

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



June 27, 2007

Advice Letter 2813-G/2999-E

Brian K. Cherry
Vice President, Regulatory Relations
Pacific Gas & Electric Company
77 Beale Street, Mail Code B10C
P.O. Box 770000
San Francisco, CA 94177

Subject: Report on Tax Deductibility of ClimateSmart Premiums from Residential
Customers in Compliance with D. 06-12-032

Dear Mr. Cherry:

Advice Letter 2813-G/2999-E is effective March 31, 2007. No later than September 1, 2007, PG&E shall distribute to the advice letter service list the results of its market research on the ClimateSmart program.

PG&E shall distribute the responses on tax deductibility received from the Internal Revenue Service (IRS) and Franchise Tax Board (FTB) to the advice letter service list within 7 days of receipt. The Energy Division and Division of Ratepayer Advocates shall be notified of the status of its request to the IRS and FTB by December 1, 2007, if pending.

PG&E shall file an advice letter containing the results of the investigation specified in Ordering Paragraph 18 of Decision 06-12-032 no later than 20 days following receipt of both IRS and FTB rulings.

PG&E may send a letter to the Director of the Energy Division requesting a change to this schedule.

Sincerely,

A handwritten signature in black ink, appearing to read "Sean H. Gallagher".

Sean H. Gallagher, Director
Energy Division



Brian K. Cherry
Vice President
Regulatory Relations

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March 1, 2007

Advice 2813-G/2999-E

(Pacific Gas and Electric Company ID U 39 M)

Public Utilities Commission of the State of California

Subject: Report on Tax Deductibility of ClimateSmart Premiums from Residential Customers in Compliance with Decision 06-12-032

Purpose

In compliance with Decision (D.) 06-12-032, which approved, with modifications, PG&E's Climate Protection Tariff Program (now titled 'ClimateSmart'), the purpose of this advice filing is to report on PG&E's investigation of tax deductibility for ClimateSmart premiums collected from residential customers. PG&E timely files this advice letter on March 1, 2007, in compliance with Ordering Paragraph 18 of D.06-12-032. PG&E details its investigation and recommended course of action in the attached report.

Protests

Anyone wishing to protest this filing may do so by sending a letter by **March 21, 2007**, which is 20 days from the date of this filing. The protest must state the grounds upon which it is based, including such items as financial and service impact, and should be submitted expeditiously. Protests should be mailed to:

CPUC Energy Division
Tariff Files, Room 4005
DMS Branch
505 Van Ness Avenue
San Francisco, California 94102

Facsimile: (415) 703-2200
E-mail: jnj@cpuc.ca.gov and mas@cpuc.ca.gov

Copies of protests also should be mailed to the attention of the Director, Energy Division, Room 4004, at the address shown above.

The protest also should be sent via U.S. mail (and by facsimile and electronically, if possible) to PG&E at the address shown below on the same date it is mailed or delivered to the Commission:

Brian K. Cherry
Vice President, Regulatory Relations
Pacific Gas and Electric Company
77 Beale Street, Mail Code B10C
P.O. Box 770000
San Francisco, California 94177

Facsimile: (415) 973-7226
E-mail: PGETariffs@pge.com

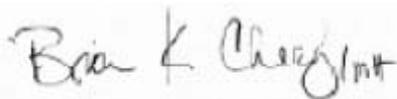
Effective Date

PG&E requests that this advice letter become effective on regular notice, **March 31, 2007**, which is 30 calendar days after the date of filing.

Notice

In accordance with General Order 96-A, Section III, Paragraph G, a copy of this Advice Letter is being sent electronically and via U.S. mail to parties shown on the attached list and to the service list for A.06-01-012. Address changes to the General Order 96-A service list should be directed to Rose de la Torre at (415) 973-4716. Advice Letter filings can also be accessed electronically at:

<http://www.pge.com/tariffs>



Vice President - Regulatory Relations

Attachments

cc: Service List – A.06-01-012
Stephen Larson, Executive Director
Sean Gallagher, Director of the Energy Division

CALIFORNIA PUBLIC UTILITIES COMMISSION

ADVICE LETTER FILING SUMMARY ENERGY UTILITY

MUST BE COMPLETED BY UTILITY (Attach additional pages as needed)

Company name/CPUC Utility No. **Pacific Gas and Electric Company (ID U39)**

Utility type:

ELC GAS
 PLC HEAT WATER

Contact Person: Megan Hughes

Phone #: (415) 973-1877

E-mail: mehr@pge.com

EXPLANATION OF UTILITY TYPE

ELC = Electric GAS = Gas
 PLC = Pipeline HEAT = Heat WATER = Water

(Date Filed/ Received Stamp by CPUC)

Advice Letter (AL) #: **2813-G/2999-E**

Subject of AL: Report on Tax Deductibility of ClimateSmart Premiums from Residential Customers in Compliance with Decision 06-12-032

Keywords (choose from CPUC listing): Compliance, Taxes

AL filing type: Monthly Quarterly Annual One-Time Other _____

If AL filed in compliance with a Commission order, indicate relevant Decision/Resolution #:

D.06-12-032

Does AL replace a withdrawn or rejected AL? If so, identify the prior AL: No

Summarize differences between the AL and the prior withdrawn or rejected AL¹: _____

Resolution Required? Yes No

Requested effective date: **March 31, 2007**

No. of tariff sheets: 0

Estimated system annual revenue effect (%): N/A

Estimated system average rate effect (%): N/A

When rates are affected by AL, include attachment in AL showing average rate effects on customer classes (residential, small commercial, large C/I, agricultural, lighting).

Tariff schedules affected: N/A

Service affected and changes proposed¹: N/A

Pending advice letters that revise the same tariff sheets: N/A

Protests and all other correspondence regarding this AL are due no later than 20 days after the date of this filing, unless otherwise authorized by the Commission, and shall be sent to:

CPUC, Energy Division

Tariff Files, Room 4005

DMS Branch

505 Van Ness Ave.,

San Francisco, CA 94102

jnj@cpuc.ca.gov and mas@cpuc.ca.gov

Pacific Gas and Electric Company

Attn: Brian K. Cherry

Vice President, Regulatory Relations

77 Beale Street, Mail Code B10C

P.O. Box 770000

San Francisco, CA 94177

E-mail: PGETariffs@pge.com

¹ Discuss in AL if more space is needed.

**Report
of Pacific Gas and Electric Company
on Required Investigation Into
Tax Deductibility of Premiums Paid by
Climate Protection Tariff Participants
(A. 06-01-012; D. 06-12-032)**

I. INTRODUCTION

Pacific Gas and Electric Company (PG&E) provides the following report on tax deductibility issues, in compliance with an order of the California Public Utilities Commission (CPUC or Commission) in Decision (D.) 06-12-032 (Decision) granting, with modifications, PG&E's Application 06-01-012 for approval of an optional Climate Protection Tariff (CPT) and related three-year demonstration program. During the proceeding, PG&E had noted that "Climate Protection Tariff" was a placeholder name; subsequent to the issuance of the above-referenced CPUC Decision, PG&E determined through focus group testing that this program will be known as "ClimateSmart."

Ordering Paragraph of D.06-12-032 provides:

18. PG&E shall immediately investigate the feasibility of residential CPT customers deducting their premiums on their tax returns. At a minimum, PG&E shall:

1) ask for guidance from the Internal Revenue Service and California Franchise Tax Board,

2) analyze whether it can accommodate deductibility through an existing charitable foundation within PG&E, and

3) if it prefers an outside partnership, discuss such a partnership with a number of third party charitable organizations.

PG&E shall report to the Commission on the results of its efforts no later than March 1, 2007 by making a compliance advice letter filing, served on the Commission's Executive Director and copied to the Director of the Energy Division. The Commission delegates to the Energy Division authority to issue a resolution addressing PG&E's advice letter filing, including an order that PG&E institute deductibility, *if such program is feasible and consistent with the goals of the CPT.*

II. EXECUTIVE SUMMARY

PG&E has reviewed possible options that may enable residential customers to deduct their ClimateSmart premium payments in computing their federal and California state income

taxes.¹ PG&E believes that only one such option – formation of a **new public charity** (discussed in more detail in Section III below) – may meet Ordering Paragraph 18’s two criteria: that it be “feasible *and consistent with the goals of the CPT.*” Such goals include that this be a top performing program that meets all the operational requirements of the CPUC Decision, within the adopted budget for the program. PG&E is accountable for the achievement of results to advance program goals, with the CPUC adding a provision that PG&E’s shareholders guarantee a minimum level of greenhouse gas (GHG) reductions under contract by the end of 2009. PG&E has determined that establishing and carefully structuring a new charitable entity to administer the ClimateSmart program may be able to ensure that the new organization diligently pursues the letter and spirit of the ClimateSmart program, with no other competing charitable purposes or priorities, while also enabling residential customers to claim a charitable contribution deduction for their ClimateSmart payments. However, before PG&E can recommend that making ClimateSmart payments tax deductible for residential customers is “feasible and consistent with the goals of the CPT,” PG&E will seek a ruling from the Internal Revenue Service (IRS) and Franchise Tax Board (FTB); investigate concerns regarding the impacts to tax deductibility of ClimateSmart premiums to business customers; and conduct market research regarding the effects of making ClimateSmart tax deductible on customer enrollment.

Other potential approaches risked delay, added substantial administrative costs and complexities, and/or placing total programmatic control in the hands of third parties having competing charitable responsibilities. Therefore, and for the reasons discussed in detail below, PG&E found other approaches to be inappropriate and inconsistent with the CPUC’s Decision. Accordingly, in compliance with the Decision, PG&E is pursuing and further investigating the option of creating a new public charity as the approach that best balances the goals of affording residential customers the potential opportunity to take a tax deduction² while also providing

¹ As noted in D.06-12-032, business customers’ relatively larger ClimateSmart premiums are deductible as a business expense under the program as approved. It is the residential customers’ relatively smaller premiums that are not deductible under the program’s current structure.

² In all cases, whether a particular individual or company is entitled to a tax deduction depends on the taxpayer’s own particular tax circumstances, including for example, whether the individual itemizes his or her deductions, and whether the taxpayer’s total charitable contributions for the year exceed various statutory limitations. For this reason, PG&E is unable to state that all taxpayers would be entitled to deduct their ClimateSmart payments (if this option is permitted by authorities), but only that the deduction could potentially be available depending on the person’s circumstances.

PG&E, the CPUC, and the External Advisory Group certainty that the organization will always remain focused upon and committed to the ClimateSmart program as outlined in the Decision.

PG&E addresses the CPUC's three key guidelines from D.06-12-032 below:

CPUC Compliance Item 1: Has PG&E asked for guidance from the Internal Revenue Service and California Franchise Tax Board?

Yes. PG&E has begun the process of seeking guidance from the IRS and the California FTB in the form of filing a determination letter affirming that the new charitable entity meets the standards for a public charity, and seeking a private letter ruling as to whether customers' ClimateSmart premium payments to the new public charity otherwise qualify as a charitable contribution for federal and state tax purposes.³ Because the IRS and FTB do not give rulings on a hypothetical situation, after the CPUC's Decision, PG&E had to first explore and develop in enough detail this new potential charitable entity approach before formally approaching the IRS and FTB. The estimated time to receive a response on both the determination letter filing and the private letter ruling requests is approximately 6 to 9 months. If the IRS and FTB issue favorable rulings, however, the deductibility will apply retroactively to the date on which the new public charity was formed. As a result, ClimateSmart participants who sign up in 2007 potentially may be able to deduct all the payments made from their time of sign-up until year-end on their 2007 tax returns filed in 2008, dependent on whether the appropriate authorities respond to PG&E's requests in a timely manner. However, unless and until the IRS and FTB have ruled favorably, PG&E will make no statements about potential deductibility when publicizing the ClimateSmart program at and after its launch. PG&E will supplement this report within a reasonable time of receiving all such rulings from both the IRS and FTB.

CPUC Compliance Item 2: Has PG&E analyzed whether it can accommodate deductibility through an existing charitable foundation within PG&E?

Yes. PG&E has analyzed this option and, as discussed in Section IV.A below, has concluded that it is inappropriate and inferior to the new public charity approach that PG&E is now in the process of pursuing and further investigating.

³ For example, clarity is needed from the IRS as to whether the full amount of the premium is deductible.

CPUC Compliance Item 3: Did PG&E consider whether it prefers an outside partnership?

Yes. PG&E considered this approach and found it inappropriate and inferior to the new public charity approach that PG&E is now in the process of pursuing and further investigating, for the reasons set forth in section IV.B below.

Additional Parallel Action Item: Conduct Market Research into the Impacts of Making ClimateSmart Tax Deductible on Business and Residential Customer Enrollment

While awaiting the IRS/FTB ruling requests, in order to make a more fully informed judgment about the merits of making ClimateSmart a charitable deduction, PG&E will also conduct further customer research. Specifically PG&E will test, with both residential and business customers, potential implications such as whether making ClimateSmart tax deductible would significantly increase residential customer enrollment without significantly decreasing business customer enrollment.

Such customer research will help PG&E understand whether structuring all ClimateSmart premiums (from both business and residential customers) as a charitable contribution⁴ might harm the goals of the program. For example, if it significantly dampened business customer sign-up levels, this could significantly diminish the total amount of GHG reductions the program could contract for (relative to what might have been collected if the large premiums expected

⁴ Under the current program structure, all businesses may deduct their ClimateSmart payments as an ordinary business expense under section 162 of the Internal Revenue Code (Code). However, once PG&E begins collecting the funds on behalf of a charitable entity, the payments generally will become charitable contributions under section 170 of the Code and section 17201 of the California Revenue and Taxation Code (R&TC), rather than ordinary business expenses (unless the payor can show that its gaining the right to advertise that its energy usage is climate neutral has a direct connection with its business so as to lead to commensurate financial benefits, such as attracting greater sales). Under the applicable provisions of the Code and R&TC, corporations may not deduct charitable contributions that exceed 10 percent of their taxable income. Whether a particular payment is a business expense or instead is a charitable contribution – and the resulting tax treatment – is determined based on *each company's* facts, and is not elective. As a result, converting the payments from ordinary business expenses into charitable contributions might limit or eliminate the value of the ClimateSmart payment for some businesses (especially those with lower taxable incomes or those that have already reached their annual ceiling on deductible charitable contributions).

from business customers had remained deductible as ordinary business expenses rather than as charitable contributions).⁵

Thus, once the IRS and FTB inform PG&E whether they have determined that the ClimateSmart payments can be properly treated as charitable contributions through the public charity option, PG&E will then factor in the completed customer research to finalize its analysis about whether to proceed with charitable tax deductibility of the program. If appropriate, this will also be discussed in the supplemental Report to the CPUC to be submitted following the combined rulings of both the IRS and FTB.

III. BACKGROUND

A. Procedural Background

In Decision 06-12-032, the CPUC ordered that PG&E examine tax deductibility for residential customers following its adoption of the ClimateSmart program. The CPUC, per Ordering Paragraph 18, cited above, required PG&E to investigate options for tax deductibility and report back by March 1, 2007. This Report complies with that order.

B. Program Premiums Non-Deductible for Residential Customers Under Approved Structure

In its investigation, PG&E further studied whether the program, as currently structured, would allow residential customers to deduct ClimateSmart contributions. Under the current structure, ClimateSmart contributions are paid to PG&E, with PG&E then determining in conjunction with the External Advisory Group when and how to use the funds consistent with the CPUC's order. A charitable deduction is not allowed for any payments made to a for-profit entity such as PG&E, even if the payments are voluntary, as is the case with ClimateSmart, and even if the for-profit entity pledges to use the funds for charitable causes, such as reforestation, forest conservation, or other appropriate GHG reduction projects.

Even if PG&E were able to obtain charitable contribution status for the payments under the current structure by committing to pay the funds only to non-profit entities, that structure would place unacceptable constraints on PG&E's ability to direct the funds to the entities best

⁵ Business customer's annual premiums are likely to be significantly larger than those of residential customers. (PG&E estimates that the typical residential customer's total annual premium payments would come to about \$51 per year.)

suitable to carry-out reforestation and other GHG reduction activities. The CPUC directed in D.06-12-032 that this program “test the waters and determine the availability of forestry and other GHG reduction projects...as expertise in this area will be necessary and useful in the near future given the adoption of AB 32” (Id. at pp.12-13). As stated in the Decision, the ClimateSmart program will allow PG&E and the CPUC to gain valuable information and experience in understanding the market for offsets and the costs and benefits of using offsets as a risk mitigation tool. If GHG reduction project solicitations were limited to non-profit entities, PG&E would not be able to achieve the CPUC’s objectives stated in the Decision as few, if any, entities would submit project proposals.

In addition to a decrease in the number of potential bidders to undertake the projects, PG&E and its customers would face unacceptable administrative complexity in trying to implement a charitable deduction feature under the current ClimateSmart structure. Specifically, the timing of any charitable deduction would be problematic even if under the current structure PG&E is viewed as an agent acting on behalf of the customers, such that it collects the funds monthly and then remits the collections on the customers' behalf to one or more non-profit entities at some point in the future as programmatic needs are identified and required to be funded. For federal tax purposes, there would not be a payment by the customers (and no federal tax deduction) unless and until PG&E actually remitted the collected funds to a qualifying non-profit entity. To the extent that PG&E does not remit the payments to a non-profit entity in the same year in which they are collected, a customer will not be entitled to deduct that portion of his or her ClimateSmart payments in that year. If a customer leaves PG&E’s service area before his or her ClimateSmart payments are remitted to a qualifying non-profit entity, that individual’s deduction may, as a practical matter, be lost altogether. Unless PG&E establishes a separate account for each participating customer to track the customer’s payments and the time when that payment is actually disbursed to a qualifying charity (which is problematic and burdensome in itself), PG&E would need to devise a special accounting procedure to determine whether and to what extent a particular customer’s current or prior-years’ payments are remitted to a qualifying entity during a given year. PG&E would then inform each customer about the portion of ClimateSmart payments that are potentially deductible for that year, which would likely confuse customers as they may be expecting to deduct the entire year’s ClimateSmart contribution. In

addition, with payments for GHG reduction contracts lasting 20 years, customers would need to take their charitable deductions in part each year over that long period of time.

Considering the administrative complexity of implementing a charitable contribution deduction feature in the context of PG&E's currently-approved program, as well as the likelihood that attempting to do so would impair the fundamental purpose of the ClimateSmart program, PG&E does not recommend pursuing tax deductibility using the current structure.

IV. NEW PUBLIC CHARITY

The option worthy of further consideration is for PG&E to form a new public charity that, if approved by the IRS and FTB, would allow ClimateSmart participants to claim a charitable contribution deduction under Section 170 of the Code and Section 17201 of the R&TC for their ClimateSmart payments in the year paid to PG&E. Unlike other options considered, this approach permits a current tax deduction while also allowing PG&E to structure the new entity in a manner that ensures that the charity will always act consistently with the CPUC's Decision in implementing the ClimateSmart program.

A. Formation and Governance

In order to receive a ruling from the IRS, PG&E is forming a new corporate entity under California law whose stated purpose is the pursuit of GHG-reduction programs. PG&E anticipates that the IRS and the FTB will find this to be a qualifying charitable purpose in that it lessens the governmental burden of mitigating the impacts of climate change.

This newly formed entity is in the process of requesting a determination letter from the IRS that it meets the requirements of sections 501(c)(3) and 509(a)(1) of the Code, and from the FTB that it meets the requirements of R&TC sections 23701 et. seq., such that those who contribute funds to it are potentially entitled to a charitable contribution deduction for payments to the entity. Because the new entity will (after the start-up period) receive a significant percentage of its annual contributions from the public, PG&E believes that this new entity is likely to qualify for a ruling that it is eligible for the favorable designation as a "public charity" under those respective sections of the Code and the R&TC. The process should be relatively non-controversial, but due to normal IRS processing requirements, it may require 6 months for

the entity to receive a favorable determination letter. PG&E anticipates that the FTB will rule consistently with the IRS for state tax purposes.

Formally confirming with IRS and FTB the tax treatment of the ClimateSmart payments generally is a two-step process. First, the entity's status as a public charity eligible to receive charitable contributions is obtained through determination letters received from the IRS and the FTB. Second, upon the entity's designation as a public charity, private letter ruling(s) from the IRS and the FTB will be sought confirming that the ClimateSmart payments meet each of the statutory and regulatory requirements to be a "charitable contribution" under the Code and R&TC (*e.g.*, that the payments, in substance, to the public charity, are voluntary and that no financial benefit is expected in return).⁶ Although a private letter ruling resolves the tax treatment only of the specific taxpayer requesting the ruling and is not otherwise precedential for other taxpayers, it does provide a strong indication of how the IRS and FTB will treat identical payments made by other participants. Such private rulings generally are issued by the IRS within six to nine months after the request is made, and generally somewhat faster by the FTB. Accordingly, PG&E hopes to have clarity from the taxing authorities by the end of 2007.

As a public charity rather than a private foundation, the new entity would not be subject to the many restrictions imposed on private foundations such as the PG&E Corporation Foundation (see discussion in Section IV.A below). Although the charity would be an independent, legally distinct entity under California law, PG&E's role in establishing the entity, in carefully tailoring its articles and by-laws, and in selecting its initial board of directors provides PG&E and the CPUC the greatest degree of certainty possible that the charitable entity will always act consistently with the stated purposes of the ClimateSmart program, but without the onerous reporting requirements and other activity restrictions placed upon private foundations.

PG&E has structured the composition of the new charity's board of directors such that each director is an officer or director of PG&E (there are no federal tax law restrictions on PG&E's ability to do so). The articles of incorporation and bylaws have been tailored to ensure that the new entity's authorized purposes reflect and carry out the spirit and letter of the CPUC

⁶ A ClimateSmart participant may choose to seek a private letter ruling regarding this issue in order to confirm that a fixed, volumetrically determined amount that cannot be altered other than by not participating in the program in a given month is a "voluntary" payment treated as a charitable contribution for purposes of the Code and R&TC.

Decision, ensuring that the charity will always act to implement the ClimateSmart program in the manner that PG&E, in consultation with the External Advisory Group, believes to be the most appropriate. (The External Advisory Group would advise the new charitable entity in the same manner as it would have advised PG&E if this new charitable entity had not been formed.) To assure PG&E and the external stakeholders alike that the public charity's mission will remain focused on these carefully tailored purposes, the design of these articles of incorporation and bylaws will require approval by either all or a supermajority of the directors with respect to significant decisions such as changes to the articles of incorporation.

B. Function and Administration

Assuming the new entity qualifies as a public charity, payments to the new entity will qualify as charitable contributions for federal and state income tax purposes. PG&E would function as an agent of the new public charity, collecting ClimateSmart payments on the charity's behalf and serving as a conduit between participating customers and the new charitable entity. Because PG&E will have no current or future right to retain any of the collected funds, PG&E's receipt of ClimateSmart premiums from program enrollees would not be taxable income to PG&E. Further, because it will be collecting the funds as an agent of the charity, such that the customer's payment of the funds to PG&E should be treated as a direct payment to the charity for tax purposes, PG&E's remittance of those amounts to the public charity would not result in a charitable deduction for PG&E. Instead, for federal and state tax purposes, the ClimateSmart payments would be deemed to be paid by a customer directly to the public charity and thus, would be deductible by the customer in the year paid to PG&E.

Administratively, the program could be structured so that PG&E collects a single monthly payment as part of each ClimateSmart participant's total bill as stated in PG&E's Climate Protection Program application (A.06-01-012). The ClimateSmart portion would be remitted as soon as administratively practical by PG&E to the public charity (in other words, monthly -- collections would **not** be accrued and remitted by PG&E as a single lump-sum at the end of the calendar year). Following the end of each year, the public charity could provide each

customer with a statement reflecting that customer's aggregate ClimateSmart payments during the calendar year.⁷ PG&E can perform this administrative function on behalf of the charity.

V. OTHER OPTIONS (FOUND INADVISABLE FOR THIS DEMONSTRATION PROGRAM)

A. Use of PG&E Corporation's Existing Charitable Foundation

PG&E also investigated implementing the ClimateSmart program using its existing, independent PG&E Corporation Foundation (the Foundation), but found it inappropriate and inferior in comparison to establishing a new public charity (discussed in Section IV above). The basic program involving the Foundation would be similar to that operated through a public charity, in that PG&E could serve as the Foundation's collection and disbursement agent for the ClimateSmart payments received from customers, functioning as a conduit between the participating customers and the Foundation. As with the public charity approach, PG&E would not include the ClimateSmart payments in its income, and the customers would be entitled to a charitable deduction for federal and state tax purposes in the year the amounts are received by the Foundation. The federal tax laws impose many more restrictions and obligations upon private foundations, however, than upon public charities. The Foundation is subject to numerous operating rules including those governing self-dealing, mandatory annual distributions for charitable purposes, permissible business holdings, investments which might jeopardize exempt purposes, and grant-making oversight (partial listing). Furthermore, unlike public charities, private foundations must pay a tax on their investment income, thereby diverting funds that could otherwise be used in pursuit of the GHG reduction programs.

In addition, whereas the ClimateSmart program could be made the sole focus of a new public charity, as with an existing public charity, it would simply be one more of the many philanthropic purposes of the Foundation. As with use of an existing charity, this would make it more difficult to ensure unwavering consistency with the program structure, goals and other requirements of the CPUC's Decision for which PG&E would still be accountable.

Thus, use of the existing Foundation was rejected as being more costly, administratively burdensome, and less conducive to an assured, concentrated focus on the ClimateSmart program.

⁷ Because the amount of a charitable contribution deductible by a particular individual depends upon various limitations imposed by the Code, PG&E will advise ratepayers to consult their tax advisors to determine the extent to which an amount may be deducted as a charitable contribution for federal and state tax purposes.

B. Partnership with an Existing Outside Charitable Entity

PG&E briefly explored the option of partnering with an existing public charity to implement the ClimateSmart program (rather than forming a new public charity). Although on one level there are similarities with the proposed structure (PG&E would serve as a conduit between participating ratepayers and the selected public charity), and there are means by which to do so (discussed below), this option was determined to be inappropriate for several key reasons. First, PG&E would be able to exercise little if any influence over the authorized purposes and priorities of an existing charitable entity, as an existing charity has a pre-existing board of directors and governing charter, yet PG&E would still be accountable for the results and proper operation of the ClimateSmart program under the CPUC's Decision. Second, there is no guarantee about how a third party's board and operational employees would treat the External Advisory Group's advice and input, something the new public charity's articles would expressly contemplate. Third, although the selected charity would presumably have to be favorably disposed toward this program to take it on, that entity would still have other charitable missions as well. Thus, in practice, it might not consistently place the same priority on the ClimateSmart program as would the new charitable entity discussed above, which would be structured to focus exclusively on the goals of the ClimateSmart program, as outlined in the CPUC's Decision.

Fourth, the charity would have its own administrative costs in addition to those which PG&E would have to retain. This would divert a portion of each participant's contributions away from GHG reductions, undermining the program's commitment to customers that 100% of their payments would go to greenhouse gas reduction projects and that each participant would be made climate neutral.

One means of engaging with an existing third-party charity would be through a "donor-advised fund" ("DAF") which allows a certain donor to a charity (here PG&E, arguably as the agent of all ClimateSmart participants) to contribute and thereafter provide nonbinding advice or recommendations regarding distributions from the fund or investment of the assets of the fund. However, the sponsoring charity is the entity that has legal ownership and control of the assets of the fund with the associated problems discussed above.

The current federal tax climate does not favor use of DAFs. Specifically, the recently enacted Pension Protection Act of 2006 (the Act) has imposed a number of new restrictions on

DAFs, such as imposing the stricter rules applicable to private foundations on DAFs as well as new restrictions regarding the types of organizations to which DAFs may make distributions. More significantly, the Act requires the Treasury Department to conduct a study of DAFs, indicating that further IRS regulation is likely. Therefore, it would be inadvisable to rely upon this tax structure in light of the possible future IRS actions, even if it were otherwise workable for ClimateSmart.

An alternative method of partnering with an outside charity that PG&E briefly explored would be for PG&E to donate the ClimateSmart funds to an existing charity that agrees to implement the program. However, apart from perhaps obtaining one or more seats on the existing charity's board of directors, PG&E would have no mechanism to ensure that the existing organization consistently provides adequate focus or priority to the ClimateSmart program. Instead, PG&E would largely rely on: (1) the organization's existing charitable purposes and track-record, and (2) the ability to discontinue donations to the organization and to substitute another charity to implement the ClimateSmart program as necessary and appropriate. Because issues may arise as to the priority placed on the ClimateSmart program by an outside group with multiple charitable missions, and given PG&E's accountability under the CPUC Decision for program operations and results, this option was deemed inconsistent with the goals of the program. In addition, PG&E has not identified such an existing entity with the relevant expertise, reliable track record, and ability to very quickly scale up to handle this complex and novel California-based program so as to be able to timely meet the many ClimateSmart program requirements per the CPUC's Decision.

VI. CONCLUSION

For the reasons discussed above, PG&E is pursuing formation of a new public charity to implement and administer the ClimateSmart program. PG&E believes this option may allow residential customers to claim a charitable deduction and at the same time satisfy the objectives of the CPUC, in terms of oversight, education, diversification, and the baseline guarantee of GHG reductions. In the event that market research finds that the impact on residential and business customer signups due to the activation of such a charitable structure could significantly reduce total premiums thus diminishing program success at achieving GHG reductions, PG&E will update its analysis. If and when the IRS and the FTB certify the new entity as a public

charity implementing the ClimateSmart purpose and rule that PG&E is a mere conduit between residential customers and the charity, PG&E will, within a reasonable time, file a supplemental report informing the CPUC of the outcome. Such supplemental report will discuss the results from the taxing authorities on whether customers may deduct ClimateSmart premiums as charitable contributions on their federal and state income taxes and, if so, the additional customer research on its programmatic effects, as discussed above.

**PG&E Gas and Electric Advice
Filing List
General Order 96-A, Section III(G)**

ABAG Power Pool	Douglass & Liddell	PG&E National Energy Group
Accent Energy	Downey, Brand, Seymour & Rohwer	Pinnacle CNG Company
Aglet Consumer Alliance	Duke Energy	PITCO
Agnews Developmental Center	Duke Energy North America	Plurimi, Inc.
Ahmed, Ali	Duncan, Virgil E.	PPL EnergyPlus, LLC
Alcantar & Kahl	Dutcher, John	Praxair, Inc.
Ancillary Services Coalition	Dynegy Inc.	Price, Roy
Anderson Donovan & Poole P.C.	Ellison Schneider	Product Development Dept
Applied Power Technologies	Energy Law Group LLP	R. M. Hairston & Company
APS Energy Services Co Inc	Energy Management Services, LLC	R. W. Beck & Associates
Arter & Hadden LLP	Exelon Energy Ohio, Inc	Recon Research
Avista Corp	Exeter Associates	Regional Cogeneration Service
Barkovich & Yap, Inc.	Foster Farms	RMC Lonestar
BART	Foster, Wheeler, Martinez	Sacramento Municipal Utility District
Bartle Wells Associates	Franciscan Mobilehome	SCD Energy Solutions
Blue Ridge Gas	Future Resources Associates, Inc	Seattle City Light
Bohannon Development Co	G. A. Krause & Assoc	Sempra
BP Energy Company	Gas Transmission Northwest Corporation	Sempra Energy
Braun & Associates	GLJ Energy Publications	Sequoia Union HS Dist
C & H Sugar Co.	Goodin, MacBride, Squeri, Schlotz &	SESCO
CA Bldg Industry Association	Hanna & Morton	Sierra Pacific Power Company
CA Cotton Ginners & Growers Assoc.	Heeg, Peggy A.	Silicon Valley Power
CA League of Food Processors	Hitachi Global Storage Technologies	Smurfit Stone Container Corp
CA Water Service Group	Hogan Manufacturing, Inc	Southern California Edison
California Energy Commission	House, Lon	SPURR
California Farm Bureau Federation	Imperial Irrigation District	St. Paul Assoc
California Gas Acquisition Svcs	Integrated Utility Consulting Group	Sutherland, Asbill & Brennan
California ISO	International Power Technology	Tabors Caramanis & Associates
Calpine	Interstate Gas Services, Inc.	Tecogen, Inc
Calpine Corp	IUCG/Sunshine Design LLC	TFS Energy
Calpine Gilroy Cogen	J. R. Wood, Inc	Transcanada
Cambridge Energy Research Assoc	JTM, Inc	Turlock Irrigation District
Cameron McKenna	Luce, Forward, Hamilton & Scripps	U S Borax, Inc
Cardinal Cogen	Manatt, Phelps & Phillips	United Cogen Inc.
Cellnet Data Systems	Marcus, David	URM Groups
Chevron Texaco	Matthew V. Brady & Associates	Utility Cost Management LLC
Chevron USA Production Co.	Maynor, Donald H.	Utility Resource Network
City of Glendale	MBMC, Inc.	Wellhead Electric Company
City of Healdsburg	McKenzie & Assoc	Western Hub Properties, LLC
City of Palo Alto	McKenzie & Associates	White & Case
City of Redding	Meek, Daniel W.	WMA
CLECA Law Office	Mirant California, LLC	
Commerce Energy	Modesto Irrigation Dist	
Constellation New Energy	Morrison & Foerster	
CPUC	Morse Richard Weisenmiller & Assoc.	
Cross Border Inc	Navigant Consulting	
Crossborder Inc	New United Motor Mfg, Inc	
CSC Energy Services	Norris & Wong Associates	
Davis, Wright, Tremaine LLP	North Coast Solar Resources	
Defense Fuel Support Center	Northern California Power Agency	
Department of the Army	Office of Energy Assessments	
Department of Water & Power City	OnGrid Solar	
DGS Natural Gas Services	Palo Alto Muni Utilities	