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SDG&E

REBUTTAL TESTIMONY OF RAGAN G. REEVES

(TAXES)

June 2015

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**



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1 **SDG&E REBUTTAL TESTIMONY OF RAGAN G. REEVES**
2 **(TAXES)**
3

4 **I. SUMMARY**

5 **A. OFFICE OF RATEPAYER ADVOCATES (“ORA”)**

6 ORA issued its report on Taxes on April 24, 2015.¹ The following is a summary of
7 ORA’s positions:

- 8 • ORA accepts SDG&E’s methodology for forecasting ad valorem taxes (i.e., property
9 taxes).
- 10 • ORA accepts SDG&E’s methodology for forecasting deferred income taxes.
- 11 • ORA accepts SDG&E’s methodology for forecasting franchise fees.
- 12 • ORA accepts the tax rates and tax adjustments that SDG&E uses in its calculation of
13 income tax expense; however, ORA proposes that adjustments to tax expense be updated
14 if any tax-related bills are enacted before a final decision in this GRC.
- 15 • ORA proposes two changes to the calculation of SDG&E’s composite payroll tax rate:
 - 16 ○ ORA proposes that SDG&E use the actual 2015 Old-Age, Survivors, and
17 Disability Insurance (“OASDI”) wage base limitation of \$118,500 for calculating
18 the 2015 and forecasted 2016 composite payroll tax rates instead of the OASDI
19 wage base limitations for 2015 and 2016 as forecasted by the Social Security
20 Administration in its 2014 Annual Report (“2014 Annual Report”).
 - 21 ○ ORA proposes that SDG&E use a California Unemployment Insurance (“UI”)
22 rate of 3.4% for calculating the 2015 and forecasted 2016 payroll tax rates instead
23 of the 3.7% UI rate forecasted by SDG&E for 2015 and 2016.

24 **B. THE UTILITY REFORM NETWORK (“TURN”)**

25 TURN submitted testimony on May 15, 2015.² The following is a summary of TURN’s
26 position on Income Taxes:

- 27 • TURN is proposing to take the incremental increase in the repairs deduction resulting
28 from the change in accounting method for SDG&E from its 2011-2014 tax years, which

¹ Exhibit ORA-21 (M. Campbell), Report on Taxes (full title truncated) (“ORA-21”).

² Prepared Testimony of William B. Marcus on Behalf of TURN (full title truncated) (“TURN/Marcus”).

1 SDG&E had treated as flow-through items in those years, and normalize that total
2 amount beginning in the 2016 Test Year.

- 3 • TURN is proposing to flow through to ratepayers the end-of-2015 amount of money
4 reflected in the memorandum account established for SDG&E’s 2015 repairs deduction.
5 Alternatively, TURN proposes to normalize the 2015 repairs deduction for SDG&E
6 beginning in the 2016 Test Year.
- 7 • TURN also proposes that any future voluntary “tax changes” made by SDG&E should
8 not take effect until a GRC test year “unless provisions are made to make ratepayers
9 whole.”

10 **II. REBUTTAL TO PARTIES’ PROPOSALS**

11 **A. ORA**

12 1. Issues Not in Dispute

13 ORA accepts SDG&E’s methodology for forecasting ad valorem taxes,³ franchise fees,⁴
14 and deferred income taxes.⁵ ORA also accepts the tax rates and tax adjustments that SDG&E
15 uses in its calculation of income tax expense.⁶ Accordingly, any differences between SDG&E’s
16 and ORA’s estimates of ad valorem taxes, franchise fees, income tax expense, and deferred taxes
17 are attributable to differences in forecasted capital additions, rate base, and other non-tax-related
18 adjustments resulting from ORA’s proposed changes to the SDG&E GRC application.

19 2. ORA’s Proposed Timing for Updating the Tax Calculations to Reflect Potential 20 Future Changes in Tax Law Go Beyond the Procedures Set Forth in the Rate Case 21 Plan and Scoping Memorandum for this GRC

22 While ORA accepts SDG&E’s income tax rates and income tax adjustments, ORA
23 proposes that adjustments to tax expense be updated if any tax-related legislative bills are
24 enacted before a final decision in this GRC.⁷ In response to ORA’s proposal, SDG&E notes that
25 the Rate Case Plan already includes a mechanism for SDG&E to update its testimony to reflect
26 changes in the relevant tax laws. Under the Rate Case Plan, “[k]nown changes due to
27 governmental action such as changes in tax rates . . .” are to be reflected during the Update phase

³ ORA-21, page 8, lines 6-7.

⁴ *Id.* at page 11, lines 4-6.

⁵ *Id.* at page 10, lines 17-18.

⁶ *Id.* at page 8, line 18; page 9, lines 3-4 and 9-10.

⁷ *Id.* at page 10, lines 7-11.

1 of the GRC.⁸ Under the Assigned Commissioner’s Scoping Memo and Ruling for this GRC
2 dated February 15, 2015 (“Scoping Memo”), the due date for Update Testimony is August 24,
3 2015.⁹

4 SDG&E will follow the procedures and deadlines set forth in the Rate Case Plan and
5 Scoping Memo for updating its forecasts to reflect tax law changes, including tax-extender
6 legislation, extension of bonus depreciation, or other tax-related law changes that occur prior to
7 the closing of the record in this GRC. ORA’s proposal would go beyond the procedures set forth
8 in the Rate Case Plan and Scoping Memo and would require SDG&E to update its forecasts after
9 the record in this GRC has closed. Accordingly, ORA’s proposal should not be adopted.

10 3. SDG&E’s Methodology for Computing its Composite Payroll Tax Rate Is
11 Reasonable, and ORA’s Proposed Changes to that Methodology Should Not Be
12 Adopted

13 ORA recommends a composite payroll tax rate of 6.81% for Test Year 2016 as compared
14 to SDG&E’s proposed rate of 6.89%.¹⁰ The difference in the proposed tax rates reflects two
15 proposed changes to the composite payroll tax rate computation by ORA: (1) ORA proposes
16 that SDG&E use the actual 2015 OASDI wage base limitation of \$118,500 for calculating the
17 2015 and forecasted 2016 composite payroll tax rates instead of the OASDI wage base
18 limitations for 2015 and 2016 as forecasted by the Social Security Administration in the 2014
19 Annual Report; and (2) ORA proposes that SDG&E use a UI rate of 3.4% for calculating the
20 2015 and forecasted 2016 payroll tax rates instead of the 3.7% UI rate forecasted by SDG&E for
21 2015 and 2016. Each of ORA’s proposals will be discussed in turn.

22 a. SDG&E’s OASDI Wage Base Limitation Methodology Is the Same
23 Methodology that the Commission Adopted in SDG&E’s 2012 GRC

24 ORA recommends that SDG&E use the 2015 actual OASDI wage base of \$118,500 as
25 the wage base for Test Year 2016 “because it is the most accurate and currently available
26 information to estimate TY 2016.”¹¹ SDG&E uses the projected OASDI wage base for 2016
27 from the 2014 Annual Report from the Social Security Administration, which was \$123,600.

⁸ Decision (“D.”) 07-07-004, Appendix A, page A-36.

⁹ Scoping Memo, page 10.

¹⁰ ORA-21, page 7, Table 21-4.

¹¹ *Id.* at page 5, lines 11-12.

1 The methodology that SDG&E uses to forecast the OASDI wage base for 2016—i.e., to
2 use the wage base amount projected for the Test Year from the most recently published Social
3 Security Administration Annual Report available at the time the application was filed—is the
4 same methodology that SDG&E used in its prior 2012 GRC forecast, which was adopted by the
5 Commission. In the final decision for SDG&E’s 2012 GRC, the Commission held that
6 SDG&E’s “forecasts of the payroll taxes are reasonable and should be used instead of adopting
7 the adjustments that DRA, TURN and UCAN have proposed.”¹²

8 Similar to its approach in the 2012 GRC, ORA is proposing to make isolated adjustments
9 to 2016 test year amounts using 2015 information. The Commission agreed with SDG&E’s
10 position in the 2012 GRC that such selective updating is inappropriate because it “ignores the
11 fact that while certain costs may be lower than expected, other costs are higher than expected and
12 there is no provision to reflect those instances.”¹³

13 b. ORA’s Proposed OASDI Wage Base Methodology Does Not Provide a
14 More Reasonable Forecast than SDG&E’s Methodology

15 ORA has not demonstrated in its testimony that its proposed approach to forecasting the
16 OASDI wage base for 2016 is a more accurate or reliable indicator of the wage base than
17 SDG&E’s approach. To the contrary, as shown in ORA’s testimony, the actual OASDI wage
18 base has increased each year for four consecutive years by an average of \$2,875 over the prior
19 year.¹⁴ Accordingly, ORA’s recommendation to use the current year OASDI wage base to
20 estimate the wage base for the following year would yield inherently and historically inaccurate
21 results.

22 c. ORA’s Challenge to SDG&E’s OASDI Wage Base Methodology is
23 Inconsistent with ORA’s Position on the Same Issue in Southern
24 California Edison’s 2015 GRC

25 As discussed above, SDG&E’s methodology for forecasting the OASDI wage base
26 limitation in this GRC is the same methodology that was adopted by the Commission in its prior
27 2012 GRC. Specifically, SDG&E’s methodology is to use the wage base limitation projected for
28 the Test Year from the most recently published Social Security Administration Annual Report at
29 the time the GRC application was filed (which for this GRC is the 2014 Annual Report). In its

¹² D.13-05-010 at 939.

¹³ *Id.*

¹⁴ ORA-21, page 4, Table 21-3.

1 2015 GRC application, Southern California Edison (“Edison”) used the same methodology as
2 SDG&E in forecasting its OASDI wage base limitation for Edison’s 2015 Test Year.¹⁵ ORA in
3 Edison’s GRC did not challenge any aspect of Edison’s composite payroll tax rate computation,
4 including the OASDI wage base methodology shared by Edison and SDG&E. Specifically,
5 ORA in its direct testimony in Edison’s 2015 GRC stated: “ORA agrees with [Edison’s] payroll
6 tax rates and wage bases.”¹⁶ It is not appropriate or reasonable for ORA to accept another
7 utility’s methodology in full while challenging the exact same methodology in SDG&E’s GRC.

8 d. SDG&E’s Methodology for Forecasting the UI rate is the Same
9 Methodology that the Commission Adopted in SDG&E’s 2012 GRC

10 For the UI portion of the composite payroll tax rate calculation, ORA also recommends
11 that SDG&E use the “current 2015 3.4% UI tax rate until the new UI tax rate is approved for
12 2016,”¹⁷ instead of the 3.7% UI rate forecasted by SDG&E. SDG&E’s methodology for
13 forecasting its UI rate for the Test Year is the same methodology SDG&E employed in its 2012
14 GRC, which was adopted by the Commission. In the final decision for SDG&E’s 2012 GRC,
15 the Commission held that SDG&E’s “forecasts of the payroll taxes are reasonable and should be
16 used instead of adopting the adjustments that DRA, TURN and UCAN have proposed.”¹⁸

17 Similar to its approach in the 2012 GRC, ORA is proposing to make isolated adjustments
18 to 2016 test year amounts using 2015 information. The Commission agreed with SDG&E’s
19 position in the 2012 GRC that such selective updating is inappropriate because it “ignores the
20 fact that while certain costs may be lower than expected, other costs are higher than expected and
21 there is no provision to reflect those instances.”¹⁹

22 e. ORA’s Proposed Forecasting Methodology for the UI Rate Does Not
23 Provide a More Reasonable Forecast than SDG&E’s Methodology

24 As with its OASDI wage base proposal, ORA are proposing selective updating and have
25 not demonstrated that its proposed approach is a more accurate or reliable indicator of the
26 forecasted UI rate than SDG&E’s approach. Moreover, ORA provides no support for its
27 proposed 3.4% UI rate, and the “current 2015 3.4% UI tax rate” proposed by ORA is not, in fact,

¹⁵ See A.13-11-003 (“Edison 2015 GRC”), Ex. SCE-10, Vol.2, Chapter IV, page 287, Table B-2, line 1.

¹⁶ Edison 2015 GRC, Exhibit ORA-22 (M. Campbell), Report on Taxes (full title truncated), August 4, 2014, page 5, lines 17-18.

¹⁷ ORA-21, page 6, lines 8-9.

¹⁸ D.13-05-010 at 939.

¹⁹ *Id.*

1 SDG&E’s current 2015 UI tax rate. ORA instead cites a link to the federal Social Security
2 Administration website to support the California UI rate.²⁰ The federal authority cited by ORA
3 is irrelevant for state payroll tax purposes and includes no discussion of California UI rates and
4 no reference to any 3.4% rate.

5 According to the State of California’s Employment Development Department (“EDD”) website,
6 the 3.4% UI rate for 2015 proposed by ORA applies only to new employers.²¹ For all
7 other employers (including SDG&E), the UI rate varies by employer and is computed based on a
8 formula that uses historical unemployment benefit payout experience specific to that employer.²²
9 The EDD computes the UI rate annually for each employer and notifies the employer in late
10 December of its UI rate for the following year.

11 SDG&E’s actual UI rate for 2015 as established by the EDD is 3.6%,²³ which is within
12 0.1% of the UI rate of 3.7% that SDG&E forecasted for 2016 in its GRC application. This 0.1%
13 difference in the UI rate is immaterial to the composite payroll tax rate computation –
14 specifically, even if SDG&E had utilized a 3.6% UI rate for 2016 in its application, the
15 composite payroll tax rate, rounded to two decimal places, would remain unchanged at 6.89% for
16 2016. Therefore, even if ORA’s proposed methodology of using the actual UI rate for 2015 as
17 the Test Year 2016 projected rate were adopted, there would be no change to SDG&E’s
18 composite payroll rate computation if the 2015 actual 3.6% UI rate applicable to SDG&E were
19 utilized as the forecasted UI rate for Test Year 2016.

20 **B. TURN**

21 TURN proposes to retroactively recapture the flow-through impact of repair deductions
22 for 2011-2015 that SDG&E received by electing to change its method of accounting for the
23 repairs deduction under the guidelines of Internal Revenue Service (“IRS”) Revenue Procedure
24 (“Rev. Proc.”) 2011-43.²⁴ TURN’s proposals and SDG&E’s response to those proposals differ
25 somewhat for the 2015 year versus the 2011-2014 years. The reason is that on January 15, 2015,
26 the Commission granted TURN’s motion to establish memorandum accounts to track the
27 revenue requirement impact of Southern California Gas Company’s (“SoCalGas”) and SDG&E’s

²⁰ ORA-21, page 6, footnote 10.

²¹ http://edd.ca.gov/Payroll_Taxes/Rates_and_Withholding.htm

²² *Id.*

²³ The EDD’s 2015 Contribution Statement applicable to all Sempra Energy companies shows the actual UI rate of 3.6%. *See* Appendix A.

²⁴ 2011-37 I.R.B. 326, issued on August 19, 2011.

1 increased repairs deductions for the 2015 year. As instructed by the Commission, SDG&E filed
2 a Tier 3 Advice Letter to establish a Repairs Deduction Memorandum Account for the 2015 year
3 on March 2, 2015.

4 TURN proposes to take the incremental increase in the repairs deduction resulting from
5 SDG&E's change in accounting method for its 2011-2014 tax years, which SDG&E had treated
6 as a flow-through tax adjustment in those years, and normalize that total amount beginning in the
7 2016 Test Year. Normally, a flow-through tax adjustment impacts the cost of service, but
8 TURN's proposal would instead reverse the flow-through treatment and instead calculate the
9 incremental Accumulated Deferred Income Tax ("ADIT") increase resulting from the accounting
10 method change and reduce ratebase with those deferred taxes for the next 25-30 years. Then, in
11 2016, TURN would have the Commission reverse course once again and begin flowing the tax
12 adjustment through as a revenue requirement reduction in the cost of service. According to
13 TURN's testimony, this proposal, if adopted, would increase ADIT by \$93.0 million,²⁵ which in
14 turn reduces rate base and the revenue requirement over the next 25-30 years. For the 2015 year,
15 TURN proposes to flow through to ratepayers the end-of-2015 amount of the revenue
16 requirement reduction reflected in the memorandum account established for SDG&E's 2015
17 repairs deduction. TURN estimates that approximately \$20 million would be flowed through to
18 ratepayers for 2015 if its proposal is adopted. Alternatively, TURN proposes to normalize the
19 2015 repairs deduction for SDG&E beginning in the 2016 Test Year (i.e., the same approach
20 TURN proposes for the 2011-2014 years).

21 Consistent with the Commission's longstanding precedent and policy²⁶, SDG&E flowed
22 through the repairs deductions for its 2011-2015 tax years. TURN acknowledges in its testimony
23 that "[t]he repairs deduction is a flow-through deduction"²⁷ and that SDG&E changed its method
24 of accounting for the repairs deduction "between rate cases."²⁸ TURN cites no precedent or
25 authority to support an argument that SDG&E's treatment of the repairs deduction in between
26 rate cases was improper. Rather, TURN objects to the outcome of SDG&E's treatment, and

²⁵ As of the date this testimony was written, SDG&E was unable to confirm the accuracy of TURN's tax computations based on the workpapers TURN provided.

²⁶ The Commission's longstanding preference for flow through treatment of repairs deductions was reaffirmed in two comprehensive decisions dealing with the proper ratemaking treatment of income taxes. *See* D.93848, 7 CPUC 2d 332 (1981); D.84-05-036, OII-24, 15 CPUC 2d 42 (1984).

²⁷ TURN/Marcus at 15.

²⁸ *Id.*

1 attempts to create the perception that any tax-related benefits that are not immediately flowed
2 through to ratepayers serve to enrich shareholders to the detriment of ratepayers.

3 TURN’s “zero-sum game” portrayal is flawed, and its proposed remedy for the 2011-
4 2014 years would be impermissible retroactive ratemaking. SDG&E’s tax elections, and the
5 timing of those elections, were appropriate, fully supported by tax law and regulatory precedent,
6 and do in fact provide ratepayers with a substantial benefit. A taxpayer is prudent to minimize
7 its tax liability as permissible by law. For a regulated utility, resulting tax benefits can be flowed
8 to ratepayers, shareholders, or both, depending on timing of events, the existence of sharing
9 mechanisms, and compliance with longstanding ratemaking principles. The changes in tax
10 guidance described further below drove SDG&E’s deduction elections and the Commission’s
11 flow-through policy dictated the result. Moreover, as shown in its data request responses to
12 TURN, both the ratepayers and the shareholders received more tax benefits from the cumulative
13 effect of the accounting method change for the 2011-2015 period than if SDG&E had not made
14 the accounting method change for repairs. In addition, SDG&E forecasts that the enhanced
15 repairs deductions being flowed through to the ratepayers beginning in 2016 will increase tax
16 deductions by more than \$280 million for the 2016-2018 years,²⁹ which results in a
17 corresponding reduction to the revenue requirement of over \$134 million more for those years
18 than if SDG&E had not changed its method of accounting for repairs on its electric distribution
19 property.³⁰ Thus, SDG&E’s change of accounting method for repairs provides significant
20 additional tax benefits to ratepayers now and into the future, but those benefits must be reflected
21 within the regulatory framework and timing approved by the IRS and Commission.

22 1. TURN’s Proposal Contravenes Years of Established Commission Ratemaking
23 Precedent and Policy

24 TURN’s proposal to reach back into prior years and re-characterize flow-through repairs
25 deductions for those years as normalized deductions beginning in 2016 ignores long-established
26 Commission precedent. Specifically, because TURN does not agree with the particular outcome
27 regarding the enhanced repairs deduction, TURN sets forth a proposal that contravenes (1) the

²⁹ The repairs deduction for SDG&E includes repairs on electric distribution property and gas property. The forecasted repairs deduction for 2016-2018 reflects the post-test-year Operations and Maintenance (“O&M”) escalation rate for SDG&E of 2.58% and 2.46% for 2017 and 2018, respectively. See Ex. SDG&E-37-R-WP, Table 2.

³⁰ SDG&E’s calculation of the revenue requirement impact for 2016-2018 is shown in Appendix B.

1 Commission's long-stated precedent and policy to treat expenses as flow-through items
2 whenever possible under the federal tax law; and (2) the Commission's long-standing precedent
3 and policy prohibiting true-ups of forecasted tax expenses adopted in a prior GRC to actual
4 expenses for years in between rate cases. TURN's testimony does not include any authority that
5 would support TURN's proposed deviation from long-standing Commission precedent and
6 policy.

7 a. The Commission's Longstanding Ratemaking Policy Has Been to Flow
8 Through All Income Tax Deductions Except Where Otherwise Required
9 By Law

10 As TURN acknowledges in its testimony, the Commission's longstanding policy has
11 been to flow-through all deductions except when specifically required by law (or authorized in a
12 proceeding) to be normalized.³¹ In Pacific Bell Telephone Company Interim Opinion, the
13 Commission described the difference between flow-through and normalized ratemaking for
14 income taxes as follows:

15 There are two methods to account for income tax expense for regulatory purposes.
16 Under the flow-through method, the income tax expense recognized for
17 regulatory purposes during a given period is equal to the taxes that are assessed
18 and paid during the period. Under the normalization method, the income tax
19 expense for a given period is based on the net income recognized for regulatory
20 accounting purposes during the period, regardless of when the taxes associated
21 with the accounting income are actually paid. The flow through method can be
22 viewed as cash-basis accounting, while the normalization method reflects accrual
23 accounting.³²
24

25 In that same decision, the Commission reiterated that its longstanding policy has been to
26 flow through income tax deductions for ratemaking purposes except when otherwise required by
27 law:

28 In 1981, newly enacted federal tax laws effectively mandated the use of
29 normalized tax accounting for accelerated depreciation and ITC [Investment Tax
30 Credit]. The effect of the new laws was that the Commission could no longer
31 require utilities to flow through to ratepayers the substantial tax benefits
32 associated with accelerated depreciation and ITC. As a result, ratepayers had to

³¹ TURN's testimony states that the Commission "has for the last 50 years" preferred, when possible, to flow through deductions as they occur. TURN/Marcus at 15.

³² *Re Pacific Bell*, D.04-02-063, pp. 96-97, 2004 Cal. PUC LEXIS 55 (2004), at *163.

1 pay substantially more money in rates for income taxes than were actually paid by
2 the utilities.

3
4 Although federal law had preempted the Commission's flow-through policy with
5 respect to accelerated depreciation and ITC, in D.84-05-036, the Commission
6 held that its flow through policy should remain in effect to the extent allowed by
7 law.³³
8

9 Following that policy, SDG&E treated repair deductions on a flow-through basis.

10 b. Adjustments Can Cut Both Ways And The Commission Has Previously
11 Held That Absent A Memorandum Account, There Should Be No "True
12 Up" to a Prior Year's Ratemaking To Match A Subsequent Adjustment

13 Forecast test year ratemaking carries with it the inherent risk that actual income tax
14 amounts will differ from forecast. Among the many situations when this can occur include:

- 15
16 • a difference between the amount and/or type of actual expenditures incurred and
17 the amount and/or type of expenditures that had been forecasted;
18 • a change in tax authority impacting a forecasted year where this change was not
19 known at the time the forecast was established;
20 • a challenge to a tax position by the IRS (or a state taxing authority) employing an
21 argument that had not yet been developed by the IRS and/or not known by the
22 taxpayer at the time the forecast was established.
23

24 The ratemaking impact of differences between forecast and actual will vary based on
25 whether the tax item to which the difference relates is normalized or flowed through.³⁴ In either
26 case, the rate impact will be prospective, but a difference in a normalized tax item can be
27 remediated by the resetting of rates to reflect the actual result in the next rate case; a difference in
28 a flow through tax item cannot be reset.

29 In this regard, the Commission has previously held in OII 24 that the impact of tax
30 adjustments in periods in between rate cases in excess of or below what was forecasted in the
31 prior GRC should not be trued up.³⁵ In that same decision, the Commission agreed with the view

³³ *Id.* at *190.

³⁴ Normalization amortizes the difference between book accounting ("GAAP") and income tax accounting over a period of years. Flow through matches deductions used to compute cost-of-service income tax expense to those used on the tax return.

³⁵ See D.84-05-036, OII 24, 1984 Cal. PUC LEXIS 1325, at *33-34, 15 CPUC 2d 42 (1984) ("such differences are inherent in the use of future test periods for ratemaking . . . Since income taxes are derived residually, we agree that individual factors should not be isolated for purposes of comparing estimated and recorded results.").

1 expressed by both Commission staff and Industry representatives that seeking a change from this
2 general ratemaking policy for a particular, isolated tax item (which TURN is proposing to do in
3 this case regarding the repairs deduction) would not be appropriate:

4 Staff and Industry agree . . . that differences in income taxes between estimated
5 and actual cannot be isolated from other factors in determining whether an
6 adjustment should be made to the test year estimate. Any review of differences
7 would have to include the effects of differences of all estimates for revenues,
8 operating expenses, income taxes and return on investment. Any prospective
9 adjustment based on past over or underestimates would have to take into
10 consideration the overall effect of the differences for all components of the test
11 year. Under these circumstances parties recommend no change in the present
12 ratemaking procedure.³⁶

13
14 The Commission's policy on tax adjustments between rate cases set forth in OII 24 is
15 consistent with the Commission's general policy toward the treatment of differences between
16 forecasted and actual results between rate cases. The Commission has previously explained its
17 reasons for adopting this general policy:

18 In the short term, between general rate proceedings, the shareholders benefit when
19 the company's management can 'do it for less', and correspondingly, ratepayers
20 ultimately benefit because the productivity improvement will be reflected
21 periodically when there is a comprehensive review of the utility's revenue
22 requirement. Keeping this incentive for utility management is a cornerstone of
23 ratemaking . . .³⁷

24
25 Similarly, the Commission has previously recognized that "[u]nder traditional rate of
26 return regulation, utilities are given an incentive to reduce expenditures through increased
27 productivity, with the understanding that these savings accrue to shareholders between
28 rate cases and are passed on to ratepayers in the next GRC."³⁸

29
30 2. TURN's Proposed Adjustments for 2011-2014 Are Impermissible Retroactive
31 Ratemaking

³⁶ *Id.* at *33.

³⁷ *Re General Telephone of California*, D.85-03-042, 17 CPUC 2d 246, 254 (1985).

³⁸ *Re Application of Pacific Gas & Electric Company*, D.00-02-046, 2000 Cal. PUC LEXIS 239 (Cal. PUC 2000), at *201. *See also re Application of Pacific Gas & Electric Company*, D.96-12-066, 1996 Cal. PUC LEXIS 1111 (Cal PUC 1996), at *9 ("Any savings the utility can generate between general rate cases belong to the shareholders. In exchange for this opportunity, the shareholders take on the burden of added expenses it may incur during a rate case cycle").

1 a. The Commission Has Previously Rejected An After-The-Fact Attempt To
2 Match Ratemaking Taxes With Paid Taxes

3 TURN is proposing to reach back into prior rate case periods (i.e., 2011-2014) and use
4 tax deductions from those prior years to compute prospective ratemaking adjustments. A
5 deviation of paid taxes from forecast is not and has never been a basis for the Commission to
6 reach back to prior year taxes and change the ratemaking methodology to “true up” the
7 difference. Retroactive ratemaking is prohibited by California Public Utilities Code Section 728.
8 TURN’s proposed adjustments are inconsistent with that law and Commission policies.

9 Although TURN describes its normalization proposal as not violating the rule against
10 retroactive ratemaking,³⁹ it would in fact do so. This proposal is no different in principle than an
11 issue the Commission addressed in SoCalGas’ 1990 GRC. At issue in that case was the tax
12 treatment of certain employee benefit costs. In a prior GRC, SoCalGas had treated these costs as
13 currently deductible and flowed through the tax benefit in its cost-of-service calculations. The
14 IRS later determined that these amounts should be capitalized. In its 1990 GRC, SoCalGas
15 sought to recover the difference. DRA and TURN objected to SoCalGas’ request, arguing that it
16 amounted to retroactive ratemaking. Agreeing with those parties, the Commission observed that,
17 unless a memorandum account had been established in advance, there can be no after-the-fact
18 true-up to match ratemaking taxes with paid taxes:

19 First, as pointed out by DRA, it is fundamental that there can be no after-the-fact
20 “true up” to match ratemaking taxes with as-paid taxes, unless the Commission
21 specifically made provision for such an adjustment prior to the rates in question
22 becoming effective.

23
24 Second, a tax return is filed with the IRS after the tax year in which the return
25 relates is over and tax positions may not have been developed at the time of a
26 general rate case. Because of the rule against retroactive ratemaking, we cannot
27 make a tax memorandum account available to address a tax year that has passed
28 even if such IRS action was not anticipated in the general rate case for that year.⁴⁰

29
30 SoCalGas’ position in that rate case is the counterpart of TURN’s position in this case,
31 which the Commission anticipated in that earlier decision: “The same rule applies whether the
32 amount at issue is an overcollection, resulting in a windfall to the utility, or an undercollection,

³⁹ TURN/Marcus at 27.

⁴⁰ *Re Southern California Gas Co.*, D.92-08-007, 1992 Cal. PUC LEXIS 532, at *5-6, 45 CPUC2d 256 (1992).

1 as is alleged in the instant case.⁴¹

2 b. The Commission Similarly Restricts a Utility from Recovering Tax
3 Obligations Paid in Prior Years

4 A year later the Commission addressed an application from Southern California Water
5 Company “to establish a memorandum account in which it could book as much as \$4 million in
6 payments to the IRS for contested back taxes.”⁴² The Division of Ratepayer Advocates (“DRA”)
7 protested the application, claiming that granting it would amount to retroactive ratemaking. As
8 the Commission described DRA’s position:

9 Tax deductions and credits have long since been estimated in SCWC's general
10 rate cases covering the years 1983 through 1988. Those estimates were calculated
11 in the rates that SCWC was authorized to collect in those years. The utility did
12 not seek to keep any tax estimates open for reconsideration by the Commission at
13 a later date. To revisit those estimates now and, ultimately, to collect from
14 ratepayers the actual tax assessment that IRS says should have been paid at that
15 time is, in DRA's view, a classic example of revising rates retroactively. The
16 Division states:

17 The Commission would no more guarantee the utility be made whole for taxes
18 than for any other estimated expense.... Tax deductions and credits are estimates
19 based on the best information available at the time of the estimate. This
20 Commission has never made prospective adjustments to ratemaking tax
21 deductions and credits based on tax refunds received or additional taxes owed
22 based on real world audits by the IRS except for specific unique items held open
23 by Commission decision.⁴³

24 The Commission held in the Southern California Water Company decision that the
25 SoCalGas decision discussed above was “dispositive:”

26 The SoCalGas decisions are dispositive of the issues in this application. The facts
27 in SoCalGas were virtually identical to those here. A claim was made that the
28 IRS deficiency claim could not have been foreseen. The disputed tax matter had
29 been part of a rate case. SoCalGas argued that it could not pursue aggressive tax
30 strategies if it was compelled to bear all of the risk of claimed deficiencies. Our
31 conclusion was that none of these factors overcomes our mandate to set rate
32 increases and rate reductions on a prospective basis only, except under certain
33 prescribed conditions. We noted that a utility could always seek and would be
34 likely to obtain memorandum account treatment to deal with significant tax
35 uncertainties, provided it sought such relief prospectively.

⁴¹ *Id.* at *4.

⁴² *Re Southern California Water Co.*, D.93-04-046, 1993 Cal. PUC LEXIS 223, at *1, 49 CPUC2d 60 (1993).

⁴³ *Id.* at *7-8.

1 SCWC argues that the claimed deficiency in its case constitutes a prospective
2 cost, rather than an adjustment of a past cost, because the amount has not yet been
3 paid and is not absolutely due until after the IRS appeal process. That argument
4 approaches sophistry. Clearly, the alleged deficiency relates to tax obligations
5 that are alleged to have been due for each of the tax years 1983 through 1988, and
6 that is what the utility would seek to recover through rates.⁴⁴

7 If Southern California Water Company's argument "approaches sophistry," then the
8 Commission has to conclude that the TURN's proposed adjustment does so as well. TURN
9 wants to reach back to prior ratemaking years and use "real world" tax calculations from those
10 years to compute a prospective adjustment. If for no other reason, the TURN proposal should be
11 rejected for the same reason the Commission rejected the prior proposals of SoCalGas and
12 Southern California Water Company. Accepting such proposals would be retroactive
13 ratemaking.

14 c. Rates May Only Be Set Prospectively

15 The prohibition against retroactive ratemaking reflected in the SoCalGas and Southern
16 California Water Company decisions is more than a matter of Commission ratemaking policy.
17 Public Utilities Code §728 specifically prohibits retroactive ratemaking. Interpreting that
18 statute in *Pacific Telephone and Telegraph Company v. Public Utilities Commission*,⁴⁵ the
19 California Supreme Court held that the Commission was empowered in general rate case
20 proceedings to set rates *prospectively* only, and that the Commission had overstepped its
21 statutory power by ordering a refund of previously approved rates after a Commission
22 investigation had determined that these previously approved rates were too high:

23 *Section 728 of the Public Utilities Code* provides so far as here material that
24 "Whenever the commission, *after* a hearing, finds that the rates . . . demanded,
25 observed, charged, or collected by any public utility for or in connection with any
26 service . . . are . . . unreasonable, . . . the commission shall determine and fix, by
27 order, the just, reasonable, or sufficient rates . . . *to be thereafter* observed and *in*
28 *force.*" (Italics added.)

29
30 As Pacific states, this language is plain and unambiguous. The Legislature has
31 instructed the commission that after a hearing it is to make its order fixing rates to
32 be in force *thereafter*.⁴⁶
33

⁴⁴ *Id.* at *11-12.

⁴⁵ *Pacific Telephone and Telegraph Company v. Public Utilities Commission*, 62 Cal.2d 634; 1965 Cal. LEXIS 286.

⁴⁶ *Id.* at 650.

1 TURN's retroactive ratemaking proposal in this GRC would also violate Section 728.
2 TURN's attempt to distinguish its proposal from retroactive ratemaking is premised on its use of
3 the word "prospectively" in its testimony.⁴⁷ But merely labeling its proposal as "prospective"
4 does not save it from being retroactive ratemaking. It does not matter that the impact of TURN's
5 retroactive ratemaking proposal will apply to future 2016 rates. All retroactive proposals
6 propose future ratemaking impact. What all retroactive ratemaking proposals also have in
7 common is that they modify what was reflected in prior settled rates by adjusting future rates.

8 TURN states that "[t]his rate case is the first time [the Commission] will get a chance to
9 address how to treat these funds for ratemaking purposes, starting from first principles, without
10 any prior testimony or half-measures."⁴⁸ This statement does not support TURN's argument
11 because *any* attempt to adjust previously approved rates is prohibited retroactive ratemaking.⁴⁹
12 TURN's proposal to reach back into the 2011-2014 prior rate case periods and use actual taxes
13 from those prior rate case proceeding years to compute prospective adjustments would be
14 retroactive ratemaking, prohibited by Public Utilities Code Section 728.

15 TURN asks to have it both ways at the same time, accept current deductions under the
16 Commission's flow through policy, and change historical deductions using a "normalization"
17 methodology. These inconsistent and unsupported requests should be rejected.

18 3. SDG&E's Tax Filing Actions and Regulatory Treatment were Proper and
19 Appropriate

20 TURN acknowledges that SDG&E's change in accounting method for its repairs
21 deduction was made between rate cases.⁵⁰ Nonetheless, TURN questions the timing of the
22 election and criticizes SDG&E for not taking certain steps following (or in some cases even
23 before) SDG&E made its decision to change its method of accounting for repairs. The facts and
24 timeline of events does not support TURN's criticisms, as discussed below.

25 a. SDG&E Has the Responsibility to Comply with Changing Tax Authority
26 to Legally Minimize its Tax Burden

27 SDG&E's 2011 accounting method change for computing repair deductions was prudent
28 and made to minimize its income tax liability. Income tax authority is constantly changing. Each

⁴⁷ TURN/Marcus at 27.

⁴⁸ *Id.* at 25.

⁴⁹ Exceptions apply if a memorandum account has been established in advance.

⁵⁰ TURN/Marcus at 15.

1 year Congress passes new legislation amending the Internal Revenue Code. In addition, the IRS
2 frequently issues new guidance in various forms (e.g., regulations, rulings, notices and
3 procedures) that constitute either a change in the application of current law or an interpretation of
4 existing law. The accounting method change made by SDG&E was just such a change; it was a
5 change in the application of current law by the IRS to reduce the number of disputes between the
6 IRS and taxpayers. In addition, federal court decisions serve to create new or modified income
7 tax authority.

8 SDG&E, like any other taxpayer (whether rate-regulated or not), strives to legally comply
9 with the income tax rules and to pay the tax it owes, but no more than the law requires.⁵¹

10 SDG&E appropriately monitors tax law changes and IRS administrative guidance to identify
11 opportunities to minimize its liability. The Commission develops the rules that determine how
12 income taxes are to be addressed in ratemaking. The impact to customers of SDG&E's efforts to
13 minimize its tax liabilities ultimately results from applying the Commission's ratemaking
14 policies.

15 b. SDG&E's Repair Deductions Were Prudent and Appropriate

16 TURN claims SDG&E's management "pursued a tax strategy that enriches shareholders
17 at the expense of ratepayers."⁵² This claim is not supported by the facts. As explained below, it
18 was the technical requirements of the tax law and prudent income tax administration that
19 determined how and when SDG&E acted to change its accounting method for repairs. The
20 regulatory outcome to which TURN objects was just that – an outcome. The regulatory outcome
21 was not why SDG&E made the voluntary accounting method change, nor did it impact the
22 timing of when such changes were made. Almost all utilities in the United States have made
23 changes in their repair deductions over the past several years as a result of changes in guidance
24 contained in Revenue Procedure notices issued by the IRS to address the longstanding disputes
25 between the IRS and taxpayers over the proper expensing or capitalization of expenditures to
26 repair, replace, or relocate portions of their network assets.

⁵¹ In a seminal court decision regarding the obligation to pay taxes, Judge Learned Hand of the U.S. Second Circuit Court of Appeals said: "Anyone [sic] may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes. Over and over again the Courts have said that there is nothing sinister in so arranging affairs as to keep taxes as low as possible. Everyone does it, rich and poor alike and all do right, for nobody owes any public duty to pay more than the law demands." *Helvering v. Gregory*, 69 F.2d 809, 810 (2d Cir. 1934), *aff'd*, 293 U.S. 465, 55 S. Ct. 266, 79 L.Ed. 596 (1935).

⁵² TURN/Marcus at 14.

1 There are two key aspects relating to the tax deductions a utility is entitled to claim on
2 account of its incidental repair expenditures: (1) which expenditures qualify as incidental
3 repairs under the applicable tax rules; and (2) when a taxpayer can change its method of
4 accounting for any material item, such as treating an expenditure as a repair versus a capital
5 improvement. The distinction between whether or not these expenditures are deductible as
6 paid or capitalized and depreciated for income tax purposes has long been a complex and
7 disputed issue between taxpayers and the IRS. The Internal Revenue Code provides that
8 expenditures that: (1) do not substantially prolong the life of an asset; (2) materially increase its
9 value; or (3) adapt it for a substantially different use may be deducted as an expense. Even if a
10 utility were to know which of its expenditures qualified as deductible repairs, if it has not
11 historically deducted them, it cannot start to deduct them unless and until the IRS grants it
12 permission to change its accounting method.

13 Beginning in 2011, the IRS issued a series of guidance in this area to help clarify the
14 distinction between capital expenditures versus expenditures that qualify for immediate
15 deduction and also to provide taxpayers with additional options for making an accounting
16 method change from one acceptable method to another acceptable method for the repairs
17 deduction. TURN mischaracterizes the guidance and method change options as “administrative
18 largesse from a very generous IRS at the expense of all US taxpayers.”⁵³ In reality, the IRS’s
19 primary reason for its guidance and the additional options for making accounting method
20 changes were to make IRS audits of taxpayers’ repairs deductions less contentious, controversial,
21 and time consuming.⁵⁴ Moreover, as discussed in more detail below, these new procedures
22 required significant analysis before a taxpayer could determine whether the new options for
23 making an accounting method change would be beneficial.

24 c. SDG&E’s Analysis of the Impact of Electing the Accounting Method
25 Change for Repairs

26 On August 19, 2011, the IRS issued Rev. Proc. 2011-43, which established a “safe
27 harbor” method of accounting for electric transmission and distribution repairs.⁵⁵ SDG&E
28 immediately began analyzing the potential impact of the Rev. Proc. on its repairs deduction. It

⁵³ *Id.* at 19.

⁵⁴ *See* Rev. Proc. 2011-43, 2011-37 IRB 326 (August 19, 2011), Section 2.02.

⁵⁵ “Safe harbor” is a term used to describe an accounting method prescribed by the IRS, that when followed by the taxpayer, will result in audit protection upon later examination by the IRS.

1 soon became clear that the complexity of this analysis would require substantial resources and
2 time. Due to limitations on SDG&E's ability to extract the required circuit data directly from its
3 workflow systems (a limitation shared by most other utilities), SDG&E could not perform a
4 scoping study to determine whether an increased repair deduction would be available under IRS
5 Rev. Proc. 2011-43 before the end of 2011.⁵⁶

6 On February 8, 2012, SDG&E engaged the accounting firm of Deloitte, LLP ("Deloitte")
7 to assist in performing a scoping study using statistical sampling methods to determine whether
8 the safe harbor methodology would increase the repairs deduction over the percentage repair
9 allowance methodology.⁵⁷ Based on the results of the scoping study, SDG&E engaged Deloitte
10 on April 2, 2012 to perform a complete study, using expanded statistical sampling methods, to
11 determine the actual tax repairs deduction SDG&E would be eligible to claim under Rev. Proc.
12 2011-43.⁵⁸

13 A team from Deloitte in concert with SDG&E staff performed the complete study
14 required to determine the allowable repairs deduction utilizing the safe harbor method contained
15 in Rev. Proc. 2011-43 between April and September 2012.⁵⁹ SDG&E was able to adopt the safe
16 harbor on its 2011 income tax return due to specific implementation provisions in Rev. Proc.
17 2011-43. The procedure required for perfecting this 2011 repairs accounting method change was
18 to include the impact of the adoption along with the attachment of an election form. Since the
19 Sempra Energy consolidated 2011 federal income tax return was not filed until September 2012,
20 the Company had slightly over a year to perform the necessary analysis before SDG&E needed
21 to reflect such change on its 2011 return. Ultimately, the method change for repairs authorized
22 by Rev. Proc. 2011-43 was determined to be favorable and resulted in a larger repairs deduction
23 compared to percentage repairs allowance method that SDG&E had used prior to its 2011 repairs
24 method change. SDG&E formally adopted the new accounting method for repairs under Rev.
25 Proc. 2011-43 by filing IRS Form 3115 with the Ogden office of the IRS on September 5,
26 2012.⁶⁰

27 As a result of these efforts, SDG&E forecasts annual repair deductions in excess of \$91

⁵⁶ See SDG&E's response to TURN Data Request-02, Question 23 (Appendix C)

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.*

1 million each year for both the 2016 test year and the post-test-year period, which is significantly
2 larger than what the repairs deduction would have been had SDG&E not changed its method of
3 accounting from the percentage repair allowance method. Those deductions are being flowed
4 through to SDG&E ratepayers beginning in the 2016 test year, which is the first GRC test year in
5 which SDG&E has had the opportunity to flow through the benefits of the higher repairs
6 deduction to ratepayers.

7 d. SDG&E Adopted the Method Change as Soon as it Determined the Tax
8 Benefits of Doing So

9 There were at least three reasons for SDG&E to adopt the safe harbor at the earliest
10 possible time. The most obvious reason was that the sooner it was adopted, the sooner
11 SDG&E's tax liabilities would be reduced. The second reason was audit protection. The Rev.
12 Proc. specifically directed IRS personnel not to audit the repair deduction claimed in any prior
13 year by a utility that adopted the Safe Harbor in 2010 or 2011. Absent adoption in one of these
14 two years, the deduction was subject to full audit and the IRS had signaled that they would direct
15 significant resources to audit those taxpayers who chose not to adopt the safe harbor. Finally,
16 under the terms of the Rev. Proc., utilities adopting the safe harbor in 2010 or 2011 were relieved
17 of restrictions on the timing of their change in accounting method to which taxpayers are
18 normally subject (e.g., taxpayers may not make an accounting method change when under audit,
19 where the accounting method for the same item has been changed in the past five years, etc.).⁶¹
20 The practical impact of these limitations is that SDG&E could not make the automatic
21 accounting method change while under audit by the IRS. Since Sempra Energy and its affiliates,
22 including SDG&E, are under virtually continuous IRS audit, the opportunity to file an automatic
23 request for an accounting method change within the window provided was a critical factor in the
24 timing of the accounting method change.

25 In conclusion, SDG&E proceeded in a rational manner. We quantified the impact of
26 implementing Rev. Proc. 2011-43 as quickly as practicable. We reduced our tax liability at the
27 earliest possible time. We took steps to reduce the time, expense, and risk of potentially
28 contentious IRS audits for prior year tax returns subject to audit. SDG&E could not have
29 incorporated the incremental repair deductions into its 2012 GRC or, as alternatively proposed
30 by TURN, waited until the next rate case (i.e., the 2016 GRC) to adopt the change in method for

⁶¹ Rev. Proc. 2011-43, Section 7.03(2).

1 repairs. Contrary to TURN's assertion, SDG&E was not motivated by the desire to "transfer"
2 tax benefits to shareholders. SDG&E handled its corporate tax affairs prudently.

3 4. SDG&E's Accounting Method Change Benefitted Ratepayers

4 TURN provides several tables attempting to demonstrate what SDG&E could have done
5 differently in regard to its treatment of the repairs deduction between rate cases. Yet, none of
6 these tables reflects that SDG&E, at its first opportunity to do so in a GRC, is flowing through to
7 ratepayers a forecasted repairs deduction of more than \$280 million for the 2016-2018 years
8 (with similar benefits expected for future years). Moreover, TURN downplays the critical fact
9 that even when isolating just the 2011-2015 years, both shareholders and ratepayers were better
10 off as a result of SDG&E's decision to change its method of accounting in 2011 than they would
11 have been if SDG&E had not made the method change. TURN was made aware of this fact
12 through SDG&E's response to TURN Data Request-02, Question 21. The table provided in that
13 response (reproduced below) shows that, as of the end of 2015, the cumulative balance of ADIT
14 was \$26.5 million higher that it would have been if SDG&E had made no method change. The
15 increased ADIT balance reduces ratebase and revenue requirement, thereby benefiting
16 ratepayers.

SDG&E						
Calculation of (Additional)/Foregone ADIT Due to Change in Method for Repairs						
(amounts in thousands)						
Electric Distribution		2011	2012	2013	2014	2015
		Actual	Actual	Actual	Forecasted	Forecasted
Actual and Forecasted Repairs Deduction	a	(71,530)	(65,616)	(90,911)	(70,240)	(70,240)
Foregone Percentage Repair Allowance Deduction	b	9,369	9,369	9,369	9,369	9,369
Incremental Repairs Deduction	a-b = c	(62,161)	(56,247)	(81,542)	(60,871)	(60,871)
Incremental Foregone Deferred Tax Calculation:						
Bonus Depreciation	c x rate = d	(62,161)	(28,124)	(40,771)	(30,436)	(30,436)
1st Yr MACRS Depreciation	c-d x rate = e	-	(1,406)	(2,039)	(1,522)	(1,522)
2nd Yr MACRS Depreciation	c-d x rate = f		-	(2,672)	(3,873)	(2,891)
3rd Yr Macrs Depreciation	c-d x rate = g			-	(2,405)	(3,486)
4th Yr MACRS Depreciation	c-d x rate = h				-	(2,166)
5th Yr MACRS Depreciation	c-d x rate = i					-
Annual Foregone Tax Depreciation on Incremental Repairs	sum of (d:i) = j	(62,161)	(29,530)	(45,481)	(38,235)	(40,500)
1st Yr Book Depreciation	j x rate = k	2,146	1,968	2,727	2,107	2,107
2nd Yr Book Depreciation	j x rate = l		2,146	1,968	2,727	2,107
3rd Yr Book Depreciation	j x rate = m			2,146	1,968	2,727
4th Yr Book Depreciation	j x rate = n				2,146	1,968
5th Yr Book Depreciation	j x rate = o					2,146
Total Annual Book Depreciation on Incremental Repairs	sum of (k:o) = p	2,146	4,114	6,842	8,949	11,056
Difference	j + p = q	(60,015)	(25,415)	(38,640)	(29,286)	(29,444)
Tax Rate	r	35%	35%	35%	35%	35%
Incremental Foregone Deferred Taxes	q x r = s	(21,005)	(8,895)	(13,524)	(10,250)	(10,305)
Offset for Incremental ADIT Due to Section 481(a) Adjustment	\$258.6M x 35% = t	90,510				
Incremental (Foregone)/Additional Accumulated DIT	s + t	69,505	60,609	47,086	36,835	26,530
Conclusion: ADIT on Electric Distribution at the beginning of 2016 would have been lower by \$26.5 million had SDG&E not changed its method of accounting for repairs.						
Electric Transmission		2011	2012	2013	2014	2015
		Actual	Actual	Actual	Forecast	Forecast
Actual and Forecasted Repairs Deduction	a	(27,325)	(27,425)	(40,251)	Not Available	Not Available
Foregone Percentage Repair Allowance Deduction	b	3,003	3,003	3,003	Not Available	Not Available
Incremental Repairs Deduction	a-b = c	(24,322)	(24,422)	(37,248)		
Incremental Foregone Deferred Tax Calculation:						
Bonus Depreciation	tax basis x rate	(24,322)	(12,211)	(18,624)		
1st Yr MACRS Depreciation	tax basis x rate	-	(611)	(931)		
2nd Yr MACRS Depreciation	tax basis x rate		-	(1,160)		
3rd Yr Macrs Depreciation	tax basis x rate			-		
4th Yr MACRS Depreciation	tax basis x rate					
5th Yr MACRS Depreciation	tax basis x rate					
Annual Foregone Tax Depreciation on Incremental Repairs	sum of (d:i) = j	(24,322)	(12,822)	(20,715)		
1st Yr Book Depreciation	book basis x rate	820	823	1,208		
2nd Yr Book Depreciation	book basis x rate		820	823		
3rd Yr Book Depreciation	book basis x rate			820		
Total Book Depreciation		820	1,643	2,850		
Difference	j - k = l	(23,502)	(11,179)	(17,865)		
Tax Rate	m	35%	35%	35%		
Incremental Foregone Deferred Taxes	l x m = n	(8,226)	(3,913)	(6,253)		
Offset for Incremental ADIT on Section 481 Adjustment	\$78.9M x 35% = o	27,615				
Incremental (Foregone)/Additional ADIT	n + o	19,389	15,477	9,224		
Conclusion: ADIT on Electric Transmission at the beginning of 2016 would have been lower by \$9.2 million had SDG&E not changed its method of accounting for repairs. In addition, for transmission rates, all tax adjustments are normalized and the resulting deferred taxes adjust ratebase, so this exercise is irrelevant.						
Gas Transmission and Distribution Repairs - SDG&E has not changed its method of accounting for gas repairs.						
Nuclear and Steam Generation Repairs- SDG&E has not changed its method of accounting for nuclear and steam generation repairs.						

1 TURN claims in its testimony that “[i]f shareholders are going to win, as the Sempra
2 Utilities propose, then of necessity, ratepayers must lose.”⁶² Yet, as shown by the table above,
3 SDG&E’s change in accounting method benefits both shareholders and ratepayers. Moreover,
4 the table does not reflect the significant repairs deductions that will be flowed through to the
5 ratepayers beginning with the 2016 test year. Specifically, SDG&E’s change in accounting
6 method for repairs on its electric distribution property will result in a reduction to the revenue
7 requirement of over \$134 million for the 2016-2018 years. SDG&E fully acknowledges that
8 shareholders benefited from the accounting method change for the 2011-2015 years. In contrast,
9 TURN describes the fact that the change in accounting method for repairs also benefited
10 ratepayers for the 2011-2015 period as “no big deal,”⁶³ focusing instead on the shareholder
11 benefits during this period. SDG&E believes that the more appropriate focus should be on
12 whether the change in accounting method benefitted ratepayers (which it did for 2011-2015 and
13 will even more so beginning in 2016) and whether SDG&E’s treatment of the repairs deduction
14 was consistent with Commission precedent and policy (which it was as discussed earlier in this
15 testimony), and not on “who wins more” for years preceding the test year. The fact is that both
16 ratepayers and shareholders clearly benefitted from SDG&E’s accounting method change, and
17 ratepayers will continue to benefit in the future.

18 5. TURN’s Criticisms of SDG&E’s Approach to the Method Change for Repairs are
19 Factually Incorrect and/or Are Based on Incorrect Assumptions

20 In discussing the higher repairs deduction for 2011-2015, TURN states in its testimony
21 that SDG&E “took absolutely no steps to pass any of this money through to ratepayers, even
22 though they had several options to do so.”⁶⁴ As discussed below, TURN’s statement is incorrect.
23 Moreover, all of the “options” suggested by TURN were either precluded by the facts,
24 unrealistic, or inconsistent with the precedent and policy established by the Commission.

25 a. SDG&E Proposed an Earnings Sharing Mechanism in the 2012 GRC
26 Which Would Have Shared the Benefits of the Increased Repairs
27 Deduction Between Ratepayers and Shareholders

28 SDG&E proposed an earnings sharing mechanism in the 2012 GRC, which would have
29 shared the earnings above or below the authorized rate of return with ratepayers and shareholders

⁶² TURN/Marcus at 14.

⁶³ *Id.* at 22.

⁶⁴ *Id.* at 17.

1 during the post-test-year period.⁶⁵ The proposed earnings sharing mechanism would have
2 covered items such as the increased repairs deduction. Under the proposed mechanism, 65% of
3 the first band of earnings (i.e., 51 to 100 basis points above the authorized rate of return) would
4 have gone to ratepayers.⁶⁶ The Commission ultimately decided to adopt an alternative, more
5 conventional post-test-year mechanism that did not include the earnings sharing mechanism
6 proposed by SDG&E.⁶⁷ Nonetheless, the fact that SDG&E proposed an earnings sharing
7 mechanism that would have provided significant benefits from the increased repairs deduction to
8 ratepayers during the 2013-2015 period further demonstrates that TURN's statement that
9 SDG&E "took absolutely no steps to pass any of this money through to ratepayers" is incorrect.

10 b. TURN's Suggestion that SDG&E Should Have Included the Increased
11 Repair Deduction in 2012 GRC Update Testimony is Contrary to the Facts

12 TURN suggests that SDG&E should have reflected the increased repairs deduction in its
13 2012 GRC Update testimony. As SDG&E explained in its response to TURN Data Request-02,
14 Question 24:

15 The initial scoping work regarding the potential impact of a change in accounting
16 method for repairs had not been completed for SDG&E and had not yet begun for
17 SoCalGas at the time the 2012 update testimony was served. Therefore, neither
18 SDG&E nor SoCalGas knew at the time whether a method change would be
19 made, or what the potential amount of the repairs deduction could be under the
20 alternative method of accounting. Additionally, the 2012 update testimony was
21 limited in scope and included only enacted tax law changes and changes to
22 published tax rates.

23
24 Accordingly, at that point in time, SDG&E could not include the repairs impact in
25 its update testimony, even if the scope of the update phase of the proceeding had allowed
26 it.

27 c. There Was No Precedent at the Time to Suggest that a Memorandum
28 Account Was Appropriate for IRS Accounting Method Changes

29 As discussed earlier in this testimony, at the direction of the Commission, SDG&E filed
30 Advice Letter 4771 on filed March 2, 2015 to track its repairs tax deductions for 2015. Prior to
31 the Commission's order to establish this memorandum account on January 15, 2015, SDG&E
32 was unaware of any Commission precedent that would have suggested that a memorandum

⁶⁵ D.13-05-010 (May 14, 2013), at 1002.

⁶⁶ *Id.* at 1004.

⁶⁷ *Id.* at 1010.

1 account was appropriate for tracking the impact of IRS administrative guidance which allowed
2 taxpayers to change from one acceptable method of accounting to another acceptable method of
3 accounting.⁶⁸ Unlike the adoption of a new tax law, such administrative guidance from the IRS
4 is very common and is not at all an unusual event in the tax world. To the contrary, there were
5 64 Revenue Procedures issued by the IRS during 2014 alone, and Revenue Procedures are just
6 one of many forms of administrative guidance that the IRS issues each year. Thus, for TURN to
7 suggest in 2015 that SDG&E should have anticipated the need for a memorandum account to
8 track the repairs deduction back in 2012 or 2013 is unrealistic and does not accurately reflect the
9 Commission precedent available at the time.

10 d. The Increased Repairs Deduction Does Not Qualify for Z-Factor
11 Treatment

12 TURN also lists Z-Factor treatment as an “option” for SDG&E regarding the increased
13 repairs deductions.⁶⁹ However, as TURN explains in its own testimony, Z Factors are
14 “exogenous events” which are “largely uncontrollable by management” and include costs “which
15 are not a normal part of doing business.”⁷⁰ Repairs clearly are a normal part of the utilities
16 business, and repair deductions in some form have been claimed by utilities for decades. In
17 addition, the change in method was elective and not something “uncontrollable by management.”
18 As discussed in more detail below, these facts alone preclude Z-Factor treatment for the
19 increased repairs deduction.

20 Nonetheless, TURN ignores these requirements and states that “[p]otential Z Factors
21 shall include, **but are not limited to** . . . Tax law changes by the federal government, the State
22 Franchise Tax Board, Board of Equalization, or any local jurisdiction having taxing authority”
23 (emphasis in original).⁷¹ Since the change in accounting method for repairs is clearly not a
24 federal, state, or local tax law change of any kind, TURN is trying to shoehorn the “but are not

⁶⁸ In Resolution No. L-411-A (issued June 23, 2011), the Commission established a memorandum account to track the impact of new legislation that, for the first time, authorized utilities to claim a 100% bonus depreciation deduction on qualified assets. The Commission specifically limited the scope of this memorandum account to encompass only the impact of this new tax legislation and denied TURN’s request to expand the scope of the Resolution beyond the new legislation. SDG&E was exempt from the memorandum account established in the Resolution because of the timing of SDG&E’s upcoming 2012 GRC.

⁶⁹ TURN/Marcus at 18-19.

⁷⁰ *Id.* at 19.

⁷¹ *Id.*

1 limited to” language to encompass this kind of administrative change. TURN, however, cites
2 nothing to support such a stretch in interpreting the requirements of the Z Factor.

3 The Z Factor tariff includes eight specific requirements, all of which must be met for the
4 Z Factor to apply. These eight requirements are that the event must be:

- 5 1. Caused by an event exogenous to the utility;
- 6 2. Caused by an event that occurred after the implementation of rates;
- 7 3. Costs that the utility cannot control;
- 8 4. Costs that are not a normal cost of doing business;
- 9 5. Caused by an event that affects the utility disproportionately;
- 10 6. Costs that have a major impact on the utility;
- 11 7. Costs that have a measureable impact on the utility; and
- 12 8. Costs that the utility has reasonably incurred.⁷²

13 In regards to the accounting method change for the repairs deduction, SDG&E clearly
14 does not meet Z Factor requirements 1, 3, 4, and 5, above. And since all eight requirements must
15 be met for the Z Factor to apply, Z Factor treatment is inappropriate in this case.

16 e. TURN’s Suggestion that SDG&E Could Have Waited until 2016 to Make
17 its Repairs Method Change is Factually Inaccurate

18 As an additional “option,” TURN speculates that “[i]f Sempra had/could have waited
19 until 2016 to begin taking this [higher repairs] deduction, when it could have been flowed
20 through to ratepayers, the operation of Section 481(a) through 2015 would have given the
21 ratepayers at least the same amount if not a slightly larger normalized amount relative to 2011
22 (for SDG&E) or 2012 (for SoCal).”⁷³ This statement neglects the procedural details of the IRS
23 Revenue Procedure allowing an accounting method change. As discussed earlier in this
24 testimony, SDG&E faced time sensitivities for making the method change to take advantage of
25 the audit protection and scope limitations waiver provisions included in Rev. Proc. 2011-43. The
26 Rev. Proc. specifically directed IRS personnel not to audit the repair deduction claimed in any
27 prior year by a utility that adopted the safe harbor in 2010 or 2011. Absent adoption in one of
28 these two years, the deduction was subject to full audit and the IRS had signaled that they would
29 direct significant resources to audit those taxpayers who chose not to adopt the safe harbor. In

⁷² SDG&E Preliminary Statement part IV.D.1.

⁷³ TURN/Marcus at 23.

1 addition, under the terms of the Rev. Proc., utilities adopting the safe harbor in 2010 or 2011
2 were relieved of restrictions on the timing of their change in accounting method to which
3 taxpayers are normally subject (*e.g.*, taxpayers may not make an accounting method change
4 when under audit, where the accounting method for the same item has been changed in the past
5 five years, etc.).⁷⁴ The practical impact of these limitations is that SDG&E could not make the
6 automatic accounting method change while under audit by the IRS. Since Sempra Energy and its
7 affiliates, including SDG&E, are under virtually continuous IRS audit, the opportunity to file an
8 automatic request for an accounting method change within the window provided was a critical
9 factor in the timing of the accounting method change. Moreover, it would not be a prudent
10 business practice for SDG&E to forego until a later year a material tax deduction for which it has
11 determined it is qualified to claim in the current year. Thus, TURN's suggestion that SDG&E
12 should have or even could have waited until 2016 to make its accounting method change for
13 repairs is unrealistic and is not supported by the facts.⁷⁵

14 6. TURN's Comparison to PG&E's Approach to Repairs Is Incomplete

15 TURN notes that Pacific Gas & Electric Company ("PG&E") has taken a different
16 approach to its repairs deduction from SDG&E and "effectively recommends the PG&E method
17 be adopted."⁷⁶ In order to make a meaningful comparison between SDG&E's approach and
18 PG&E's approach, we would need to know the details of PG&E's repair methodology – for
19 example, how much of its repairs deduction was federal versus California, the timing of its
20 repairs analysis, the impact of the Section 481(a) adjustments, etc. We would also need to
21 understand how PG&E's overall ratemaking policy regarding taxes compares to that of SDG&E.
22 To illustrate this point, TURN quotes the following PG&E testimony from PG&E's 2014 GRC:
23 "It is PG&E's policy to reflect changes in accounting method in the first rate filings after it has
24 received full approval from the IRS, California Franchise Tax Board and if applicable, the
25 congressional Joint Committee on Taxation."⁷⁷ SDG&E has a different policy in this regard.
26 Specifically, SDG&E's policy is that it does not wait for full approval from the IRS, California
27 Franchise Tax Board, or the Joint Committee on Taxation before reflecting the tax impact of

⁷⁴ Rev. Proc. 2011-43, Section 7.03(2).

⁷⁵ The calculations shown in Table 9 of TURN's testimony are premised upon this unrealistic assumption that SDG&E could have waited until 2016 to make the repairs method change; therefore, the Table is not instructive or relevant to the underlying repairs deduction issue.

⁷⁶ TURN/Marcus at 26.

⁷⁷ *Id.* (emphasis added).

1 changes in accounting methods in rates. SDG&E's policy is more ratepayer-favorable, because
2 SDG&E bears the full risk of IRS or Franchise Tax Board audit adjustments that reduce the
3 amount of the deduction for SDG&E (while ratepayers would have already received the benefit
4 of the pre-audit forecasted amount of the deduction). Without understanding the full picture of
5 the two utilities' repairs deductions and overall ratemaking policy regarding taxes, a comparison
6 between the two utilities on the treatment of repairs would not be complete or meaningful.

7 7. The Commission Has the Discretion to Change Its Policies But Should Only Do
8 So Prospectively and Consistently

9 TURN also recommends that the Commission "order that any future voluntary tax
10 changes made by SDG&E and SoCal should only take effect in GRC test years unless provisions
11 are made to make ratepayers whole."⁷⁸ It is often not possible and/or not prudent to wait until a
12 GRC test year before making an accounting method change. As explained earlier in this
13 testimony, that was the case with SDG&E's accounting method change for repairs. Thus,
14 TURN's proposal to force utilities to wait until a GRC test year before implementing an
15 accounting method change is not practical.

16 Presumably, TURN's request for provisions "to make ratepayers whole" is akin TURN's
17 proposal in this GRC, in which TURN proposes that the repair deduction be treated on a flow-
18 through basis prospectively (i.e., starting in 2016) but also that a special rate base adjustment be
19 applied to the repairs deductions for the 2011-2014 years. This rate base adjustment applies a
20 normalization-like offset to repair deductions that were subject to flow through treatment based
21 on longstanding Commission policy. If the Commission seeks to consider such a major change
22 to its long-standing flow through policy, this GRC is not the proper forum, given the many
23 ramifications yet to be raised and discussed, and all the stakeholders potentially impacted.
24 However, the Commission has shown consistency through the years in upholding its
25 longstanding tax ratemaking precedent, even amidst aggressive challenges that have come in
26 many forms and argued from many different angles. This is not a zero-sum game, as TURN
27 suggests. TURN's proposal does not comport to the Commission's enduring tax policies and
28 precedent and should therefore be rejected.

29

⁷⁸ *Id.* at 13.

1 **III. CONCLUSION**

2 To summarize, SDG&E uses the same methodology for forecasting payroll taxes in this
3 GRC that it used in its 2012 GRC. That methodology was found to be reasonable by the
4 Commission and was adopted in the 2012 GRC final decision. ORA has not demonstrated in its
5 testimony that its proposed approach to forecasting payroll taxes is more accurate or reliable than
6 SDG&E's approach. To the contrary, ORA's proposed methodology is either historically less
7 accurate than SDG&E's methodology or is unsupported by any authority. In addition, SDG&E's
8 OASDI wage base methodology that ORA is challenging is the same methodology that Southern
9 California Edison used in its 2015 GRC to forecast the OASDI wage base limitation, yet ORA
10 accepted Southern California Edison's methodology without challenge. For these reasons,
11 ORA's proposals regarding SDG&E's payroll taxes should be rejected, and SDG&E's forecasts
12 should be adopted in full.

13 TURN's proposals regarding SDG&E's income tax repairs deduction should also be
14 rejected. SDG&E followed long-established Commission precedent and policy in its treatment
15 of the accounting method change for repairs that occurred between rate cases. As a result of its
16 accounting method change, ratepayers benefitted for the 2011-2015 years through the increased
17 ADIT balance, which reduces ratebase and the revenue requirement. Ratepayers will benefit
18 even more significantly in 2016 and subsequent years, when the benefit of the larger repairs
19 deduction is flowed through to ratepayers, consistent with Commission precedent and policy.
20 Thus, SDG&E's treatment of the repairs deductions for 2016 and prior years is reasonable and
21 should be adopted. Moreover, TURN's proposal to reach back into the 2011-2014 years and re-
22 characterize the flow-through repairs deductions for these years as normalized deductions
23 constitutes impermissible retroactive ratemaking.

24 This concludes my prepared rebuttal testimony.

APPENDIX A

2015 California Unemployment Insurance Rate

EDD DE 2088
 PO BOX 826880 MIC 4
 SACRAMENTO, CA 94280-0001



SEMPRA GLOBAL SERVICES, INC
 101 ASH ST # HQ01C
 SAN DIEGO CA 92101-3017

Letter ID L0238891840
 Issued Date December 31, 2014
 Account ID 001-5390-8
 981925888_P9913_E3305

NOTICE OF CONTRIBUTION RATES AND STATEMENT OF UI RESERVE ACCOUNT FOR THE PERIOD OF JANUARY 1, 2015, TO DECEMBER 31, 2015

IMPORTANT NOTICE

This is not a bill, do not pay this amount This is to inform you of your UI, ETT, and SDI contribution rates for the year shown above. The following is a breakdown of your UI reserve account balance and the factors used to calculate your UI contribution rate. **YOUR UI RESERVE BALANCE IS NON-REFUNDABLE**

Your Unemployment Insurance (UI) Contribution Rate is	3.60%
UI Rate Schedule is	F+
Your Employment Training Tax (ETT) rate is	0.10%
Your SDI Rate is	0.90%
The Annual Taxable Wage Limit Per Employee for UI and ETT is	\$7,000.00
SDI is	\$104,378.00

1 Previous reserve balance as of 7/31/13		\$10,239,405.19
2 UI Contributions paid from 8/1/13 to 7/31/14	\$3,866,787.25	
3 Interest earned by the UI Fund (for positive reserve account employers only)	\$0.00	
4 Negative balance reduction (for negative reserve account employers only)	\$0.00	
5 Benefit overpayments collected	\$92,317.79	
6 Positive reserve balances cancelled	\$66,508.21	
7 Other income to the UI Fund	\$10,683.26	
8 TOTAL CREDITS		+ \$3,836,276.51
9 UI benefits charged to your reserve account from 7/1/13 to 6/30/14	\$1,439,557.00	
10 Increase in the total of all negative reserve account balances	\$1,240,264.31	
11 Benefit overpayments established	\$144,971.64	
12 UI benefits not charged to reserve accounts	\$251,006.25	
13 Other expenses of UI Fund	\$17,990.23	
14 TOTAL CHARGES		- \$3,093,789.43
15 New reserve account balance as of 7/31/14		\$10,981,892.27
16 UI taxable payroll for calendar years 2011-2012-2013	\$304,207,429.32	
17 Ratio (Line 15 divided by the average of Line 16)	0.1083	

COMPUTATION OF SHARED CREDITS AND CHARGES Lines 5, 6, 7, 10, 11, 12 and 13 are credits and charges shared by all California employers. The shared amounts are computed using fiscal year UI taxable wages.

Your UI taxable wages from 7/1/13 through 6/30/14 were	\$101,746,120.28
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APPENDIX B

Ratepayer Benefit from Change in Accounting Method for Repairs

APPENDIX B

SDG&E

Ratepayer Benefit from Change in Accounting Method for Repairs 2016 - 2018

(\$ in thousands)

	2016 Forecasted	2017 Forecasted	2018 Forecasted	TOTAL
Actual and Forecasted Repairs Deduction - Electric Distribution ¹	(78,508)	(80,534)	(82,515)	
Total Annual Ratemaking Depreciation Offset to Repairs Deduction ²	17,368	20,413	23,532	
Net Repairs Tax Deduction	<u>(61,140)</u>	<u>(60,121)</u>	<u>(58,983)</u>	
Forecasted Repairs Deduction Under PRA Method ¹	(9,369)	(9,611)	(9,847)	
Total Annual Ratemaking Depreciation Addback on PRA ²	2,125	2,488	2,860	
Net PRA Tax Deduction	<u>(7,244)</u>	<u>(7,123)</u>	<u>(6,987)</u>	
Difference in Net Tax Deduction Between Repairs and PRA Method	(53,895)	(52,998)	(51,996)	
Combined Federal & State Tax Rate (net of federal impact of state taxes)	40.746%	40.746%	40.746%	
Incremental Tax Benefit	(21,960)	(21,595)	(21,186)	
Gross up Factor	1.68746	1.68746	1.68746	
Incremental Revenue Requirement Repairs Method vs. PRA	<u>(37,057)</u>	<u>(36,440)</u>	<u>(35,751)</u>	
IRC Section 481(a) Catch-up Adjustment ²	(213,283)	(205,220)	(197,463)	
Federal Tax Rate ³	35%	35%	35%	
ADIT Liability	(74,649)	(71,827)	(69,112)	
Pre-Tax ROR	11.59%	11.59%	11.59%	
Revenue Requirement Impact of 481(a) Adjustment	<u>(8,652)</u>	<u>(8,325)</u>	<u>(8,010)</u>	
Net Revenue Requirement Benefit to Ratepayers in 2016-2018	<u>(45,709)</u>	<u>(44,765)</u>	<u>(43,761)</u>	(134,235)

Notes:

¹ 2017 and 2018 amounts reflect the post-test-year O&M escalation rates of 2.58% and 2.46%, respectively. See Ex. SDG&E-37-R-WP, Table 2.

² Calculations reflects a book depreciation rate of 3.78% for all years. See Ex. SDG&E-29-WP-R, page 34.

³ California does not allow a Sec. 481(a) adjustment for repairs because all vintages of assets are eligible for PRA in California.

APPENDIX C

Response to TURN Data Request-02, Question 23(a-d)

TURN DATA REQUEST-02
SDG&E-SOCALGAS 2016 GRC – A.14-11-003-004
SDG&E_SOCALGAS FINAL RESPONSE
DATE RECEIVED: DECEMBER 22, 2014
DATE RESPONDED: JANUARY 16, 2015

23. Please answer the following questions for each of the Sempra Utilities. If the answer to any question is different as it relates to SDG&E and SoCal Gas, answer separately for each utility and explain why there is a difference between the two Sempra utilities.
- a. When did the Sempra utilities first become aware that an increased repair deduction could potentially be available?
 - b. When did the Sempra utilities determine that they were going to implement the changes to the repair deduction as a result of the IRS revenue procedures?
 - c. Please explain and describe the process involved in determining whether the Sempra utilities would take the larger deductions, including but not limited to identification of the persons who provided material input, the persons who ultimately made the decision, and the dates of each step of the consideration. Please also provide all internal memoranda or other documents addressing the question of whether a memorandum account should be established to track increased repair deductions.
 - d. Please identify each corporate officer who reviewed or ultimately approved any decision to implement the changes to the repair deduction, and the approximate date of that review or approval.
 - e. Please provide all internal memoranda or other documents given or made available to the corporate officer(s) on the topic of the repair deduction and any minutes or other documentation of meetings that addressed this topic.
 - f. Please provide all internal memoranda or other documents addressing the question of the timing of the increased repair deductions, including but not limited to the impact of taking the increased repair deductions immediately versus waiting until the Test Year of the next general rate case.
 - g. Please provide all internal memoranda or other documents regarding the change to the repair deduction once the Sempra utilities had decided to make the change, including but not limited to material given to staff on how to implement the change in the Sempra Energy Utilities' accounting system and material given to internal and external auditors supporting the change.

Utility Response:

Each Sempra utility relied on IRS guidance applicable to that utility, therefore, a separate response will be provided for each utility:

SDG&E:

- a. When did the Sempra utilities first become aware that an increased repair deduction could potentially be available?

Response: On August 19, 2011, the IRS issued Revenue Procedure 2011-43 which established a “safe harbor” method of accounting for electric transmission and distribution repairs. Due to limitations on SDG&E’s ability to extract the required circuit data directly from its workflow systems (a limitation shared by most other utilities), SDG&E could not perform a scoping study to determine whether an increased repair deduction would be available under IRS revenue procedure 2011-43 before the end of 2011. As a result, SDG&E filed its 2011 10K report with the SEC in late February 2012 with an income tax provision that included a tax adjustment using the percentage repair allowance methodology. On February 8, 2012, SDG&E engaged the accounting firm of Deloitte, LLP to assist in performing a scoping study using statistical sampling methods to determine whether the safe harbor methodology would increase the repairs deduction over the percentage repair allowance methodology. Based on the results of the scoping study, SDG&E engaged Deloitte on April 2, 2012 to perform a complete study, using expanded statistical sampling methods, to determine the actual tax repairs deduction SDG&E would be eligible to claim under IRS revenue procedure 2011-43.

- b. When did the Sempra utilities determine that they were going to implement the changes to the repair deduction as a result of the IRS revenue procedures?

Response: A team from Deloitte in concert with SDG&E staff performed the complete study required to determine the allowable repairs deduction utilizing the safe harbor method contained in Revenue Procedure 2011-43 between April and September 2012. SDG&E indicated its intent to formally implement the changes to the repair deduction by filing IRS Form 3115 with the Ogden office of the IRS on September 5, 2012 to request automatic consent to change its accounting method.

- c. Please explain and describe the process involved in determining whether the Sempra utilities would take the larger deductions, including but not limited to identification of the persons who provided material input, the persons who ultimately made the decision, and the dates of each step of the consideration. Please also provide all internal memoranda or other documents addressing the question of whether a memorandum account should be established to track increased repair deductions.

Response: To the best of our knowledge, documentation of exact dates of each step in SDG&E’s consideration to change from a percentage repair allowance methodology to the IRS approved safe harbor methodology does not exist; however, the decision-making would have coincided with the dates described in the responses to a and b above.

The individuals involved in generating and reviewing the data and making the decision to adopt the safe harbor methodology were Steve Olivier, Tax Manager, Randall Rose, Tax Director, Paul Yong, Vice President of Tax, Robert Schlax, CFO and Controller of the Sempra Utilities, and Joseph Householder, Controller

for Sempra Energy. These individuals would have been responsible for briefing any senior officers on the change in accounting method.

- d. Please identify each corporate officer who reviewed or ultimately approved any decision to implement the changes to the repair deduction, and the approximate date of that review or approval.

Response: Paul Yong, Vice President of Tax for Sempra Energy, Joseph Householder, Controller for Sempra Energy, and Robert Schlax, CFO and Controller for the Sempra Utilities would have had the ultimate decision to implement the changes to the repair deduction. Their review and decision to implement would have coincided with the preparation and review of the 2011 tax return, which occurred between July and September 2012.

The Form 3115 (Application for Change in Accounting Method) that was filed with the IRS on September 5, 2012 was previously provided on January 9, 2015 in our response to question 27.