Date of Issuance
June 23, 2011

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Legal Division

San Francisco, California
Date: June 23, 2011
Resolution No.: L-411A

RESOLUTION

REVISED 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, ALPINE NATURAL GAS, NRG ENERGY CENTER, SMALL LOCAL EXCHANGE CARRIER TELEPHONE CORPORATIONS AND THOSE ENERGY AND WATER UTILITIES THAT WILL BE ADDRESSING THE TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOB CREATION ACT OF 2010 IN A 2011 OR 2012 TEST YEAR GENERAL RATE CASE, TO ALLOW THE COMMISSION TO CONSIDER REVISING RATES TO REFLECT THE TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOB CREATION ACT OF 2010

SUMMARY

It has come to the Commission's attention that Resolution L-411, as approved by the Commission on April 14, 2011, contained a number of internal inconsistencies and other similar errors. Accordingly, we are issuing this revised Resolution L-411A to remove the inconsistencies, correct the errors, and clarify the Ordering Paragraphs of the original resolution. The effective date of the memorandum account established by the resolution remains April 14, 2011.

This resolution establishes a one-way memorandum account for all cost-of-service rate regulated utilities that do not address the New Tax Law in a 2011or 2012 test year General Rate Case proceeding, to track the impacts of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 ("New Tax Law" or "Tax Relief Act"). By its terms, however, this resolution exempts all Class C and D water and sewer utilities, Mountain Utilities, Alpine Natural Gas, NRG Energy Center, and small

local exchange carrier telephone corporations. More specifically, the memorandum account established by this resolution will track on a CPUC-jurisdictional, revenue requirement basis: (a) decreases in each impacted utility's revenue requirement resulting from increases in its deferred tax reserve; and (b) other direct changes in revenue requirement resulting from taking advantage of the New Tax Law. This resolution also authorizes impacted utilities to use savings from this new tax law to invest in certain additional, needed utility infrastructure, not otherwise funded in rates, within a time frame shorter than would be practicable through the formal application or advice letter processes. 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 be concerned with issues of retroactive ratemaking.

BACKGROUND

On December 17, 2010, President Obama signed the 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 (Small LECs), 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

[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).

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 years between general rate 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. However, we decline to do so because the Small Business Act is a re-authorization of four previous bonus depreciation laws enacted since 2002, none of which triggered any adjustment to rates other than in test years.

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 Tax Relief Act (or New Tax Law), 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 D.10-04-031:

> 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 Law 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]

[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 previously 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.

The approach the Commission should adopt to achieve this purpose:

The Original Draft Resolution[3] 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 Law is to encourage additional capital investment, thereby stimulating employment and the economy. The utilities could use tax savings realized under the New Tax Law to fund additional, needed utility infrastructure investment not otherwise funded by rates. This may be an opportune time to increase capital investment, 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 Law 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 Law. This approach still permits the Commission to determine at a later date whether some of the impacts of the New Tax Law 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 Law is intended to encourage.

The second and third drafts of this resolution accommodated the desire of some utilities to use the tax savings realized under the New Tax Law 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 Law to be tracked as an offset to the memorandum account. This resolution authorizes such an offset. This resolution also establishes that this memorandum account will be a one-way memorandum account. This means that this memorandum account shall not be used to recover any net revenue requirement increase. If, at the end of the period covered by the memorandum account, the account reflects a

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[3] See immediately preceding footnote.

net revenue requirement increase, the memorandum account shall be terminated without any impact on rates.

Southern California Edison (SCE) has demonstrated that it may well have a revenue requirement increase due to the New Tax Law during 2011, while the revenue requirement decreases will be fully reflected in rates for its 2012 GRC test year and the years thereafter.

If this were a two-way memorandum account, the revenue requirement associated with additional, needed utility infrastructure enabled by the bonus depreciation provisions of the New Tax Law, 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).[4]

For the foregoing reasons we are establishing that the memorandum account shall be a one-way memorandum account and instead of requiring a pre-spending application or advice letter for all projects funded by the tax benefits, we are establishing guidelines for the utilities to follow. To the extent a utility stays within these guidelines, it would not need to seek pre-approval of the spending (although reasonableness would still be subject to review in a subsequent GRC). Should a utility determine that it would be best to invest the tax benefits in some area outside of this resolution's guidelines, it would need to file an application or advice letter seeking Commission approval to record the revenue requirement impacts of that investment as an offset in the memorandum account.

Accordingly, for a utility that wishes to use savings from the New Tax Law to invest in additional needed utility infrastructure, not otherwise funded in rates, the following guidelines should be followed. Allowable types of infrastructure projects would include typical types of projects included in general rate case type applications. For example, for the electric utilities, projects would include proactive replacement of poles and underground cables, replacement of existing substation transformers that are over 50 years old or that otherwise require replacement based on reasonable engineering assessments, and work to improve the reliability of the worst-performing or highest priority distribution circuits on their system based on reasonable engineering assessments. The spending must not provide generation capacity at a new plant. For gas utilities, projects would include accelerating existing programs of distribution pipeline replacement, replacement of the riskiest or highest priority gas transmissions based on reasonable engineering assessments, and installing "smart pig" and associated plant in gas transmission lines. For water utilities, allowable types of infrastructure projects would include distribution systems, storage, pipeline, pumping, and treatment facilities.

[4] 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.

The property that the investment is made in must be Commission-jurisdictional. For all utilities that provide more than one kind of service, e.g., both gas and electric, at least 90% of the incremental investment amount must be attributable to the tax benefits associated with that particular service function. The property that the investment is made in must itself be eligible for bonus depreciation. At least 90% of the investment must have a tax depreciable life of at least 15 years, and any remaining investments must be ancillary to such investments.

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 basis. As noted above, these generally include water and sewer system corporations, Small LECs, gas and electrical corporations, pipeline corporations, and heat 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 which 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. 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. Alpine Natural Gas Operating Company No. 1, LLC (Alpine) also requested an exemption in comments on the Third Draft Resolution. Alpine is a small natural gas company with 1,200 service connections. We conclude that, like Mountain Utilities, Alpine should be exempted from the operation of this resolution due to its small size.

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.

In their comments on the Third Draft Resolution, the Small LECs argue that they all should be exempt from this resolution because they are all similar to Class C and D water utilities, a disproportionate cost of complying with the requirement, and the application of the annual means test in the California High Cost Fund-A (CHFC-A) mechanism which serves to limit the draws of those who receive CHFC-A funding to their authorized earnings levels. We concur that the cost of compliance and the limitations of the CHFC-A justify an exemption for the Small LECs

SCE and the Sempra Utilities (San Diego Gas & Electric Company and Southern California Gas Company) argue that since their GRCs are for a 2012 test year, their capital spending motivated by the 2010 Tax Act would be captured and appropriately treated in the GRC. We concur and will exempt SCE and the Sempra Utilities. To the extent that other cost of service utilities will be addressing the 2010 Tax Act in a 2011 or 2012 test year GRC they should be similarly exempted from the memorandum account requirement.

Pacific Gas and Electric Company (PG&E) appears to be in a unique position of having filed a settlement in its GRC with the Commission in late 2010 before the New Tax Law was signed into law in December. Because it will not be addressing impacts of the New Tax Law until its next GRC filing, PG&E is not exempted from the memorandum account.

The details of the memorandum account:

This resolution will establish for each cost-of-service rate-regulated utility, except for those exempted above, (collectively the Covered Utilities) a memorandum account to reflect, on a CPUC-jurisdictional, revenue requirement basis, impacts from the New Tax Law.

The memorandum account will be used to determine whether any future rate changes are appropriate to reflect impacts of the New Tax Law 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 Law during the Memo Account Period, reflecting on a CPUC-jurisdictional, revenue requirement basis the effects of the New Tax Law 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:[5] (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 Law. 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.[6]

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 decrease in prospective rates.

This memorandum account will be a one-way memorandum account. 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 Law. 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.

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[5] 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.

[6] In its comments on the Third Draft Resolution, PG&E suggests that the memorandum account may need to reflect the treatment of net operating losses, but does not spell out why that is the case, or what kind of adjustment may be required. The need for such an adjustment may be discussed with Commission staff before PG&E files its advice letter containing specific language for its memorandum account.

In their comments on the Original Draft Resolution, the energy utilities pointed out that the bonus depreciation afforded by the New Tax Law 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 Law 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 Law 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 Law is 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, the California Water Association (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 under the New Tax Law prior to 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, 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 Law 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.

<u>What it means when we establish a memorandum account</u>:

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 Law, while avoiding any issue of retroactive ratemaking.

<u>When advice letters should be filed</u>:

It will be necessary for each Covered Utility to file an advice letter to incorporate the memorandum account into its tariffs. The proposed tariff language should describe in detail the kinds of revenue requirement impacts that are to be entered into the memorandum account. For kinds of revenue requirement impacts not specifically mentioned in this resolution, the utility will need to provide some justification in its advice letter. We will allow all Covered Utilities until June 30, 2011 to file the required advice letters. This should provide ample time for the utilities to develop tariff language and for discussions with staff. This period should not be problematic because the memorandum accounts are effective for all Covered Utilities as of the date of the original Resolution L-411.

<u>COMMENTS ON DRAFT RESOLUTION</u>

<u>The Original Draft Resolution</u>

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 PU 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. The Original Draft Resolution was issued for comment on December 30, 2010 and 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.

Comments were submitted by PG&E, TURN, SCE, 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 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, the Small LECs, and Alpine.

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. Here, the impacts of the New Tax Law are so large that a number of the major energy utilities have informed the Commission that they expect to pay no federal income tax for at least one year.

There was also 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 Law only apply to property placed into service beginning September 9, 2010. Therefore, only the increase in deferred tax reserve resulting from property placed into service beginning September 9, 2010 needs to be calculated.

Some utilities have expressed concerns regarding the potential complexity of refund mechanisms and the need for prompt resolution so they can initiate desired incremental infrastructure spending. We recognize that attempting to precisely reflect all incremental impacts from the New Tax Law and additional infrastructure spending may create unwarranted complexity and controversy. We, therefore, reiterate our overall intent that this memorandum account should not impede the additional capital spending that the New Tax Law was intended to encourage. We understand that this memorandum account will be implemented on a revenue requirement basis using a mixture of forecasted and actual data and will not be a traditional balancing account matching revenues and expense. While we wish to reflect the incremental effects of the New Tax Law and additional spending on infrastructure for ratemaking purposes, we also understand that estimates and simplifying assumptions will be necessary, some of which have been discussed herein. We encourage Commission staff to support additional practicable and workable solutions for memorandum account implementation and to help facilitate expeditious implementation of these new accounts without engaging in a complex evaluation of the utilities' GRCs.

Several comments 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 after September 8, 2010, it tracks only those revenue requirement effects occurring after the date of Resolution L-411. 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 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, and parties to their rate cases 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. 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 Law was intended to stimulate additional capital spending in the short term.

In its comments on the Third Draft Resolution, SCE argues that, although this memorandum account is not being established as a Z-factor, the memorandum account should be subject to the $10 million threshold applicable to *its* Z-factor. However, not all utilities have Z-factors. This resolution establishes a generic memorandum account for all Covered Utilities. Arguments about whether the amount recorded in the memorandum account of a specific utility should later be reflected in rates should be litigated later. SCE also argues that establishing a memorandum account here is inconsistent with the policy stated in our 1984 decision *Re: Income Tax Expense for Ratemaking Purposes* (D.84-05-026, 15 CPUC 2d 42). SCE focuses on the portion of the decision describing the Commission's reliance on forecast ratemaking. We simply note that in the past nearly 27 years our ratemaking policies for energy utilities have departed in many respects from the kind of forecast ratemaking we engaged in at that time.[7]

Draft Resolution L-411A

Draft Resolution L-411A was issued for comment on May 19, 2011 for a 20-day comment period. Comments were limited to discussing whether the changes made in Resolution L-411A correctly resolve the internal inconsistencies, correct other errors, and clarify the Ordering Paragraphs of the original resolution, consistent with the Commission's intent in approving Resolution L-411. Comments were also permitted to address any other errors or inconsistencies that should have been, but were not, addressed in Draft Resolution L-411. Comments were due on June 8, 2011. Comments were received from CWA, PG&E and TURN.

[7] PG&E makes a similar argument in its comments on the Third Draft Resolution.

We agree with PG&E and TURN that the list of the kinds of infrastructure projects that would qualify as offsets to be recorded in the memorandum account was not intended to be a complete list of all of the kinds of projects that would qualify as offsets, but rather just a list giving examples of the kinds of projects that would qualify. We have revised the resolution accordingly. However, we re-emphasize that for types of projects not typically included in general rate case type applications, the utility would need to file an application or advice letter seeking Commission approval in order to record the revenue requirement impacts of that investment as an offset in the memorandum account.

In its comments, CWA notes that, at the beginning of the guidelines for needed utility infrastructure, not otherwise funded in rates, whose revenue requirement impact may be recorded as an offset in the memorandum account, Resolution L-411 refers to "[a]llowable types of infrastructure *replacement* projects" (emphasis added). CWA then points out that not all of the examples of allowable projects listed in the guidelines are "replacement" projects, citing specifically the example of "installing 'smart pig' and associated plant in gas transmission lines". While most of the examples are indeed of infrastructure replacement projects, our intent was not to require that all projects whose revenue requirement impact can be recorded in the memorandum account be "replacement" projects. Accordingly, we have eliminated the word "replacement" at the beginning of the guidelines.

Also in response to CWA's comments, we have clarified that the requirement imposed by *this* resolution -- to obtain approval, by advice letter or application, for projects that are *not* of the type typically included in general rate case type applications -- *only* applies in order to record the revenue requirement impact of such projects as an offset to the memorandum account. The question of whether Commission approval is required to commence construction of such projects, or to recover the cost of such projects from ratepayers, is determined *not* by this resolution, but by reference to the Public Utilities Code and other orders of this Commission.

We grant CWA's request to extend until July 31, 2011, the time for filing tariffs specifying the details of each utility's memorandum account. This extension will not change the effective date of the tariffs and the memorandum accounts, which will remain April 14, 2011, the date the Commission approved Resolution L-411. Concerning another issue raised by CWA, our intention was *not* to exempt from the requirement to establish a memorandum account those utilities whose rate cases might be heard in 2012 for a test year beginning later than 2012. Accordingly, we reject CWA's request to exempt additional water utilities from the memorandum account requirement, and instead adopt the clarifying language suggested by TURN.

FINDINGS AND CONCLUSIONS

1. President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 ("Tax Relief Act" or "New Tax Law") 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. The general rates of utilities are typically reviewed only once every three years.
4. The benefits of bonus or accelerated depreciation are generally reflected in rates through "normalization" and the use of a deferred tax reserve.
5. While existing ratemaking mechanisms likely will result in ratepayers benefiting from a portion of the tax benefits utilities receive under the New Tax Law, it is not clear that all of the tax benefits resulting from this new law will have an impact on rates under current mechanisms, because the general rates of utilities are typically reviewed only once every three years.
6. 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 Law not otherwise reflected in rates may accrue to ratepayers, while avoiding issues of retroactive ratemaking.
7. The appropriate method for preserving the opportunity to consider, at a later time, whether some or all of the impacts of the New Tax Law not otherwise reflected in rates should be reflected in rates is to establish a memorandum account.
8. The memorandum account should reflect not only the tax benefits of the New Tax Law, but other direct changes in revenue requirement resulting from each utility's taking advantage of the New Tax Law. Such changes may include, but are not limited to, impacts on Section 199 deductions, working cash, and contributions in aid of construction.
9. So as not to discourage utilities from using the tax savings resulting from the New Tax Law for investment in additional, needed infrastructure, the costs and expenses of that infrastructure not otherwise reflected in rates should also be reflected in the memorandum account, to the extent allowed by the limitations specified in this resolution.
10. 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.

11. Class C and D water and sewer utilities are very small utilities for which 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.
12. Class C and D water and sewer utilities should be exempted from the establishment of this memorandum account.
13. Mountain Utilities and Alpine Natural Gas Operating Company No. 1, LLC should be exempted from the establishment of this memorandum account because they are also very small utilities.
14. 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.
15. Small LECs should be exempted from the establishment of this memorandum account because they will incur a disproportionate cost of complying with the requirement and the application of the annual means test in the CHCF-A mechanism serves to limit the draws of those who receive CHFC-A funding to their authorized earnings level.
16. Southern California Edison Company and the Sempra Utilities (San Diego Gas & Electric Company and Southern California Gas Company) should also be exempted from the memorandum account since their General Rate Cases are for a 2012 test year. Further, to the extent that any other cost of service energy or water utilities will be addressing the New Tax Law in a 2011 or 2012 test year general rate case, they should also be exempted from the memorandum account.
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 Law, while avoiding retroactive ratemaking concerns.
18. The Commission's overall intent is that this memorandum account should not impede the additional capital spending that the New Tax Law was intended to encourage. Consistent with this intent, the Commission understands that estimates and simplifying assumptions will be necessary, some of which have been discussed herein, and encourages staff to support additional practicable and workable solutions for memorandum account implementation and to help facilitate expeditious implementation of these new accounts.
19. Three rounds of comments have been allowed on drafts of this resolution.
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 Resolution L-411. Therefore, the effect of this resolution is entirely prospective.
21. Resolution L-411 should be modified to eliminate inconsistencies and clarify the Commission's intent.

ORDER

1. There is hereby established for the Covered Utilities described in Ordering Paragraph 2, effective April 14, 2011, 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 (“The New Tax Law”).
2. The Covered Utilities are: Pacific Gas and Electric Company and other cost-of-service rate-regulated utilities except for: Class C and D Water and Sewer Corporations, Mountain Utilities, Alpine Natural Gas, NRG Energy Center LLC, small local exchange carrier telephone corporations, Southern California Edison Company, Sempra Utilities (San Diego Gas & Electric Company and Southern California Gas Company), and any other cost of service energy or water utilities that will be addressing the New Tax Law in a 2011 or 2012 test year general rate case.
3. This memorandum account shall track on a CPUC-jurisdictional, revenue requirement basis the impacts of the New Tax Law not otherwise reflected in rates during the period starting on the date of this resolution until the effective date of the 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 revenue requirement resulting from increases in deferred tax reserve; (b) offsets to reflect additional costs or expenses, not otherwise recovered in rates, incurred as a result of additional utility infrastructure investment enabled by the bonus depreciation provisions of the New Tax Law, to the extent allowed by Ordering Paragraph 5; and (c) amounts to reflect the impacts of any decrease in Section 199 deductions resulting from bonus depreciation taken, changes in working cash resulting from the New Tax Law, any decrease in the tax component of contributions-in-aid-of-construction (CIAC) received due to changes in the tariffed tax component of CIAC to reflect the New Tax Law, and any other direct changes in revenue requirement resulting from the utility’s taking advantage of the New Tax Law.
4. This memorandum account shall be used in determining whether any future rate adjustment is appropriate to reflect impacts of the New Tax Law during the Memo Account Period. This memorandum account shall not be used to recover any net revenue requirement increase recorded during the Memorandum Account Period. If, at the end of the Memo Account Period, this memorandum account reflects a net revenue requirement increase, the memorandum account shall be terminated without any impact on rates.
5. The following limits apply to the additional needed utility infrastructure investments that may be tracked in the memorandum account: (a) the property that the investment is made in must be Commission-jurisdictional; (b) for all utilities that provide more than one kind of service, e.g., both gas and electric, at least 90% of the incremental investment amount must be attributable to the tax benefits associated with that

particular service function; (c) the property that the investment is made in must itself be eligible for bonus depreciation; (d) at least 90% of the investment must have a tax depreciable life of at least 15 years, and any remaining investments must be ancillary to such investments; (e) for electric utilities, the spending must not provide generation capacity at a new plant; and (f) if a utility determines that it would be best to invest in something other than the typical types of projects included in general rate case type applications, the utility must file an application or advice letter seeking Commission approval in order to record the revenue requirement impacts of that investment as an offset in the memorandum account.

6. 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 decrease in prospective rates.
7. No later than July 31, 2011, each Covered Utility shall file an advice letter to add a memorandum account to its tariffs consistent with the requirements of Ordering Paragraphs 1, 3, 4, 5, and 6, above. The proposed tariff language shall describe in detail the debits and credits that are to be entered into the memorandum account.
8. 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.
9. The effective date of this order is June 23, 2011.

I certify that this Resolution was adopted by the California Public Utilities Commission at its regular meeting of June 23, 2011, and that the following Commissioners approved it:

PAUL CLANON
Executive Director

MICHAEL R. PEEVEY
President
TIMOTHY ALAN SIMON
MICHEL PETER FLORIO
CATHERINE J.K. SANDOVAL
MARK FERRON
Commissioners