NB

Decision No. 77984

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a corporation, for authority to increase certain intrastate rates and charges applicable to telephone services furnished within the State of California.	Application No. 51774 (Filed March 17, 1970)
AND RELATED MATTERS.	Case No. 9036 (Filed April 13, 1970) Case No. 9042 (Filed April 2, 1970) Case No. 9043 (Filed April 6, 1970) Case No. 9044 (Filed April 7, 1970) Case No. 9045 (Filed April 7, 1970)

(See Appendix A for Appearances)

INTERIM OPINION

INTRODUCTION

By motion filed August 5, 1970, The Pacific Telephone and Telegraph Company (Pacific) seeks an order expressing the Commission's intention to establish Pacific's cost of service for rate-making purposes on and after January 1, 1970, on the basis of

accelerated depreciation with normalization. Written responses in opposition to the motion were filed by the Commission staff, the Attorney General of the State of California, the Cities of Los Angeles, San Diego and San Francisco, and a group known as Consumers Arise Now (CAN). Pacific filed a written reply to the opposing responses.

Oral argument on Pacific's motion was held before Commissioner Sturgeon and Examiner Catey in Los Angeles on September 16, 1970. Pacific opened and closed the argument. Opposing argument was presented by the Commission staff, the Attorney General of the State of California, the Cities of Los Angeles and San Diego, and CAN. The City of Beverly Hills did not present any argument but asked that its opposition to the motion be noted on the record. The argument of California-Pacific Utilities Co. (Cal-Pacific) is in favor of the motion but points out that granting of the motion with respect to Pacific would not solve the accounting and tax problems of other telephone utilities which have adopted or wish to adopt accelerated depreciation for tax purposes. In this regard, Cal-Pacific already has adopted accelerated depreciation with flow-through and would not be precluded from continuing accelerated depreciation under the revised tax laws.

Background

Straight-line depreciation provides for essentially uniform annual write-offs of a depreciable asset over the life of that asset. Accelerated depreciation, as the term is commonly used, provides for larger than straight-line annual write-offs of a depreciable asset during early years and diminishing annual write-offs during later years of the asset's life. For a given depreciable asset, the total amount written off during its lifetime would

be the same under either depreciation method but the rates of accruals would differ. For a group of assets of different vintages, the diminution of accruals for older plant can be obscured by the larger accruals on newer plant.

Pacific's depreciation expense recorded in its books and its depreciation expense historically allowed by this Commission for rate-making purposes are on a straight-line basis. Pacific's depreciation used as a deduction in filing its income tax returns for past years, through the year 1969, also has been on a straight-line basis.

For several years, the tax laws have permitted most taxpayers, including Pacific, to use either straight-line or accelerated depreciation as a deduction in filing income tax returns. In Decision No. 74917, dated November 6, 1968, in Application No. 49142, Pacific's previous rate proceeding, the Commission "imputed" the use of accelerated depreciation for income tax purposes in determining the allowable income taxes for the test year 1967 adopted for setting rates. This approach permitted the lower current tax liability, which would have resulted from a change by Pacific from straight-line to accelerated depreciation in filing income tax returns, to flow through to customers as a lower revenue requirement for the test year.

Significant changes in the eligibility of utilities to adopt accelerated depreciation for income tax purposes were incorporated in the Tax Reform Act of 1969. Section 441 of that act amended Section 167 of the Internal Revenue Code to permit a utility to change from straight-line to accelerated depreciation for post-1969 plant in filing its tax returns and concurrently to continue to use the straight-line method of determining "book" depreciation

only if a normalization method of accounting for income taxes is used (1) in its regulated books of account and (2) for rate-making purposes. The term "normalization" as used in the Act refers to (1) the recording and recognition for rate-making purposes of the income taxes which would have been payable if straight-line depreciation had been used in filing income tax returns, and (2) the recording of appropriate entries in a reserve account to reflect the difference between those "normalized" taxes and the taxes actually payable as a result of using accelerated depreciation in filing income tax returns.

The Issues

There are only two real issues that are relevant to the pending motion:

1. Is it possible for Pacific to use accelerated depreciation in filing its federal income tax returns unless normalization is adopted both for accounting and rate-making purposes?

2. If the motion is to be granted, should it be granted now or later?

Normalization and Flow-Through

In Pacific's last rate proceeding, we imputed accelerated depreciation with flow-through for the test year 1967 even though Pacific had been filing its tax returns using straight-line depreciation. As the City and County of San Francisco pointed out in its reply to the pending motion, we had no power to direct Pacific to use any specific method of depreciation in filing its income tax returns. The imputation of accelerated depreciation with flow-through did not deprive Pacific of its property without due process because there was then no legal restriction against Pacific's changing to accelerated depreciation with flow-through and paying essentially those income taxes that had been allowed in the decision.

That no longer is the case. If we now were to attempt to impute accelerated depreciation with flow-through for setting rates in this proceeding, the law clearly would preclude Pacific from actually using accelerated depreciation in filing its federal income tax returns. We thus would be assuming lower taxes than Pacific would be required by law to pay.

The point was raised by several of the parties that the Federal Government cannot dictate regulatory policy to this Commission. This, in general, is true. We must, however, give recognition to the law of the land insofar as it affects such things as a utility's eligibility for specific income tax items. For example, during the period when the Investment Tax Credit was prescribed by law to be a lower percentage for utilities than for other businesses, it would not have been appropriate, in setting rates for utilities, for us to have imputed the greater tax savings that were available to nonutilities. Also, whenever income tax rates are changed, such as the imposition and the later elimination of a surcharge on federal income taxes, recognition of those changes is given by this Commission. In such matters, the question of whether or not we agree with the propriety of such laws is moot. The Congress does, in fact, dictate to some extent what is possible for this Commission to adopt as reasonable operating expenses in rate proceedings.

Under the present law, the only way Pacific and its customers can actually realize the benefits of accelerated depreciation for tax purposes is through the use of normalization for accounting and rate-making purposes. We are thus not now relitigating issues already decided in prior proceedings; we are merely recognizing changes in the law. Since accelerated depreciation with flow-through is no longer an option available to Pacific under federal law, it

would now be futile to consider the relative merits of flow-through and normalization.

In support of the motion, Pacific cites the actions taken on the issue of normalization by numerous other regulatory commissions. Several of the parties contend that this Commission is not bound by the opinions of other regulatory bodies. We agree. Some rate-making principles long used by this Commission are not universally used by other commissions. In arriving at the decision herein, we have not considered in any way the agreement or lack of agreement with other commissions.

In further support of the motion, Pacific filed as part of its pleading certain correspondence with the Internal Revenue Service. Opposing parties contend that this portion of Pacific's presentation should not be considered unless the parties first have an opportunity to cross-examine the authors of the correspondence. There may be some merit in this argument in regard to some of the correspondence. We, therefore, have not considered any of the correspondence that was presented. This decision is based solely upon our careful consideration of the changes in the law, which changes are quite explicit.

Reason for Interim Decision

Pacific requests a prompt interim decision rather than awaiting the final disposition of the entire rate application. Pacific contends that, in the absence of the requested decision, tax authories might disallow Pacific's use of accelerated depreciation for its 1970 tax return. This could deprive Pacific and its customers of the benefit of some eight million dollars of interest-free funds.

One of the two basic arguments presented in opposition to the motion is that a decision should not be rendered until additional evidence is received on the subject of accelerated depreciation. Parallels were drawn between directed verdicts in jury trials and the relief requested by Pacific. This could have been a valid position if the Tax Reform Act had been equivocal or ambiguous on the subject of the availability of depreciation methods. Under revised Section 157(2)(B) of the Internal Revenue Code, a utility may change from straight-line to accelerated depreciation for tax purposes only "if the taxpayer uses a normalization method of accounting." Under Section 167(3)(G), the term "normalization of accounting" is defined. It clearly specifies that, in order to qualify, the normalization must be both "for purposes of establishing its cost of service for rate-making purposes and for reflecting operating results in its regulated books of accounts." This leaves only two possible basic ways for Pacific to file its 1970 tax returns: (1) using straight-line depreciation, or (2) using accelerated depreciation for post-1969 property, with normalization. Because of the lower revenue requirement resulting from the deduction of tax reserves in developing a rate base under the normalization method, that method will benefit Pacific's customers as compared with the use of straight-line depreciation for tax purposes.

The second basic argument presented in opposition to the motion is that the granting thereof might be an idle act. On the one hand, a statement of intent might not be sufficient to qualify Pacific for accelerated depreciation for its 1970 returns and the implementation of that intent in the actual setting of rates might be required. On the other hand, Pacific's use of accelerated depreciation in its 1970 returns might not be rejected by the Internal

Revenue Service as long as the final order adopts normalization. There is no point, however, in jeopardizing the benefits that will accrue to Pacific's ratepayers from the larger tax reserve which will result from commencing normalization with 1970 plant, instead of 1971 plant. It is not worth delaying action even if only a small risk would result from such delay.

Presentation of extensive evidence would not change the provisions of the Tax Reform Act of 1969. A decision can be and should be rendered now, based solely on those provisions.

Findings

The Commission finds that:

1. In Decision No. 74917, dated November 6, 1968, in Application No. 49142, the Commission imputed the use by Pacific of accelerated depreciation with flow-through. The Commission stated in that decision:

> "For the rate-making purposes of this proceeding, therefore, we shall compute Pacific's income tax expense for the test year 1967 as though Pacific had taken the favorable option for which the law provides." (Emphasis added.)

2. Pacific has used straight-line depreciation in filing its past income tax returns through the year 1969.

3. The Tax Reform Act of 1969 permits utility taxpayers such as Pacific to change to accelerated depreciation on post-1969 plant only if normalization, rather than flow-through, as those terms are discussed hereinbefore, is used for both accounting and rate-making purposes.

Conclusions

The Commission concludes:

1. We should not jeopardize, by delaying this decision, the benefits to Pacific's customers that will accrue from the lower rate

base that will result for many years from the deduction of the tax reserves related to 1970 taxes.

2. We should issue concurrently with this decision supplemental orders in appropriate accounting proceedings (Cases Nos. 4540 and 4923) to set forth for Pacific and other California telephone utilities similarly now blocked from conversion to accelerated depreciation, the normalization accounting prescribed by the Tax Reform Act of 1969.

3. We should now declare that we intend to adopt normalization of taxes in setting rates in Application No. 51774.

INTERIM ORDER

IT IS ORDERED that:

1. For the period from and after January 1, 1970, The Pacific Telephone and Telegraph Company (Pacific) may use accelerated depreciation with the normalization method of accounting as defined in Section 167(l) of the Internal Revenue Code.

2. Pacific, if it elects to use accelerated depreciation pursuant to Section 167(l) of the Internal Revenue Code, shall comply with the requirement therein that "the taxpayer must make adjustments to a reserve to reflect the deferral of taxes" resulting from the use of accelerated depreciation with normalization.

3. In Application No. 51774, we will use straight-line depreciation to compute both Pacific's tax expense and its depreciation expense for purposes of establishing its cost of service for

rate-making purposes, and will give recognition to the normalization tax reserve in determining rate base.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 24th day of NOVEMBER, 1970.

Chairman

Commissioners

I will file a dissent.

I will file a dissent
Angelo

List of Appearances

PARTY	APPEARANCES	POSITION* A.51774	C.9036	C.9042	C.9043	C.9044	C9045
UTILITIES							
California-Pacific Utilities Company	Ross Workman	I	-	-	-	-	R
Continental Telephone Company of California	Robert C. Abrams and Stephen C. Jones	I	-	-	-	-	R
General Telephone Company of California	A. M. Hart and H. Ralph Snyder, Jr.	I	-	-	-	I	R
Golden West Telephone Company	(See Continental Telephone Co. of Calif.)	I	-	-	-	-	R
The Pacific Telephone and Telegraph Company	George H. Eckhardt and Richard W. Odgers	A	D	D	D	R	I
The Western Union Telegraph Company	J. A. Moore	I	-	-	-	-	I
FEDERAL GOVERNMENT							
General Services Administration	Hart T. Mankin, Marvin H. Morse and Max M. Misenar	I	I	I	I	I	I
STATE GOVERNMENT							
California Public Utilities Commission staff	Richard D. Gravelle and Leonard L. Snaider, staff counsel, John J. Gibbons and James G. Shields	-	-	-	-	-	-
State of California	Thomas C. Lynch by Charles A. O'Brien and Donald B. Day	I	I	I	I	I	I
COUNTIES							
Alameda	Richard J. Moore by Jacob Levitan	I	I	I	I	I	I
Marin	Douglas J. Maloney by Thomas G.Hendricks	I	I	I	I	I	I
Placer	Richard E. Saladana and Douglas A. Lewis	I	I	I	I	I	I
San Francisco	Thomas M. O'Connor, Milton Mares and Robert R. Laughead	I	I	I	I	I	I
CITIES							
Anaheim	Joseph B. Geisler and Alan R. Watts	I	I	I	I	I	I
Bellflower	Alexander Googooian	P&I	I	I	I	I	I
Benicia	L. S. Brady	I	I	I	I	I	I
Beverly Hills	George Slaff and Allen Grimes	P	I	I	I	I	I
Eureka	Chesley Norton Gaylord	P	I	I	I	I	I
Los Angeles	Roger Arnebergh by Charles E. Mattson, Robert W. Russell and Manuel Kroman	I	I	I	I	I	I
Long Beach	Louis Possner	I	I	I	I	I	I

* A = Applicant C = Complainant D = Defendant I = Interested Party P = Protestant R = Respondent

List of Appearances

PARTY	APPEARANCES	POSITION*					
		A.51774	C.9036	C.9042	C.9043	C.9044	C.9045
Pittsburg	Roger Golla	I	I	I	I	I	I
Sacramento	James P. Jackson	I	I	I	I	I	I
San Diego	John W. Witt by C. M. Fitzpatrick and William Kronberger	I	I	I	I	I	I
San Francisco	(See County of San Francisco)	I	I	I	I	I	I
Seaside	Saul M. Weingarten	P	I	I	I	I	I
Thousand Oaks	Raymond C. Clayton	P	I	I	I	I	I
ORGANIZATIONS and CORPORATIONS							
Allied Telephone Companies Association	Ernest W. Watson	I	-	-	-	-	-
American Taxpayers Union of California, Inc. (Unit 3)	Diamantes D. Katsikaris	P	-	-	-	-	-
Apex Janitor Supply	Nat Yanish	P	-	-	-	-	-
Association of California Consumers	Mrs Sylvia Siegel	P	-	-	-	-	-
Business Communications	Lyle C. Brackney	I	-	-	-	-	-
California Farm Bureau Federation	W. L. Knecht and Ralph Hubbard	I	-	-	-	-	-
California Farmer-Consumer Information Committee	Mrs. Borghild Haugen	I	-	-	-	-	-
California Hospital Association	Ronald G. Trayer	I	-	-	-	-	-
California Independent Telephone Association	Neal C. Hasbrook	I	-	-	-	I	I
California Labor Federation, AFL-CIO	Dennis T. Peacocke	P	-	-	-	-	-
California Retailers Association	Robert M. Shillito	I	-	-	-	-	-
California Rural Legal Assistance	Fred H. Altshuler, David H. Fielding and Lupe Quintero	P	-	I	-	-	-
Chicano Law Students (Hastings)	Steven J. Ybarra	P	-	I	-	-	-
Communications Workers of America	Stephen H. Confer and Edward Long	I	-	-	-	-	-
Consumers Arise Now	William H. Bennett, Lew Geiser, Garret P. Shean, Harold Sherwin Small and Edward Torrico	P	C	-	C	-	-
Contra Costa Legal Service Foundation	Jim Lipary	P	-	-	-	-	-
Consumers Cooperative of Berkeley	Don Rothenberg	P	-	-	-	-	-
Echo Answering Service	Clarence Ricks	I	-	-	-	-	-
Hornblower & Weeks - Hemphill, Noyes	William G. Irving	P	-	-	-	-	-
I.B.E.W. Local Union No. 1011	M. W. McWhorter	I	-	-	-	-	-
Interracial House, Inc.	Marcus Garvey Wilcher	P	-	I	-	-	-
Mexican-American Legal Defense Fund	Robert Gnaizda, Elaine Climpson and Mario Obledo	P	-	I	-	-	-
Mexican-American Political Association	(See Mexican-American Legal Defense Fund)	P	-	C	-	-	-

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PARTY	APPEARANCES	POSITION*					
		A.51774	C.9036	C.9042	C.9043	C.9044	C.9045
NAACP Legal Defense	(See Mexican-American Legal Defense Fund)	P	-	I	-	-	-
National Businessman's Association	L. David Fox	P	-	-	-	-	-
Responsible Merchants, Property Owners & Tenants, Inc.	Jack Bartolini	I	-	-	-	-	-
Retired Employees Group of T.P.T& T.	William J. Wider	I	-	-	-	-	-
San Francisco Neighborhood Legal Assistance Foundation	Gilbert T. Graham	P	-	-	-	-	-
San Pablo Community Change Foundation	(See Contra Costa Legal Service Foundation)	P	-	-	-	-	-
San Pablo County Parchester Community Organization	(See Contra Costa Legal Service Foundation)	P	-	-	-	-	-
San Pablo Housing Tenant Council	(See Contra Costa Legal Service Foundation)	P	-	-	-	-	-
Sears Roebuck and Company	Hope H. Camp, Jr.	I	-	-	-	-	-
Senior Citizens Movement	Royal C. Younger and Mrs. Joan Martin	P	-	-	-	-	-
Spanish Speaking Subscribers (144)	(See Mexican-American Legal Defense Fund)	P	-	C	-	-	-
Spanish-Speaking/Surnamed Political Association	Ricardo A. Callejo (and see Mexican-American Legal Defense Fund)	P	-	C	-	-	-
Telephone Answering Services of California, Inc.	Bacigalupi, Elkus, Salinger & Rosenberg by Lucius P. Bernard	I	-	-	-	-	-
United Auto Workers, Northern California	Salvador L. Tavares	P	-	I	-	-	-
Welfare Rights Organization	(See Contra Costa Legal Service Foundation	P	-	-	-	-	-
Windsor and Healdsburg Local Action Council	(See Mexican-American Legal Defense Fund)	P	-	C	-	-	-

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PARTY	APPEARANCES	POSITION*					
		A.51774	C.9036	C.9042	C.9043	C.9044	C.9045
INDIVIDUALS							
Bennett, William M.	Self (See Consumers Arise Now)	P	C	-	C	-	-
Bone, Donald L.	Donald L. Bone	P	-	-	-	-	-
Brierly, Philip G.	Philip G. Brierly	P	-	-	-	-	-
Ciesielski, Wladyslaw	Wladyslaw Ciesielski	P	-	-	-	-	-
Cross, Dr. Nancy Jewell	Dr. Nancy Jewell Cross	P	-	-	-	-	-
De Mattia, Douglas	Douglas De Mattia	P	-	-	-	-	-
Elder, Randy N.	Randy N. Elder	I	-	-	-	-	-
Ervin, Rebecca	Rebecca Ervin	P	-	-	-	-	-
Geiser, Lew	Self (See Consumers Arise Now)	P	-	-	-	-	-
Glass, Michael K.	Michael K. Glass	P	-	-	-	-	-
Heidrick, Harold H.	Harold H. Heidrick	I	-	-	-	-	-
Hunter, Kenneth R.	Kenneth R. Hunter	I	-	-	-	-	-
Kirschner, Kim	Kim Kirschner	P	-	-	-	-	-
Kogel, Nancy	Nancy Kogel	P	-	-	-	-	-
Markel, Leon	Leon Markel	P	-	-	-	-	-
Mercier, Andre	Andre Mercier	P	-	-	-	-	-
Mercier, Cecile	Cecile Mercier	P	-	-	-	-	-
Nolan, Otis	Otis Nolan	P	-	-	-	-	-
Pugh, David	David Pugh	P	-	-	-	-	-
Shean, Garret P.	Self (See Consumers Arise Now)	P	I	--	I	--	-
Small, Harold Sherwin	Self (See Consumers Arise Now)	P	-	-	-	-	-
Small, Mr. and Mrs. James M.	Harold Sherwin Small (See Consumers Arise Now)	P	-	-	-	-	-
Stone, Janet	Janet Stone	P	-	-	-	-	-
Torrico, Edward	Self (See Consumers Arise Now)	P	-	-	-	-	-
Viviano, Victor	Victor Viviano	I	-	-	-	-	-
Winsor, Richard	Richard Winsor	P	-	-	-	-	-
Wright, Orville I.	Orville I. Wright	I	-	-	-	-	-

J. P. VUKASIN, JR., CHAIRMAN, CONCURRING OPINION

I concur in the foregoing decision. However, in my opinion it does not give sufficient importance to policy arguments which also support the conclusion of the majority of this Commission.

The Tax Reform Act of 1969 effectively precludes Pacific from taking liberalized depreciation unless the Commission approves normalization procedures for both accounting and rate-making purposes. For this Commission to continue the imputation of liberalized depreciation with flow through when Pacific is prohibited from taking liberalized depreciation would seriously hamper the financial position of Pacific and more importantly impair its ability to continue to render satisfactory service to the people of California.

As I indicated in a concurring opinion in Application No. 49835, Decision No. 75873, "... imputation of accelerated depreciation with flow through bears many dangerous earmarks of shortsighted regulation. We must always keep in mind that it is our responsibility to 'protect the public interest.' Public interest does not mean merely low rates. It would be absurd to argue that we are protecting the public interest if we reduce rates today only to endanger the service available tomorrow."

In my concurring opinion I expressed a position similar to what the majority is adopting today. I stated that

"it may well be that an alternate method involving normalizing the effects of liberalization should be considered if liberalized depreciation is to be imputed. Appealing arguments have been made that liberalization with normalization results in benefits to both company and subscribers. This method would, over the years, result in benefits to the company in that it would provide a source of interest-free capital, and to the subscribers in that such interest-free capital could be considered in arriving at a reasonable rate of return by assigning a zero interest cost to such capital, or in the alternative the normalization reserve could be deducted from the rate base."

Perhaps the most important argument in favor of the action taken by the Commission today is the argument of fiscal responsibility. As I have previously stated, "Accelerated depreciation results in tax reductions today, which must be made up in the future if the present rate of capital expenditure is not maintained or if Section 167 of the Internal Revenue Code should be repealed. If either of these events should occur it is inevitable that there will be an immediate and substantial impact on utilities which either have taken or which have had accelerated depreciation imposed upon them and the effect thereof flowed through to income. In such case, tax savings today which are passed on to the subscribers in the form of lower rates today, must be made up in the form of higher taxes and resulting

higher rates in the future. Some elements of our society find this is an appealing technique. I deem it objectionable. I cannot with good conscience pass on to rate payers ten years hence the possible burden of paying for part of the service which I enjoy today."

In my opinion the decision signed today will best answer the interests of the subscribers of Pacific in that it will enable Pacific to obtain interest-free capital to expand and upgrade its service, and also result in the long run in lower rates.

J. P. Vukasin, Jr.
Chairman

San Francisco, California
November 24, 1970

COMMISSIONER A. W. GATOV, Dissenting:

I dissent.

As the outgoing Commissioner (my term expires 12/31/70), this dissent will probably be my last opportunity to again officially state and demonstrate that the majority of the Commission as presently constituted deliberately ignores the public interest. Today's outrageous decision promises in the form of an "order" that when Pacific's current 195 million dollar rate case is finally decided, the decision will provide for rates fixed on the basis of "liberalized depreciation" with so-called "normalization". That promise, by the testimony of Pacific's own witness, will make it necessary for the ratepayers to provide a fund of some 700 million dollars of involuntarily contributed capital to Pacific within a ten-year period. The ratepayers will have to pay 1 billion dollars more in rates in the first ten years just to set up the fund!

Today's order, sadly enough, follows the pattern established by the majority in its Western Electric decision in Case No. 8858, to which I strongly dissented, and again they have rushed headlong to do the bidding of Pacific. In doing so, they have dumped all past practices and precedent established by this Commission in some sixty years of regulation. It can only be hoped that some party will take this matter to the California Supreme Court, and I am certain that were it procedurally possible the Commission's staff itself would do so.

Furthermore, the order issued today is inexplicably made effective on the signing date, an action heretofore taken only

when time is an extremely critical element. No such crisis exists here as Pacific will not file its 1970 tax return until late in 1971. This will make more difficult, if not impossible, an effective appeal to the Court, but it may well be that the majority, in its rush to judgment, does not wish to have this matter fairly tried or judicially tested.

And now to some of the specific errors and omissions in today's "interim opinion".

First. The statement of issues set forth on page 4 (mimeo) and numbering a grand total of two, is not only incorrect but is juvenile and simplistic. The issues faced by the Commission in treating liberalized depreciation are perhaps the most varied and complex to come before it in years and require the most astute and enlightened consideration of a multitude of inter-related facts. The majority, nevertheless, has not only made inadequate findings and conclusions on such issues, they have improperly stated the issues themselves.

While the following list is by no means exhaustive, the record readily reflects at least that these essential questions have not been dealt with.

(1) What is the dollar effect of the various forms of depreciation available to Pacific on (a) Pacific itself, (b) the ratepayers, and (c) the federal government?

(2) What are the various forms of depreciation available to Pacific before and after the enactment of Section 441 of the Tax Reform Act of 1969?

(3) Does Section 441 bind only the taxpayer or both the taxpayer and the regulatory agency?

(4) If Section 441 binds a state regulatory agency which fixes intrastate rates, is such section constitutional?

(5) Can Pacific qualify for liberalized depreciation

under the new Act even if the Commission favors rates on a basis other than normalized?

(6) Is time of the essence in determining Pacific's tax expense in its current Application No. 51774?

(7) What is the proper regulatory basis upon which Pacific's depreciation tax expense should be fixed?

(8) Can the California ratepayer be legally required to contribute capital to Pacific?

Second. The reasons stated at the bottom of page 4 and the top of page 5 (mimeo) for the distinction between the legality of the imputations of flow through in Decision No. 74917, regarding Pacific, and the majority's inability to so impute now assumes, without any justification, that (1) there is now a legal restriction against the imputation of liberalized depreciation with flow through, (2) there is a legal inability for Pacific to have its rates fixed on the basis of liberalized depreciation with flow through, and (3) the Commission is without authority to make justifiable regulatory adjustments where and when required.

Third. The example cited in the middle of page 5 (mimeo) is no example at all. It is a childish absurdity. No one has suggested in Application No. 51774 that Pacific be treated differently than other utilities. As a matter of fact, today's decision will actually discriminately favor Pacific as compared to other California utilities. The majority of all California utilities have taken advantage of the benefits of liberalized depreciation and flow such benefits through to their customers. Pacific and General Telephone, however, have failed to do so, and Pacific has been found by us to be imprudent for such failure. The other major California utilities can continue with liberalized

depreciation and flow through to customers, but if the present order stands Pacific and General will be permitted to retain funds which all other companies have passed on and will continue to pass on to the ratepayers.

The majority has thus rushed to reward Pacific's past imprudence, and the benefits it has just been handed are not only unjust, they are unlawful. In Decision No. 74917, regarding Pacific, we said: "Management's discretion has exceeded a reasonable and prudent course respecting income taxes to the detriment of the public interest." Assuming a 1970 starting point, ten years from now that indiscretion will have caused over 1 billion dollars in additional rates to be extracted from ratepayers!

Fourth. At the bottom of page 5 (mimeo) the majority again assumes, without reasoning, that there are no tax expense options open to Pacific and there may not be any for the Public Utilities Commission, and as to the latter they are most certainly in error.

Fifth. On page 6 (mimeo) the majority states that it does not consider (1) what other regulatory bodies have done with respect to this question, or (2) the statements attributed to the Internal Revenue Service. What can possibly be the basis for the majority's decision? Where did it get the insights into the history, intent, background and reason for existence of the AT&T sponsored and promoted Section 441? It flatly states those changes in the law are explicit; yet our staff, the Attorney General, and the Cities of Los Angeles, San Diego and Beverly Hills, as well as the City and County of San Francisco, through their respective legal representatives, are not only in

disagreement with this interpretation, but if given the opportunity they requested will provide evidence and argument which for reasonable men would make a contrary decision inevitable. The high-handed method by which the majority slammed the door on this request, thus precluding the presentation of essential material and testimony was most unprofessional and could be a denial of due process.

Sixth. The "reason" for the interim decision is the need to allow Pacific to utilize liberalized depreciation in its 1970 tax return, thus preventing deprivation of "Pacific and its customers of the benefit of some 300 million dollars of interest-free funds". What benefits these be! It will cost Pacific's ratepayers over 60 million dollars per year in additional rates to create this enormous kitty of involuntarily invested funds.

Seventh. On page 8 (mimeo), the majority with great solemnity and acumen states: "Presentation of extensive evidence would not change the provisions of the Tax Reform Act of 1969." No party to this proceeding is making any such claim, but they have stated that presentation of such evidence would lead the Commission to apply the Tax Reform Act of 1969 in a manner far different than it has. What the majority really means is that it does not want to be confused by the facts.

Eighth. The findings and conclusions on pages 8 and 9 (mimeo) are inadequate as mentioned previously.

Ninth. Conclusion No. 2 would purport to affect other telephone utilities, principally General Telephone Company; yet there is absolutely no evidence or argument here or in Cases 4540 and 4923 with respect to this question. This action appears

to clearly constitute a decision with no hearing.

Tenth. Ordering paragraph 3 makes this order a final rate-making order for all intents and purposes. While no rate levels are established by the order, from figures presented by the staff it is clear the determination in ordering paragraph 3 will cost the ratepayers over 60 million dollars in the test year.

Such is the impact of this order. It is as final as any order could be, and it is certain no further evidence on the subject will be allowed in the rate case.

I hope that the Court will have an opportunity to correct this incredibly inept and erroneous decision and order.

Commissioner

Dated at San Francisco, California,
November 24, 1970.

COMMISSIONER THOMAS MORAN, Dissenting:

I dissent.

The majority decision herein is outrageous. Its interpretation of the law applicable would discredit a first-year law student. Its summary of the alleged "facts" and the effect of this decision is no more than a collection of falsehoods. The adoption of this decision is entirely contrary to the best interest of the people of California and may well generate a backlash which will ultimately prove it to be contrary also to the interests of the Pacific Telephone Company which alone has urged the Commission to adopt it.

The staff and the other parties have not yet even completed their cross-examination on the issue of accelerated depreciation, and have had no opportunity to put in their direct evidence on the subject. While the "presentation of extensive evidence would not change the provisions of the Tax Reform Act of 1969", there is nothing in that act which operates or purports to operate on anyone but the taxpayer, Pacific Telephone. Nowhere in the act does Congress tell State regulatory agencies that they must adopt accelerated depreciation with normalization for rate fixing.

The term "normalization" as used herein by the majority serves to confuse individuals unacquainted with accounting terminology. Translated into plain English it means herein that "Pacific Telephone Company may take all Federal income tax deductions available to it but retain the same for its own purposes" and "Pacific Telephone Company may collect from California subscribers the full amount of what its Federal income taxes would be if said Federal income tax deductions were either not available to Pacific or Pacific did not take advantage of them." In short, the majority by this decision authorizes the Pacific Telephone Company to collect

money from California subscribers each year sufficient to reimburse Pacific not only for Federal income taxes which Pacific intends to pay but also for fictitious Federal income taxes which Pacific expressly states it does not intend to pay. Never before has this Commission allowed a telephone company to collect and retain "reimbursement" from subscribers for "taxes" which the company in fact does not pay.

One effect of this decision is to confer the power of taxation upon Pacific Telephone as if Pacific Telephone were a government. It is indeed a step toward socialism and logically could lead ultimately only to government ownership of the telephone system in this country. If the public is to be compelled to put up the capital necessary to operate the telephone system, rather than voluntary investors as in the past, management and operation of the telephone system logically must ultimately also pass into the hands of a government agency as is the situation in virtually every other nation - something I would very much regret and which I believe would be very much contrary to the best interest of the American people.

If this action by the Commission is not reversed by the California Supreme Court, Pacific Telephone alone will collect from California subscribers a bonus of more than seven hundred million dollars during the next ten years according to the statement of the company's own witness. A realistic analysis of the figures indeed shows that the amount will exceed one billion dollars. All of these moneys will be in addition to collecting from subscribers reimbursement for all expenses the company incurs each year plus the usual profits for the company's stockholders.

Even this is not the whole story, as in all fairness this Commission will have to grant the same "special bonus" to all other telephone companies operating in California.

The undersigned understands and appreciates as well as any other member of this Commission the pressing need of Pacific Telephone to obtain huge amounts of capital to finance the maintenance, improvement, and continued expansion of telephone service in California. The sole proper and honest approach to the problem however is to authorize Pacific to charge reasonable rates, which in turn will enable Pacific to obtain all necessary capital from the investing public through the traditional method of selling stocks and bonds.

Thomas Moran
Commissioner

San Francisco, California
November 24, 1970