comments on the Second Draft Resolution, Mountain Utilities requested that it be exempted from the memorandum account requirement. Mountain Utilities is organized for the purpose of providing sole-source generation, distribution, and sale of electricity exclusively to a customer base of fewer than 2,000 customers and therefore is an “electric microutility” pursuant to Public Utilities (PU) Code section 2780.⁶ More specifically, Mountain Utilities serves approximately 700 customers. Thus, it is similar in size to a Class C water utility (which has between 500 and 2,000 service connections). Also, like a Class C water utility, the administrative burden of keeping track of the necessary accounting entries would likely be excessive. Accordingly, we will exempt Mountain Utilities from the requirement to establish a memorandum account. We note that section 2780.1 does not technically apply here (because this is not *hearing* in a proceeding to which Mountain Utilities is a *respondent*), nevertheless the principle behind that section (namely not to impose unnecessary regulatory costs on a microutility) is relevant here.

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

Some utilities with 2012 test year GRCs argue that they should be exempted from the memorandum account requirement. In support of this argument they point out that the Tax Relief Act will not have any effect on their cash flow until late 2011. However, these utilities’ rates are set on an accrual, not a cash, basis, and the benefits of the Tax Relief Act have already begun accruing or will accrue later during 2011⁷. Because this

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

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

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

The details of the memorandum account:

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

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

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

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

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

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

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

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

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

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

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

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

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

What it means when we establish a memorandum account:

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

When advice letters should be filed:

It will be necessary for the Covered Utilities to file advice letters to incorporate the memorandum account into their tariffs. Rather than requiring each of the Covered Utilities to quickly file such advice letters, we will instead require only the four major energy utilities to file such advice letters within 30 days. Any other Covered Utility may also file such an advice letter within 30 days of the date of this resolution. In addition, any entity that has filed comments on any draft of this resolution may, within 30 days, submit to the Legal Division suggested memorandum account language that would apply to any group of utilities. This should provide a more efficient means for Commission staff to review language that should apply to a class of utilities. However, as requested in the comments of the California Water Association on the Second Draft Resolution, these 30 day periods will be extended to 60 days for Class A and B water utilities.² In each

² We grant this extension to the water utilities, and not other utilities, as only the water utilities requested it; although we have extended the time for other utilities to file from 15 to 30 days. Furthermore, many of the water utilities have to deal with the additional complexity of multiple districts whose rates are

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

COMMENTS ON DRAFT RESOLUTION

The Original Draft Resolution

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

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

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

The Second Draft Resolution

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

The Third Draft Resolution

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

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

Additional Responses to Comments

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

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

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

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

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

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

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

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

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

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

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

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

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

FINDINGS AND CONCLUSIONS

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

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

ORDER

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

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

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

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

PAUL CLANON
Executive Director