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Decision No. 69569

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of North Los Altos Water Co., a corporation, for Authority to Increase its Rates and Charges for its Water System serving portions of the Cities of Los Altos, Palo Alto, and an adjacent unincorporated area, in Santa Clara County.	Application No. 45625

ORDER DENYING PETITION

FOR MODIFICATION

North Los Altos Water Company, a corporation, having filed a petition for modification of Decision No. 68443, the Commission having considered each and every allegation therein, and being of the opinion that no grounds for modification are stated;

IT IS HEREBY ORDERED that said petition be, and the same is, hereby denied.

Dated at San Francisco, California, this 17th day of August, 1965.

Frederick B. Holoboff
President

I will file a dissent.
George G. Grover

Commissioners

A 45625

Commissioner George G. Grover, Dissenting Opinion:

I would grant a rehearing, limited to the issue of income tax expense.

In our earlier decision in this proceeding, we simply assumed that the first $25,000 of applicant's profit would be subject to federal income tax at the 22% rate. In actual fact, under the provisions of Sections 1561-1563 of the Internal Revenue Code, applicant must share its $25,000 "surcharge exemption" with its several affiliates or else it must pay an additional 6% on that first $25,000. Because of the size and number of the affiliated corporations involved, there can be no question that the additional 6% tax ($1500) would lead to a lower total tax than would be payable if the surcharge exemption were shared. In this petition, applicant asks only that its income tax allowance be increased by $1500, the amount involved in the lesser of these two alternatives.

It is true that, if applicant's affiliates were to suffer substantial losses, the profits here might be offset on a consolidated return and a tax saving would result. In such circumstances, we should consider passing on to applicant's ratepayers all or a part of the saving. It is also true that applicant has not advised us whether or not it has filed, or will file, a consolidated return. We know, however, on the basis of our expert knowledge of the affairs of applicant and its affiliates, that there are no losses of any consequence which, for tax purposes, may be deducted from its profits; no one associated with the Commission's consideration of this petition has suggested that applicant will not in fact pay a minimum of $1500 more than the tax expense which has been allowed. Accordingly, even though the instant petition may lawfully be denied on the ground that applicant has failed to report the actual basis of its tax returns, such a denial is technical and unrealistic. Moreover, it merely postpones our determination of this issue until the next rate case of applicant or one of its California affiliates. I believe we should come to grips with the problem now.

Allowing less than the taxes actually paid by applicant cannot be justified on the ground that applicant's parent has voluntarily chosen to operate through a number of affiliated entities rather than through a single corporation. Indeed, it is only because several corporations are

involved that applicant's actual tax expense is as low as it is. In contrast, California Water Service Company, for example, operates its several California water systems as a single corporation and must spread its $25,000 surcharge exemption over 21 separate districts; the result is that for each district about $1200 of profit is taxed at 22% while the remainder of the first $25,000 is taxed at the full 48% rate applicable to profits above $25,000. It is ironic that although the corporate structure of applicant and its affiliates makes possible a lower tax than would result if they operated as a single corporation, the Commission has refused to allow the full amount of taxes paid, whereas we have consistently allowed the higher tax expense of the comparable districts of California Water Service Company. (See, for example, Decision 68606, dated Feb. 16, 1965, in Application 46729.)

It bears emphasis that the calculation of income taxes on the arbitrary assumption that each utility operation is an independent corporate taxpayer is not always advantageous to the consumer. In a given situation it can result in a phantom tax allowance for rate purposes which is not actually paid by the utility. Indeed, the Commission itself has expressed concern for this possibility (Pacific Lighting Gas Supply Co., 59 Cal.P.U.C. 610, 622-623); and in a recent proceeding before the Federal Power Commission we urged (on behalf of California ratepayers) that tax savings of affiliated corporations should be considered in fixing rates. (El Paso Natural Gas Co., FPC Docket Nos. G-4769 et al., California's Opening Brief, Aug. 3, 1962, p. 19.) We cannot advance the indefensible approach of following whichever method results in the lowest rates, but unless we do so, our refusal to recognize the full amount of taxes paid by applicant here will make it difficult to protect consumers when the thrust of the "actual taxes" principle is in the other direction. The only way to be fair to both ratepayers and utilities is to stay in the real world of actual taxes.

It is not easy to determine an appropriate income tax allowance for a public utility which also conducts nonutility operations or which is affiliated with nonutility entities. There may be situations, as here, where the law is clear and the calculations are relatively routine. Again,

in determining expenses on an out-of-pocket basis (as when we are considering a proposal to discontinue railroad passenger service), the very theory of the out-of-pocket approach will dictate that any tax savings involved be fully credited to the operation being studied. (Contra: Southern Pacific Co., 312 I.C.C. 631, 637.) But easy cases are the exceptions; when we are called upon to make a thorough and equitable tax examination of complicated corporate inter-relationships, involving both utility and nonutility operations and involving both profitable and unprofitable enterprises, then a most difficult problem is presented. (See Cities Service Gas Co., 30 F.P.C. 158; reversed 337 Fed.2d 97.)

Even so, our duty is to surmount the difficulty, not to bypass it.

George G. Grover

Commissioner