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(Rev. 1)

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Legal Division

San Francisco, California
Date: February 24, 2011
Resolution No. L-411

R E S O L U T I O N

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 REDUCING RATES TO REFLECT THE BENEFITS 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

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 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

[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).

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 benefits of the New Tax Laws, not otherwise reflected in rates, ought to benefit ratepayers through a decrease in 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.

The approach the Commission should adopt to achieve this purpose:

On December 30, 2010, the Commission issued a different version of this draft resolution (the Original Draft Resolution) for comment[2]. The Original Draft Resolution 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.

[2] The Original Draft Resolution bore the number Resolution W-4867. A substantially revised Second Draft Resolution was issued for comment on February 7, 2011, and then re-numbered as Resolution L-411.

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, 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. On the other hand, if utilities realize tax savings and do not use them to increase capital investment, or if the costs of the increased capital investment are covered by other rates, there may still be tax benefits that should benefit ratepayers through a decrease in rates.[3]

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 and the increased capital investment it may stimulate that are not otherwise reflected in rates. This approach still permits the Commission to determine at a later date whether some of the benefits of the New Tax Laws should benefit ratepayers through a decrease 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, and assures the utilities that if they spend the tax savings on additional, needed utility infrastructure investment[4] the costs of which will not otherwise be recovered in rates, those additional costs will be offset against amounts that otherwise might be used to reduce rates. As a result, this resolution should not impede the capital investment that the New Tax Laws are intended to encourage.

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

[3] If the capital costs of the investment eligible for bonus depreciation are already included in the utility's rates, then there will be a decrease in revenue requirement not reflected in rates. On the other hand, if the investment spurred by the New Tax Laws is additional to the amount of investment already included in rates, then the revenue requirement impact of the *additional* investment is a revenue requirement increase not reflected in rates.

[4] We refer to "needed" utility infrastructure investment, because our goal is not to have the utilities spend the tax savings on infrastructure that is *un*necessary, and therefore *not* useful to ratepayers. We do not determine in this resolution whether any utility indeed needs additional utility infrastructure investment not otherwise funded by rates.

corporations, 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 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.[5] 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. Furthermore, these arguments do not address the impacts of the Small Business Act. Because this exemption request would prevent ratepayers from sharing in the benefits of the New Tax Laws that accrue during the

[5] All section references are to the California Public Utilities Code unless noted otherwise.

remainder of 2011, even if the utilities do not incur any additional costs during 2011 as a result of increased utility infrastructure investment spurred by the New Tax Laws, 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 reductions 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 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:[6] (a) decreases in its revenue requirement resulting from increases in its deferred tax reserve; (b) offsets to reflect any additional costs or expenses, not otherwise recovered in rates, incurred as a result of additional, needed utility infrastructure investment enabled by the bonus depreciation provisions of the New Tax Laws, 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 Laws, and, for energy utilities, 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 Laws.

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 reduction in prospective rates. In any such GRC decision, the Commission may impose measures to ensure that plant forecast to be placed into service during the remainder of the Memo Account Period (made with savings realized from the New Tax Laws) is actually placed into service during the Memo Account Period, and if not, that rates will thereafter be reduced to reflect the amount of forecast costs and expenses not actually incurred during the Memo Account Period.

[6] 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.

Consistent with standard Commission practice, the recording of the costs of particular utility infrastructure in the memorandum account, or amortization of the memorandum account, will not, in and of itself, substitute for the reasonableness review to which capital investment is normally subject. Utility infrastructure whose costs are recorded in the memorandum account will be subject to reasonableness review in the same manner as other utility capital investments. This reasonableness review may occur in the same GRC in which disposition of the memorandum account is considered, or in another forum.

This memorandum account will be a one-way memorandum account, i.e., it will be available for the Commission to consider *only* whether utility rates should be *reduced* to reflect the tax benefits of the New Tax Laws. This memorandum account cannot be used by any Covered Utility to recover any net revenue requirement increase recorded during the Memo Account Period. If, at the end of the Memo Account Period, this memorandum account reflects a net revenue requirement increase, the memorandum account will be terminated without any impact on rates.

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 and of the additional, needed utility infrastructure investment enabled by the tax savings resulting from the bonus depreciation provisions of 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.

In several places, 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.

Another key, related concept is “additional utility infrastructure investment.” By additional utility infrastructure investment we mean investment made possible by the tax savings from the New Tax Laws that is in addition to investment otherwise included in rates. For utilities that have an adopted figure for additions to plant in service during the year(s) included within the Memo Account Period, the additional utility infrastructure investment will ordinarily be the amount by which additions to plant in service for that Period exceed the adopted figure for that same Period.[7] For some utilities, the Memo Account Period will include Attrition Year(s) for which there is no specific adopted figure for additions to plant in service. Those utilities should calculate the amount of investment that is included in rates by inflating the Test Year figure for additions to plant in service by the same percentage by which the Attrition Year's revenue requirement exceeds the Test Year's revenue requirement. If a utility without an adopted figure for additions to plant in service during any portion of the Memo Account Period contends that the foregoing methodology inaccurately reflects the amount of plant additions not already included in rates, it may propose an alternative methodology in its advice letter filing. In their comments on the Second Draft Resolution, several utilities object to using the foregoing methodology. Some do so for the purpose of arguing that, since there is not an adopted figure, the memorandum account requirement should not apply to them. None of these utilities, however, have shown that the foregoing methodology is an unreasonable or unfair proxy. Accordingly, we will not exempt any of these utilities from the memorandum account requirement, nor retreat from our view that the foregoing methodology is a reasonable proxy.

We note that additional utility infrastructure investment may have several impacts on revenue requirements, including both depreciation and return on investment. None of these impacts occur, however, until plant is placed into service. Therefore, for plant that is forecast to be placed into service during a Covered Utility's next GRC Test Year, all of the costs of that additional plant should be reflected in the utility's Test Year rates, and none of them should be recorded in the memorandum account. That will be true even if the cash flow used to fund the construction of the infrastructure comes from tax savings from the New Tax Laws.

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.[8] These Section 199 and working

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[7] The Memo Account Period will begin in the middle of Test Years or Attrition Years for Covered Utilities. This will at least require some proration of the adopted figure. Furthermore, infrastructure investment may occur in large lumps. Therefore, it may be necessary to look at plant additions during the period(s) immediately preceding the Memo Account Period for a Covered Utility to see how much of the plant additions during the Memo Account Period were actually "additional" to the adopted amount.

[8] In its comments on the Second Draft Resolution (p.6), SCE seems to suggest that it will have a shortfall in working cash due to the bonus depreciation provisions of the New Tax Laws. However, since the increase in working cash due to the lower tax payments resulting from the New Tax Laws was not included in the utilities'

cash impacts are specifically mentioned as items to be included in the memorandum account, on a revenue requirement basis. 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). This tax component of CIAC is adjusted from time to time to reflect changes in the utilities' taxes. If the energy utilities modify their CIAC tariffs to reflect new effective tax rates resulting from the New Tax Laws, it appears that there will then be a decrease in the tax component of the CIAC they receive thereafter. Presumably, there will also be a change in the amount of tax they have to pay on 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", but did not suggest any changes to its cost of service due to the New Tax Law not already specifically covered in the Ordering Paragraphs of that draft resolution. If SCE, or any other utility, believes that impacts of the New Tax Laws not specifically authorized for inclusion in the memorandum account by this resolution should also be included in the memorandum account, the utility may request and justify the inclusion of any additional, specific category of impacts in the advice letter it files pursuant to this resolution.

In its comments on the Second Draft Resolution, 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 proposition, it would seem appropriate to use an RO model to calculate revenue requirement impacts.

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existing rates, the effect of the New Tax Laws is to increase, not decrease, working cash during the Memo Account Period. However, the increase in working cash will occur later than when the increase in deferred tax reserve accrues.

However, we are not able to pass judgment on the specifics of how SCE intends to use its RO model in this generic resolution. Accordingly, we will not approve or disapprove SCE's request at this time.

In its comments on the Second Draft Resolution, TURN asks for a number of clarifications concerning the offsets that may be booked into the memorandum account. We find several of these to be reasonable. More specifically, we concur with TURN that only CPUC-jurisdictional benefits and offsets may be included in the memorandum account. Thus, for example, the costs of FERC-jurisdictional transmission investments cannot be included as offsets in the memorandum account. We also concur with TURN that the term "additional utility infrastructure investment" does not include the purchase of real estate or vehicles. Therefore, the costs of investments in real estate and vehicles may not be used as offsets in the memorandum account.[9]

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 benefits, if any, that these utilities realize from the New Tax Laws, while avoiding any issue of retroactive ratemaking. Furthermore, the specific terms of the memorandum account established by this resolution ensure that if the utilities spend the tax savings from the New Tax Laws on additional, needed infrastructure investment the costs of which will not otherwise be recovered in rates, those additional costs will be offset against amounts that otherwise might be used to reduce rates.

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

[9] However, we decline TURN's invitation to prejudge whether investments in software are needed or reasonable.

30 day periods will be extended to 60 days for Class A and B water utilities.[10] In each case, the proposed tariff language should describe in detail the debits and credits 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

[10] 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 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.

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.

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.

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, because the New Tax Laws may well result in large and unexpected decreases in costs, and in and of themselves will not increase any costs, a one-way memorandum account is appropriate.

In their comments on the Second Draft Resolution, the Small LECs argue that in its investigation into the Tax Reform Act of 1986, the Commission looked at both the positive and negative revenue requirement impacts of that law. The decision they cite, D.88-01-061,[11] reveals the 1986 Act had provisions both decreasing and increasing taxes for utilities. Accordingly, it was necessary to track both the positive and negative effects. Here, in contrast, no utility has argued that there is any increase in taxes arising from the New Tax Laws. Similarly, in its comments on the Second Draft Resolution, CWA argued that Resolution E-3331 (July 12, 1993) establishes a precedent that a memorandum account dealing with changes in the tax law should be a two-way memorandum account. We find that precedent inapposite here. Resolution E-3331 was issued before the proposed tax legislation had passed Congress. Therefore, unlike the situation here where the New Tax Laws have already been enacted, it was unknown at that time whether there might be tax decreases caused by the pending tax reform legislation in addition to the proposed increases.

The utilities have pointed out that their response to the bonus depreciation afforded by the New Tax Laws may possibility result in costs exceeding the benefits (when expressed on a revenue requirement basis). However, no utility has established that that in fact is likely to occur. If a utility believes that it will have a large, unexpected, and unrecovered increase in costs due to additional investment spurred by the New Tax Laws, it is free to file for a memorandum account. However, we note that the Commission generally prefers to evaluate large new expenditure programs in a formal application, rather than relying solely on after-the-fact review of such capital additions.

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, and that the use of recent and relevant figures is appropriate. However, it is not clear from SCE's comments whether the 2011 figure is an adopted figure. Furthermore, it appears that SCE is proposing to use a proxy, rather than directly tracking the revenue requirement impact of property placed into service after January 1, 2010; but it is not clear from SCE's comments why a proxy is needed and what the effect of using the proxy instead of the actual amounts would be. All these issues will need to be addressed in SCE's GRC (or perhaps when SCE files

[11] We also note that in that proceeding, I.86-11-019, the Commission initially "made respondents' rates subject to refund . . . in order to account for changes that might result from this investigation." (See 27 CPUC 2d 309, 315.) Thus, the approach of the Original Draft Resolution, which we have abandoned for the reasons explained above, was not without precedent.

tariff language). In either event, SCE will need to address these concerns in detail at that time.

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 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. Similarly, we are not generally requiring before-the-fact review here (i.e., in advance of the utility's next GRC) for all projects whose costs during the Memo Account Period may be booked as offsets into the memorandum account, because doing so would generally prevent utilities from promptly stimulating the economy as intended by the New Tax Laws (and might also prevent the utilities from taking advantage of lower construction costs currently available). We are still requiring after-the-fact reasonableness review of projects whose costs are recorded as offsets in the memorandum accounts, and there will also be GRC review of those projects before those projects can be included in rate base for recovery of costs for the next test year and thereafter.

We note that a number of major utilities have 2012 test year rate cases in progress, and therefore their ability to complete additional projects in time to have some of the costs of those projects included in their memorandum accounts is limited. However, the situation will be different for a utility that has a much later test year. Therefore, it may make sense for the Commission to require a utility, especially a major utility, whose next GRC is some years away to file an application for major investments, rather than having the utility just book the costs as offsets into the memorandum account. The Commission may consider imposing such a requirement on one or more specific utilities at a later date.

TURN apparently contends that the utilities do not have any needed utility infrastructure investment not already included in rates. However, this argument does not give sufficient weight to the facts that in deciding how much capital investment to authorize the Commission balances the need for capital investments and the need to keep rates from rising, and that the New Tax Laws may provide an additional source of capital funding without the need for a rate increase. TURN's arguments also presuppose that increased capital investment now will necessarily result in increased rates later, ignoring the possibility that increased utility infrastructure investment spurred by the New Tax Laws may, and perhaps should, simply allow the utility to make investments now that otherwise would have to be made later.

In its comments on the Second Draft Resolution, TURN asks that we clarify that this resolution does not eliminate any requirements imposed by prior decisions, including requirements that utilities demonstrate the need for particular programs or projects (see e.g., D.10-06-048) or requirements that shareholders be at risk for cost over-runs. As requested by TURN, we clarify that this resolution does not modify any prior decisions.

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. The appropriate method for preserving the opportunity to consider, at a later time, whether some or all of the benefits of the New Tax Laws not otherwise reflected in rates should be reflected in rates is to establish a memorandum account.
9. The memorandum account should reflect not only the tax benefits of the New Tax Laws, but other resulting changes in the utilities' revenue requirements, including the Section 199 deduction, working cash, and the tax component of contributions in aid of construction.
10. .So as not to discourage utilities from using the tax savings resulting from the New Tax Laws for investment in additional, needed utility infrastructure, the costs and expenses of that infrastructure not otherwise reflected in rates should also be reflected in the memorandum account.
11. Utility infrastructure whose costs are recorded in the memorandum account authorized by this resolution should remain subject to reasonableness review in the same manner as other utility capital investments.
12. 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.
13. The memorandum account required by this resolution should be a one-way memorandum account, because the New Tax Laws are expected to decrease, not increase, taxes the utilities pay.
14. 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.
15. 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.
16. Class C and D water and sewer utilities should be exempted from the establishment of this memorandum account.

17. Mountain Utilities should be exempted from the establishment of this memorandum account because it is also a very small utility.
18. 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.
19. 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.
20. 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.
21. 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.
22. 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.
23. The Commission generally prefers to evaluate large new expenditure programs in a formal application, rather than relying solely on after-the-fact review of such capital additions.
24. This resolution does not eliminate requirements imposed by prior decisions.

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 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) offsets to reflect

any additional costs or expenses, not otherwise recovered in rates, incurred as a result of additional, needed utility infrastructure investment enabled by the bonus depreciation provisions of the New Tax Laws; 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 Laws, and, for energy utilities, 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 Laws.

3. This memorandum account shall be used in determining whether any future rate reduction is appropriate to reflect impacts of the New Tax Laws during the Memo Account Period for each Covered Utility. 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.

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 reduction in prospective rates. In any such GRC decision, the Commission may impose measures to ensure that plant forecast to be placed into service during the remainder of the Memo Account Period is actually placed into service during the Memo Account Period, and if not, that rates will thereafter be reduced to reflect the amount of forecast costs and expenses not actually incurred during the Memo Account Period.

5. Utility infrastructure whose costs are recorded in the memorandum account authorized by this resolution shall remain subject to reasonableness review in the same manner as other utility capital investments.

6. 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, 2, and 3, above. The proposed tariff language shall describe in detail the debits and credits 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 specifically authorized for inclusion in the memorandum account by this resolution should request and justify the inclusion of any additional, specific category of impacts in an advice letter filed pursuant to this Ordering Paragraph.

7. 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.
8. 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, 2, and 3, 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.
9. All of the memorandum accounts established pursuant to this resolution shall be effective as of the date of this resolution.
10. 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.
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 February 24, 2011, and that the following Commissioners approved it:

PAUL CLANON
Executive Director