

ED DATA REQUEST-001
SDG&E 2019 GRC – A.17-11-007
DATE RECEIVED: MAY 13, 2018
DATE RESPONDED: MAY 16, 2018

1. Provide a CD with the revised RO model provided to ORA on 4/4/18 that incorporates the impact of the TCJA. Mailing address:
 - a. Michael Conklin
Energy Division, California Public Utilities Commission
320 W. 4th Street, Suite 500
Los Angeles, CA 90013

SDG&E Response 1:

A copy of the RO model was provided to Michael Conklin on May 8, 2018.

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2. Refer to Exhibit SDG&E-35-2R (Revised Testimony of Ragan G. Reeves), p. RGR-14 which states: “Only a small amount of excess AFDIT remains from the decrease in tax rate under TRA 86.”
 - a. At December 31, 2017 what was the remaining excess AFDIT from TRA 86.
 - b. State the amount of excess AFDIT returned to ratepayers under ARAM during 2017.
 - c. Provide supporting workpapers in Excel format showing the calculation that resulted in SDG&E’s answer to question 2.b.

SDG&E Response 2:

- a. The remaining excess AFDIT from TRA 86 at December 31, 2017 was \$1.0 million. By comparison, this balance is 0.317% of the excess AFDIT balance of \$315.0 million as of January 1, 2018 after the implementation of the Tax Cuts and Jobs Act (TCJA).
- b. The ARAM amount for 2017 was \$155,000.
- c. Please see Attachment A to this data request.

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3. Refer to Exhibit SDG&E-35-2R, p. RGR-24 which states: "...SDG&E has concluded that the best interpretation of the ARAM rules under TCJA is to exclude new removal costs accrued for book purposes after December 31, 2017 from its ARAM calculation."
 - a. State whether SDG&E has historically excluded new removal costs accrued for book purposes when calculating the ARAM under TRA 86.
 - b. If the answer to 3.a is no:
 - i. Explain why SDG&E has now changed its position.
 - ii. Explain why the Commission should adopt two inconsistent approaches (including/excluding removal costs) to the ARAM return of excess AFDIT.

SDG&E Response 3:

a. To the best of SDG&E's knowledge, SDG&E has not historically excluded new costs of removal (COR) accrued for book purposes when calculating ARAM.

b. i. As discussed in Exhibit SDG&E-35-2R, page RGR-22, lines 19-21, "SDG&E will return the excess deferred taxes to its customers in full. But in doing so, SDG&E must adhere to the timing rules and other requirements under the TCJA." Thus, only the timing of the flow back of the excess deferred taxes is at issue with the ARAM calculation, not the total amount of the excess deferred taxes to be returned to customers. SDG&E is indifferent as to the amount of the annual ARAM calculation. Rather, SDG&E's focus is complying with the ARAM rules as defined in the TCJA.

After analyzing the ARAM rules in the TCJA, discussing the issue with its outside advisors, and participating in several industry group discussions on this issue, SDG&E concluded that the most logical interpretation of the ARAM rules under the TCJA is to exclude new COR accrued for book purposes after December 31, 2017 from its ARAM calculation. SDG&E's position is discussed in more detail in Exhibit SDG&E-35-2R, pages RGR-23 to RGR-24.

As stated in Exhibit SDG&E-35-2R, page RGR-24, lines 13-15, "[i]f the IRS issues a private letter ruling on this issue, or if the IRS or Treasury release other guidance on this issue, and such ruling or guidance differs from SDG&E's position, SDG&E will recalculate the ARAM adjustment to conform to such guidance" and track any differences in its Tax Memorandum Account.

- c. ii. SDG&E had not specifically considered the treatment of new COR accrued for book purposes in the ARAM calculation until the TCJA was enacted, nor is SDG&E aware of any other utility that had specifically considered this issue prior to the TCJA.

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SDG&E Response 3:-Continued

When a new tax law (such as the TCJA) brings an issue to SDG&E's or the Commission's attention for the first time and causes a re-evaluation of SDG&E's approach to that issue, we believe that SDG&E and the Commission share the common goal of interpreting and applying the new law correctly and avoiding unintended or unwanted consequences, such as a normalization violation. As stated above, after its own analysis and after extensive conversations with its outside advisors and industry peers on the COR ARAM issue, SDG&E believes its approach is the most logical interpretation of the ARAM rules under the TCJA.

Moreover, prior to the enactment of the TCJA, SDG&E's ARAM amounts related to the excess ADFIT from TRA 86 were very small for several years. SDG&E's ARAM amount included in its Results of Operations (RO) Model for each of the five years prior to 2018 never exceeded \$155,000 in any year. Thus, the impact of ARAM on SDG&E's income tax expense for these years was immaterial. Accordingly, even if SDG&E's had excluded new COR accrued for book purposes from its ARAM calculation for these years, the impact to income tax expense for these years would have been negligible.

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4. Refer to Exhibit SDG&E-35-2R, p. RGR-24 which states:
- a. “Since ARAM addresses historical excess tax reserves (pre-2018), SDG&E’s position is that only the depreciation that relates to the recovery of the original cost of those capital expenditures should be included. The depreciation related to recovering new cost of removal is a new timing difference arising after 2017; thus, by definition, it is not a recovery of the original cost basis that gave rise to the historical excess tax reserves from tax accelerated depreciation.”
 - i. Provide any citation to the IRS ARAM requirements or Treasury Regulations that direct the removal of COR from book depreciation when calculating the ARAM.
 - ii. Provide any citation to the IRS ARAM requirements or Treasury Regulations that support SDG&E’s position that “only the depreciation that relates to the recovery of the original cost of those capital expenditures should be included”[in the ARAM calculation.]
 - iii. Does SDG&E agree that historic book depreciation (pre-2018) includes a Cost of Removal component?
 - iv. Does SDG&E agree that the excess deferred tax reserve balance (which is the difference between deferred tax at the old tax rate and deferred tax at the new tax rate) includes a portion related to the Cost of Removal that was included in book depreciation when the deferred tax balance was generated?
 - v. Explain why, if Cost of Removal was included in book depreciation when originally calculating deferred taxes, is it appropriate to exclude from ARAM which is simply returning the excess of the same deferred taxes?
 - b. Regarding the statement “The depreciation related to recovering new cost of removal is a new timing difference arising after 2017 thus, by definition, it is not a recovery of the original cost basis that gave rise to the historical excess tax reserves from tax accelerated depreciation.”
 - i. Explain how this timing difference arising after 2017 differs from other timing differences arising after 2017 (for example, the timing difference between book and tax depreciation in 2018 is also a “timing difference arising after 2017”).
 - ii. Explain why a “new timing difference arising after 2017” cannot be a recovery of the original cost basis that gave rise to the historical excess tax reserves from tax accelerated depreciation.

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SDG&E Response 4:

- a. i. We are not aware of any IRS or Treasury Regulations citations that specifically addresses the treatment of COR when calculating the ARAM adjustment. SDG&E's approach is based on our interpretation of the definition of ARAM in the TCJA (see discussion in our response to subpart a.ii, below).
- ii. Section 13001(d)(3)(B) of the TCJA defines ARAM as follows:

AVERAGE RATE ASSUMPTION METHOD.—The average rate assumption method is the method under which the excess in the reserve for deferred taxes is reduced over the remaining lives of the property as used in its regulated books of account which gave rise to the reserve for deferred taxes. Under such method, during the time period in which the timing differences for the property reverse, the amount of the adjustment to the reserve for the deferred taxes is calculated by multiplying— (i) the ratio of the aggregate deferred taxes for the property to the aggregate timing differences for the property as of the beginning of the period in question, by (ii) the amount of the timing differences which reverse during such period.

Accordingly, the TCJA requires the excess deferred tax reserve to be reduced (*i.e.*, returned to customers) over “the remaining lives of the property.” The statute does not mention book depreciation directly, but refers to “the time period in which the timing differences for the property reverses,” which in this case is the remaining book depreciable life.

Since tax depreciation is accelerated and over a shorter life than book depreciation, it results in a tax deduction before the offsetting book depreciation deduction. The property life component of book depreciation reverses the tax depreciation timing difference taken before December 31, 2017. This concept is consistent with the language in the statute (*i.e.*, during the time period in which the timing differences for the property reverse). That is why SDG&E believes that the property life component of book depreciation should be used in the ARAM calculation.

In contrast, the COR component of book depreciation is not reversing any timing difference in existence at December 31, 2017, as is required by the TCJA. The COR deferred tax asset (DTA) occurs because the book deduction for COR is accrued before a tax deduction is taken (*i.e.*, SDG&E takes a book deduction now and will get the corresponding tax benefit in the future). For COR, the tax benefit in the future occurs when the COR is actually incurred. Since the COR component of book depreciation is not reversing any prior timing difference, SDG&E believes that including it in the ARAM calculation would be inconsistent with the last requirement of the ARAM adjustment as defined in the TCJA, which is limited to “the amount of the timing differences which reverse during such period.”

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SDG&E Response 4:-Continued

Moreover, SDG&E's approach is consistent with its treatment of the DTA for COR, which SDG&E is also excluding from its ARAM calculation (*i.e.*, by not including any amounts for future COR incurred and thus deductible for tax purposes in its ARAM calculation). SDG&E believes it would be inconsistent to include the future COR book accruals in its ARAM calculation and yet exclude the DTA for COR from its ARAM calculation.

iii. Yes.

iv. Yes.

v. As discussed in the response to Question 4(a)(ii) above, a DTA occurs when a book deduction is accrued before a tax deduction is taken. Thus, a DTA represents a tax benefit that the company will get in the future.

The excess deferred taxes related to historical COR is a DTA, not a deferred tax liability (DTL). COR book depreciation accruals for 2018 and later years will increase the DTA rather than reverse it, because it adds more COR accrual without a tax deduction reversal. This is because the DTA for the historical COR timing difference only reverses when COR is actually incurred, which is a future event.

Therefore, SDG&E believes that including COR in book depreciation for 2018 and later years in its ARAM calculation would not reverse any portion of excess deferred taxes historically related to COR.

- b. i. As discussed in response to Question 4(a)(v) above, the timing difference related to COR is a DTA, not a DTL. This DTA will not reverse until the COR is actually incurred in the future. In contrast, the timing difference between book and tax depreciation is a DTL, the recovery of which is not subject to or dependent upon future events.
- ii. Please see the response to Question 4(a)(v) above.

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5. In PDF format, provide copies of any ARAM guidance SDG&E/Sempra has received from external sources such as legal, accounting or consulting firms.

SDG&E Response 5:

SDG&E objects to this request to the extent it seeks any documentation subject to attorney-client privilege or attorney work product. Notwithstanding that objection, SDG&E has discussed the mechanics of ARAM with several external sources, including legal and accounting firms and its utility peers. SDG&E has reflected the result of those discussions of the mechanics of ARAM with the external sources in the calculations of ARAM included in its revised testimony submitted on April 6, 2018 in this 2019 GRC proceeding. However, SDG&E has not received any written ARAM guidance from these external sources.