

ORIGINAL

Decision No. 61711

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Investigation
on the Commission's own motion con-
cerning the proper treatment for
rate-making purposes, to be
accorded accelerated amortization
and accelerated depreciation.

Case No. 6148

SUPPLEMENTAL ORDER

By Decision No. 59926, dated April 12, 1960, in the above-entitled matter, the Commission stated that, for rate-making purposes, it will not allow a public utility to charge to its operating expense for federal income taxes any amount in excess of the amount of such taxes lawfully assessed by the taxing authority and paid by the public utility.

It appears that there are some public utilities whose rates have been fixed on the basis, among other things, of an allowance for federal income taxes of amounts determined by the use of normal straight-line depreciation methods but which utilities since have elected to accrue on their corporate books, and to charge to income, their federal income taxes determined by the use of liberalized depreciation methods with the tax differentials, or savings, flowing through into surplus. It further appears that there are some utilities which, through normalization, have accrued tax reserves and carry such reserves on their balance sheets.

The Commission has considered this matter and finds and concludes that the tax differentials, or savings, thus carried to surplus represent amounts collected from the ratepayers in excess of the amounts allowed by the Commission in fixing rates. The Commission's order in Decision No. 59926 was limited to the treatment

of federal income taxes for rate-making purposes only and we find and conclude that it is reasonable and proper, in order to protect the public interest, to enter an order at this time indicating accounting procedures to be followed with respect to such tax differentials, or savings, and prescribing the method to be followed in disposing of the tax reserves.

Therefore, good cause appearing,

IT IS ORDERED:

1. That every public utility under the jurisdiction of the Commission which now has accumulated tax reserves resulting from the use of liberalized depreciation methods in computing federal income taxes, except those utilities which prior to the date of this order have been authorized to dispose of such tax reserves, shall, on or before June 30, 1961 unless otherwise earlier authorized by this Commission, transfer the balances in such tax reserve accounts to depreciation reserve accounts and report such transfers to the Commission within ten days thereafter.

2. That every public utility whose presently prevailing rate schedules have been fixed on the basis, among other things, of the inclusion in operating expenses of allowances for federal income taxes of amounts based on the use of normal straight-line depreciation methods but which since has elected, and does elect, to use liberalized depreciation methods in computing federal income taxes, shall, for each year beginning in 1960 and continuing until its rates for service shall have been fixed on that basis, charge income for such year and credit depreciation reserve accounts with amounts equal to the tax differentials, or savings, resulting from the use of liberalized depreciation methods, instead of normal straight-line depreciation methods, in computing federal income taxes.

3. That every public utility as described in paragraph 2, above, shall file with the Commission, within forty days after the effective date of this order, a statement indicating compliance with the terms of paragraph 2 of this order.

4. That this order is for accounting purposes only and shall not be construed as a recognition or an acceptance by the Commission of normalization of taxes on federal income for rate-making purposes.

5. That this order shall become effective twenty days after the date hereof.

Dated at San Francisco, California, this 21st day of March, 1961.

President

S. J. Fox

George T. Hoover

Frederick B. Holcomb
Commissioners

I dissent. Dissent will be filed later.

John E. Mitchell

I dissent, will file a dissenting opinion later
Barrett [Signature]

McKEAGE, President, and MITCHELL, Commissioner, dissenting:

We dissent from the action taken by the majority of the Commission in issuing the Supplemental Order, herein. This action will serve no useful purpose but, on the contrary, will produce the following undesirable results:

- (a) Will discourage utilities from changing from straight-line depreciation practices to liberalized depreciation practices for income tax purposes.
- (b) Will cause those utilities which have changed from straight-line depreciation practices to liberalized depreciation practices for income tax purposes to undertake to revert to straight-line depreciation.
- (c) Will create confusion and misunderstanding in the minds of both the utilities and the public as to whether or not the Commission is temporizing with "normalization" of income taxes, although the majority action disclaims such intention. This action of the majority raises a large question mark over the decision of the Commission (Decision No. 59926, issued April 12, 1960), which held, for rate-fixing purposes, that the Commission will permit as a charge to operating expense only those income taxes lawfully assessed by the taxing authority and paid by the utility, and injects confusion into a situation that had become clarified.

Speaking as two of the Commissioners who prepared and issued said Decision No. 59926, one of the prime intents of that decision was to encourage utilities to employ liberalized depreciation on the so-called "flow-through" basis so that the rate-paying public would enjoy the fruits flowing from the reduced taxes as a charge to operating expense. This benefit to the ratepayer would amount to many millions of dollars within the next few years. Also, by going to "flow-through," utilities would be able to so enhance their earnings that rate increases would be prevented because of the improved earning position resulting from employing "flow-through."

This Supplemental Order will have a natural tendency to

reverse the present trend being followed by utilities to employ liberalized depreciation practices. In our considered judgment, this would be definitely contrary to the public interest. One does not have to be an expert in the regulation of public utilities to understand that any reduction in the tax or other expense of a public utility is in the interest of the rate-paying public. What is worse, the return to straight-line depreciation or the refusal to employ liberalized depreciation by those utilities which have not changed from straight-line depreciation will inevitably lead to further rate increases. Just what public interest possibly will be served by the action taken by the majority is not readily perceived.

Apparently, the Supplemental Order proceeds upon the misconception that income taxes are some special or exclusive type of operating expense. Taxes, income or other, are merely operating expenses just as labor, materials and fuel are operating expenses. There can be no possible difference. The only thing that the law can be concerned with is the end result reflected by the operating results of a utility. If the operating results of a utility do not reflect an excessive rate of return, the fact that the income taxes of such utility may have been reduced may not be used as an argument to reduce the rate of return of the utility in proportion to the tax reduction. A rate of return which may be compensatory, when fixed, may become confiscatory by the change of circumstance resulting in either reduced revenues or increased operating expenses. In like manner, a rate of return which may be confiscatory may become compensatory by changed circumstances. The question--and the only question--which the law asks: Is the return of the utility excessive? If the answer is in the negative, inquiry is at an end, so far as the ratepayer's interest is concerned. Of course, the

utility has its lawful interest and the constitutional right to a reasonable opportunity to earn a fair return upon its property lawfully devoted to the public use.

If there be lawful reason to believe that any of the public utilities under the jurisdiction of this Commission is or are earning an excessive return, the law provides a most efficient remedy in the hands of the Commission by the issuance of an order of investigation into the reasonableness of the rates of any such public utility. In such way, that issue may be adjudicated fully and on a public record where the public may be heard as well as the utility concerned. It must be borne in mind that the action of the majority is merely an accounting order and cannot, of itself, affect the rates of any public utility. Only in a rate proceeding can Commission action affect the rates of a utility. Thus, the result flowing from the action of the majority is confusion and not benefit to anyone.

Pursuant to the provisions of said Decision No. 59926, the Commission is presently engaged in securing information from the several public utilities which had accrued tax reserves prior to the date of the rendition of said decision, with the view to adjusting any matters which lawfully should be adjusted in light of the policy declared in said Decision No. 59926. This program, in our judgment, is adequate to take care of any matters involved in this subject which may need to be revised or otherwise adjudicated. By this procedure, the Commission is moving in an orderly way to arrive at a resolution of the problems which may be presented by the depreciation practices followed by the public utilities involved.

It is our considered opinion that the action of the majority will have a direct tendency to create additional burdens to be borne by the rate-paying public and will have no tendency to bring relief to any customer of any utility.

Dated: March 21, 1961.

[Signature]
3. *[Signature]*

CONCURRING OPINION OF COMMISSIONERS
GROVER AND HOLOBOFF

We do not understand that there is any significant disagreement among the members of the Commission regarding paragraph 1 of the Order. Certainly the Commissioners who now dissent have recently approved similar handling of the accumulated tax reserves of certain utilities whose depreciation practices have received the specific attention of the Commission.

But how do we distinguish those tax savings which accrued before 1960 and those which have accrued since? The only thing that happened in 1960 was the issuance of the Decision 59926 by this Commission. The nature of those tax savings has not changed - they continue to represent, for the utilities affected by paragraph 2, the difference between the taxes envisioned by the Commission at the time rates were set and the taxes actually paid. The reasoning which compels us to withhold these savings from the stockholders for the years before 1960 equally compels us to continue to do so thereafter until rates are again set by this Commission. The use of the depreciation reserve accounts for this purpose is merely a practical expedient for assuring that the ratepayers, not the stockholders, will receive the benefit of the tax savings involved. Decision 59926 was for rate making purposes, but the rates of the affected companies have not yet been set on the "flow-through" theory there adopted. Pending such fixing of rates, today's order merely assures us, as an accounting matter, that these tax savings will not meanwhile be reflected in surplus and thereby go to profit.

It is true that this order may precipitate rate increase applications of companies whose rate of return has fallen off for other reasons. Such applications, however, will provide the direct and proper vehicle for considering the questions involved. In the absence of the relatively thorough investigation which would be possible on such applications, we are not now prepared to say that all of the affected utilities are entitled to keep these tax savings. Of course, they will refrain from asking for rate increases if we give them the benefits of "flow-through" without such requests.

It bears noting that the dissenting opinion states that one of the prime intents of Decision 59926 was to encourage the adoption of flow-through "so that the rate-paying public would enjoy the fruits flowing from the reduced taxes as

a charge to operating expense". In this regard, the minority has an erroneous conception of what was meant by flow-through as it was contemplated and urged before the Commission in Case 6148 by the advocates thereof.

There can be no doubt ^{that} ~~but~~ that true flow-through results only when both income tax expense and rates are determined on the basis of the use of liberalized depreciation. When, as in those instances to which paragraph 2 of the Order is directed, the tax savings find their way into income accounts, it may be said that flow-through occurs, but not the kind of flow-through which was advocated in this case.

Thus, in any instance where rates have been set on the basis of straight-line depreciation but income tax expense computed by the use of liberalized depreciation, there results the very burdening of the ratepayer which Decision 59926 rejected; that is, the burden of bearing a tax expense which the affected utility has not really incurred. Decision 59926 itself, therefore, dictates the order filed today.

Dated: March 21, 1961.

George H. Hoover
Commissioner

Fredrick B. Hohl
Commissioner