

Decision No. 37815

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

In the matter of the application of PACIFIC GAS AND ELECTRIC COMPANY, a corporation, for an order of the Railroad Commission of the State of California authorizing applicant to issue \$80,000,000 principal amount of its First and Refunding Mortgage Bonds, Series M, 3%, due December 1, 1979, and to use the proceeds for the purposes specified in this petition, etc.

**ORIGINAL**

Application  
No. 26584

BY THE COMMISSION:

FIRST SUPPLEMENTAL OPINION

By Decision No. 37710, dated March 12, 1945, and Decision No. 37746, dated March 26, 1945, Pacific Gas and Electric Company was authorized to issue and sell \$80,000,000 of its first and refunding mortgage bonds, Series M, 3%, due December 1, 1979, at not less than 106.879% of face value plus accrued interest, and to use the proceeds, other than the accrued interest, to pay in part the cost of redeeming its outstanding first and refunding mortgage bonds, Series G, 4%, due December 1, 1964.

Paragraph 3 of the order in Decision No. 37710 reads as follows:

"Pacific Gas and Electric Company may deviate from the uniform system of accounts prescribed by the Railroad Commission for electric corporations, gas corporations and water corporations and amortize on or before December 1, 1979, the discount, expense and premium of about \$7,109,839.90 plus the premium paid upon the redemption of said Series G, 4% bonds less such savings of taxes based on income hereafter credited to unamortized bond discount and expense, provided that the Commission reserves the right to withdraw the permission herein granted to deviate from said uniform system of accounts, and to determine hereafter whether the charges necessary to amortize said bond discount, expense and premium should be included in the cost of money to Pacific Gas and Electric Company."

The company proposes to pay its Series G bonds on June 1, 1945. It reports that as of May 31, 1945, there will be an unamortized balance of discount, expense and premium, applicable to said bonds and associated and related issues, of \$7,109,839.80; that it will be required to pay premiums of \$4,209,650 to redeem said Series G bonds; and that expenses of \$30,000 will be incurred in connection with the redemption, the three items aggregating \$11,349,489.80. It further reports that it received premiums of \$5,503,200 upon the sale of its new Series M bonds and that it estimates it will incur expenses of \$243,799 in connection with the issue and sale of said bonds, leaving a net premium of \$5,259,401. The company desires to charge the \$11,349,489.80 item to Account 140--"Unamortized Debt Discount and Expense"--and to credit the \$5,259,401 item to Account 240--"Unamortized Premium on Debt," and thereafter to amortize said amounts on or before December 1, 1979, the maturity date of the new Series M bonds.

It appears that the issue of the Series M bonds and the redemption of the Series G bonds will result in a nonrecurring reduction in federal taxes on income for the year 1945 in the estimated amount of \$4,287,000. The amount of this savings or reduction the company proposes to dispose of by a credit to "Taxes Accrued" in the amount of \$1,719,856.56, and by a credit to "Reserve for Pensions" in the amount of \$2,567,143.44.

In support of this proposed treatment the company reports that recently it has received from the United States Treasury Department a notice asserting a deficiency in its income and excess profits taxes for the years 1941 - 1942, which, if finally established, will result in the tax accrual on its books being deficient in the amount of \$1,719,856.56. As to the proposed credit to the Reserve for Pensions, the company reports that as of December 31, 1944, such reserve stood on its books in the amount of \$8,063,254.02; whereas, the amount of the unfunded actuarial reserve requirement applicable to pensions for past services, computed on a  $3\frac{1}{2}\%$  basis, was estimated to be approximately \$13,000,000. The proposed accounting action would result in a reserve for pensions of \$10,630,397.46.

The company has requested the Commission to enter its supplemental order approving the proposed accounting treatment referred to herein.

We have considered applicant's request. In our opinion, the nonrecurring reduction in federal taxes on income estimated at \$4,287,000 is not an operating expense, but may be reported under Account 507-A, Tax Savings on Bond Refunding, with an appropriate footnote showing the amount transferred to Account 228, Taxes Accrued, and the amount transferred to Reserve for Pensions. It should be understood that the Commission is giving

its approval for accounting convenience only and is not by its order herein making any finding that all the items of bond discount, expense and premium referred to should be included or considered in the future in determining the cost of money to applicant, or passing on the reasonableness or adequacy of the balance in the company's Reserve for Pensions or of the rate of accumulation of such reserve.

SECOND SUPPLEMENTAL ORDER

Application having been made to the Railroad Commission for an order as indicated in the preceding opinion, and the Commission having considered the matter;

IT IS HEREBY ORDERED as follows:

(1) Paragraph 3 of the order in Decision No. 37710, dated March 12, 1945, is vacated and set aside.


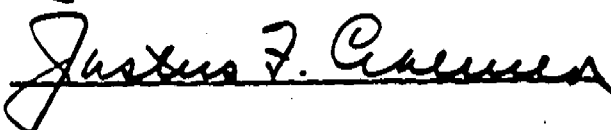
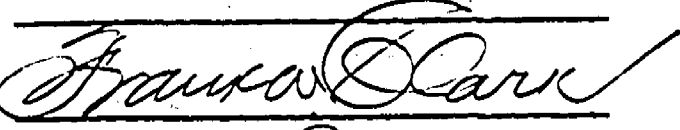

(2) Pacific Gas and Electric Company may charge Account 140, Unamortized Debt Discount and Expense, with the amount, estimated at \$11,349,489.80, representing unamortized premium, discount and expense as of May 31, 1945, on its bonds of Series G and associated and related issues, together with the amount of premium paid to redeem its bonds of Series G and estimated expenses of redemption, and may credit Account 240, Unamortized Premium of Debt with the amount, estimated at \$5,259,401, representing premiums received from the sale of its bonds of Series M, less expenses of issue, and may amortize both

of said amounts on or before December 1, 1979, it being understood that the Commission reserves the right to determine in the future whether the charges necessary to amortize said premiums, discount and expenses should be included in the cost of money to applicant.

(3) Pacific Gas and Electric Company may account for the nonrecurring reduction during 1945 in federal taxes on income, estimated at \$4,287,000, by crediting the sum of \$1,719,856.56 to Account 228, Taxes Accrued, and the sum of \$2,567,143.44, together with any portion of the \$1,719,856.56 remaining after final determination and settlement of its liability for federal taxes on income for the years 1941 to 1944, to Reserve for Pensions, it being understood that the Commission, by this order, makes no finding as to the aggregate amount that should be credited to applicant's Reserve for Pensions, or as to the rate of accumulation of such reserve.

(4) The authority herein granted will become effective upon the date hereof.

Dated at San Francisco, California, this 17<sup>th</sup> day of April, 1945.

  
  
  
  
Commissioners

CONCURRING OPINION

Under date of January 8, 1945 this Commission, by Decision No. 37605, approved the crediting to this utility's reserve for pensions of \$1,479,504.87. At that time this Commissioner wrote a Concurring Opinion, as follows:

"In connection with my signing this order I consider it appropriate and necessary to now state in writing that in doing so I am persuaded by Mr. Fankhauser's assurance that if in the future it should develop that the pension reserve hereby and heretofore established is larger in amount than necessary to fulfill the purpose for which it is intended, later action by this Commission can be taken which would capture any such surplus funds, they being subject to future treatment by the Commission as it may decide.

"Further, I deem it necessary and proper that the Commission formally and thoroughly investigate all phases of the pension matter as pertaining to the operations of this utility. In my opinion, the Commission has not heretofore taken such steps along these lines as should have been taken for the benefit of all concerned. The utility, from an operating standpoint, its employees, from the standpoint of their future security and peace of mind, as well as its rate payers are entitled to a clear-cut over-all decision from this Commission on this important matter. Until such a decision is rendered by this Commission I do not consider this order, involving \$1,479,504.87, as in any way tied in with the treatment of any other funds which have found their way into this utility's reserve for pensions, nor is it to be considered as a precedent of what my position in the future may be as to additional funds which the Commission might be called upon to approve for transfer to the company's reserve for pensions."

In signing the accompanying Commission order approving the transfer to the same account of certain funds, amounting to \$2,567,143.44, together with any portion of the \$1,719,856.56 remaining after final determination and settlement of its liability for federal taxes on income for the years 1941 to 1944, I hereby wish to record the fact that I am doing so with

similar assurance relating to the funds covered by this order, and further with the understanding that this matter has been discussed in detail and agreed to by and between the Commission's Mr. Fankhauser and appropriately authorized officials of this utility.

In addition, I wish to hereby again emphasize the importance and need of the necessary steps being taken and completed at the earliest possible date which will result in this so-called pension reserve fund being actually and properly established in all respects.



Frank W. Clark

Commissioner

Application 26584

Sachse, Commissioner; Concurring and Dissenting

I concur in the preceding Opinion and Order authorizing the disposition of Unamortized Debt Discount and Expense, in the amount estimated at \$11,349,489.80 (Account 140); and Unamortized Premium on Debt in the amount estimated at \$5,259,401 (Account 240).

I am unable to concur in the majority's authorization, at this time, of a credit in an indeterminate amount, but not less than \$2,567,143.44, to applicant's Reserve for Pensions.<sup>(1)</sup> The record shows no justification for this transfer to the reserve.

On the contrary, applicant's registration statement filed with the Securities and Exchange Commission (Exh. 3) states that the balances in the pension reserves at December 31, 1944, are more than sufficient to cover all employees now receiving pensions, and no legal obligation exists to grant past-service benefits to any employees not now on the pension rolls.<sup>(2)</sup>

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(1) See paragraph (3) of the preceding Second Supplemental Order.

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(2) The reference to Exh. 3, P. 49, in the Certificate of Independent Public Accountants, pertaining to prior-service pensions, is as follows:

"The Company hopes and expects (but is not legally obligated) to supplement, wholly at its own expense, the retirement income provided in the above plan by providing pensions based on services prior to January 1, 1937 for employees in its employ at that date who joined the plan; employees at December 31, 1936 who elected, on or before June 1, 1937, not to join the plan cannot become eligible for such pensions. The Company had granted certain pensions prior to January 1, 1937, and as of December 31, 1936, it created a reserve for pensions deemed to be more than sufficient to provide for those then on the pension rolls. Since that date additions to the reserve have been of several classes: (a) those charged to income in the statements of income, being amounts which



In January of this year the company in Application 26387 was before us with a similar request in connection with its \$115,000,000 issue of its first and refunding 3% mortgage bonds, Series L, due June 1, 1974, asking permission to transfer \$1,479,504.87 of so-called federal tax savings to its Reserve for Pensions. The Commission in Decision 37605 authorized such transfer "subject to the condition that the Railroad Commission reserves the right to exclude said \$1,479,504.87 from operating expenses."

In concurring opinions in Decision 37605, supra, by Commissioner Clark and the undersigned attention was called to the necessity of determination on the part of the Commission of the precise status and the necessary amount, as alleged by applicant, of this reserve for past pension liability.

(2) contd.

are based substantially on an actuarial computation of the amounts of annual interest accretions earned by a theoretical deposit sufficient, with the accretions, to provide for the granting of past-service benefits to all employees in the Company's employ (who were so employed prior to January 1, 1937) when and as they become eligible: additions of this nature amounted in the respective years under report to \$497,000.00, \$497,000.02, and \$497,000.00 as to the Company, and \$3,000.00, \$3,000.00, and \$3,000.00 as to the subsidiaries; these amounts were charged in 1942 to 'pension plan expenses,' in 1943 to 'pension plan expenses,' \$291,666.67, and to 'miscellaneous interest,' \$208,333.35, and in 1944 to 'miscellaneous interest,' the change in incidence of the charge having been made pursuant to instructions from the Railroad Commission of the State of California; (b) the reserve is not equal at present to an actuarial reserve so computed, but has been increased from time to time as the Company's directors consider advisable by special appropriations of income or earned surplus, or by other adjustments; no such special appropriations were made during the period here covered, but in 1944 an amount of \$1,479,504.87 was added to the reserve, being a portion of the reduction in Federal excess-profits tax arising from a bond refunding operation in that year (see Note 4 to statement of consolidated income). All pensions paid during the respective years under report were charged to the reserve in amounts of \$440,185.30, \$447,220.48, and \$468,664.28 as to the Company, and \$833.76 in each year as to the subsidiaries. "The balances of \$8,044,643.89 (Company) and \$8,063,254.02 (Consolidation) in the pension reserves at December 31, 1944 are more than sufficient to cover all employees now receiving pensions, and no legal obligation exists to grant past-service benefits to any employees not now on the pension rolls."

There is now pending before us Case 4749, an investigation upon the Commission's own motion into the reasonableness of the rates, etc., of applicant's gas service. The question of pensions and their effect on the company's employees and customers, and on operating expenses, net earnings and surplus is an important element in that proceeding. The inquiry into the status of the pension reserve is under way and it would seem preferable to await the early conclusion of that study before authorizing additional large transfers to the reserve.

The Commission should give consideration to several pertinent facts. Applicant estimates prior pension service liability at the present time in an amount of about \$13,000,000. It has from various sources gradually accumulated a book reserve for this purpose of approximately \$8,000,000. It now proposes to transfer not less than \$2,567,000 of so-called tax savings resulting from bond refunding, bringing the reserve to at least \$10,570,000. In the pending gas rate case the company contends that its customers should not be credited with any interest on this reserve, but in turn should pay a charge approximately equal to 3½% of the estimated liability of \$13,000,000.

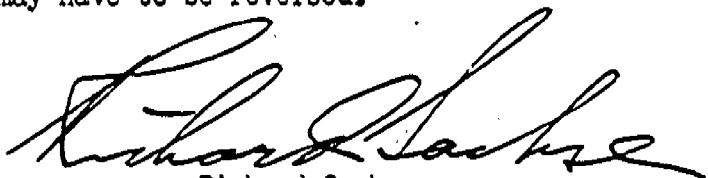
Our staff has questioned the company's proposal on at least three points: (1) the propriety of the charge as proposed; (2) the failure to credit interest on the reserve (which item affects the total amount in the reserve at this time), and (3) the amount of the liability as estimated by applicant. The utility has been requested to furnish underlying information supporting its reserve estimates. That data is now being compiled and will shortly be available.

The reserve is not funded. It is merely a book reserve and there is no legal liability to use the accumulated moneys for the purpose of paying prior-service pensions. The U.S. Treasury Department has

not recognized this reserve as meeting proper pension fund requirements and accruals to the reserve are therefore not allowed as federal income tax deductions.

If past-service pension benefits are to be granted the company's employees, and the rate payers are required by us to contribute to such benefits, we should make certain that such contributions are held and used for past-service pension purposes and for no other. Further transfers as here proposed should not be authorized by us until the legal obligations concerning the use of the reserve are definite and the reserve meets federal tax requirements.

For these reasons it would seem appropriate to leave this item open for further and more complete consideration by the Commission rather than issue a decision now based on incomplete information, with the possibility that later such decision may have to be reversed.



Richard Sachse  
Commissioner