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Decision 88 12 003

DEC 5 1988

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking concerning )  
the ratemaking treatment of capital )  
gains derived from the sale of a )  
public utility distribution system )  
serving an area annexed by )  
a municipality or public entity. )

R-88-11-041  
(Filed November 23, 1988)

ORDER CORRECTING CLERICAL ERRORS

The Commission has been informed of clerical errors which occurred during the printing of Order Instituting Rulemaking (R.) 88-11-041. More specifically:

1. The first line under point 2 on page 1 should have read:

"the distribution system consists of part or all of the utility ..."

This change also occurs in the first line on page 5.

2. The first two lines on page 3 should have read:

"Accordingly, we intend to reconsider whether these particular sales which are the subject of this rulemaking are tantamount to total or partial liquidations, ..."

3. Language indicating the Commission's intention that water utilities be included as respondents was inadvertently omitted from the first sentence of point 2 and the first sentence of point 8(a), both on page 5.

4. Point 8(c) on page 5 should have included the relevant decision numbers.

5. Point 8(d) should have been added after point 8(c) on page 5 to include on the mailing list the service list of Application 85-12-050, PG&E's last test year rate case.

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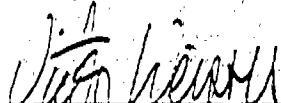
R.88-11-041

Under Resolution A-4661,

IT IS ORDERED that these errors are corrected, and that the corrected version of R.88-11-041 in its entirety is attached to this order as an appendix. Because of the necessity of correcting these errors, we will extend the time for filing comments to January 16, 1989.

This order is effective today.

Dated DEC 5 1988, at San Francisco, California.

  
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Victor Weisser  
Executive Director

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ORDER INSTITUTING RULEMAKING

We are opening this rulemaking proceeding to reconsider the ratemaking treatment of gains realized in certain sales of utility property to a municipality or other public entity. Our review will be restricted to the allocation of gains which are realized when all of the following circumstances exist:

1. a distribution system of a public utility (i.e. gas, electric, or water utility) is sold to a municipality or some other public or governmental entity, such as a special utility district;
2. the distribution system consists of part or all of the utility operating system ("system") located within a geographically defined area;
3. the components of the system are or have been included in the rate base of the utility; and
4. the sale of the system is concurrent with the utility being relieved of and the municipality or other agency assuming the public utility obligations to the customers within the area served by the system.

Although other sales of public utility assets may result in gains, we are limiting our review to sales defined by this set of circumstances because they have been the focus of most questions and continuing debate.

The Commission is presently reviewing, for example, Application No.88-02-034 of Pacific Gas & Electric Company

("PG&E") for authority to sell the electric distribution system of the Argyle Estates area to the City of Redding ("Redding"). This area was annexed by the city in 1985. Upon consummation of the sale, Redding will assume the obligation of furnishing electric service to the residential and commercial customers of the area.

The Commission has already approved the sale of the system and the transfer of the customers. (D.88-09-039) We have reserved for subsequent decision, however, the ratemaking treatment of the net after tax gain realized from the difference between the net book value of the facilities sold and the purchase price.

Disposition of the gain can be determined by application of our decision involving an earlier sale to Redding of the electric distribution facilities of another service territory, In re Pacific Gas and Electric Company and the City of Redding (November 6, 1985) D. 85-11-018, as modified by D.86-02-056. In this decision, which we shall refer to as City of Redding, the Commission found that the ratepayers were equitably entitled to the gains realized from the sale of rate base property, and we ordered that the gains be recorded in an appropriate operating revenue account. (D.85-11-018, pp.28, 30.)

We followed this decision in a subsequent review of a similar sale by PG&E to Redding, and directed that the gain over net book value flow through to PG&E's ratepayers. (D. 86-12-068, p.7.)

With the most recent sale of the Argyle Estates facilities, however, we have decided to reexamine the rationale for allocating the gain. We note that the sale of a PG&E electric distribution system to Redding has been the subject of several applications and decisions, in addition to the two cited above. (D.88718; D.90594; D.83-02-044; D.84-10-050; D.85-05-017.) Consequently, the service territory which has been transferred to Redding has expanded significantly over the years.

Our perspective on the issue, therefore, may have to be modified in light of what is effectively not only a reduction of total plant, but also a diminution of PG&E's customer base.

Accordingly, we intend to reconsider whether these particular sales which are the subject of this rulemaking are tantamount to total or partial liquidations, and whether any gains realized from a liquidation of utility assets accrues to the shareholders. We commented on this issue briefly in City of Redding. (D.85-11-018, pp.22 and 26). Nonetheless, the successive Redding sales prompt us to believe that the characterization of each transaction as a straight sale or as a liquidation requires further analysis.

Further, when City of Redding was issued, the law did not automatically compel or prohibit allocation of the gain either to ratepayers or shareholders. Our decision turned on the resolution of equitable issues. We relied primarily on the equitable theory that rewards should be assigned to those who bear the risks.

By this present order, we are providing an opportunity to update relevant case law and/or statutory provisions and to amplify our analysis of the equitable issues relevant to a Redding type sale. We intend also to determine whether other issues should be weighed in striking a fair balance of interests between the ratepayers and the shareholders of a public utility.

At this time we are specifically not inviting comments and will not consider proposals with respect to any sale of utility assets other than the kind described in this order. The Commission does not intend that this proceeding be a forum for broad rulemaking regarding all transactions in which utility property is sold or transferred.

The parties are asked to comment, therefore, on the ratemaking treatment of the gain within the framework we have described, with particular attention given to the following questions:

1. What definition of liquidation or partial liquidation should the Commission use?
2. What significance should the Commission place on the source of contributions to the value of the property sold, including the initial capital investment, the payment of carrying

costs, and other financial support given to the property while it was in rate base?

3. What should be the appropriate accounting for liquidations?

4. What is the effect on a utility's ability to attract capital if the gain is allocated to ratepayers? What has been the effect, for example, of our prior decision in City of Redding on PG&E's securities?

5. What, if any, risks should the Commission consider in balancing risks and rewards between ratepayers and shareholders (e.g., risk of loss of original capital investment? risk of loss of increased value?).

6. Should the analysis of risks be retrospective or prospective? Should we consider who has borne the risks or who bears them at the time of the sale and after the sale?

7. What should be the ratemaking treatment of a gain realized in a transaction which meets the adopted definition of a liquidation, whether partial or total? By way of comparison, what treatment is accorded such transactions in other jurisdictions?

8. On what basis could the gain be allocated between ratepayers and shareholders?

The results of this proceeding will be effective prospectively and will not modify prior decisions. We will continue to abide by the rule against retroactive ratemaking. (Pacific Telephone and Telegraph Co. v. Public Utilities Commission (1965) 62 Cal. 2d 634.)

Further, this proceeding should not be relied on in the disposition of other applications filed with the Commission involving a gain on sale, unless the facts fit substantially within the prescribed circumstances set forth in Ordering Paragraph No.1.

THEREFORE, IT IS ORDERED that:

1. Pursuant to Rule 14.2 (c) of the Commission's Rules of Practice and Procedure, a rulemaking proceeding be instituted to solicit comments on the proper disposition of gains realized upon

the sale of property by a utility within the regulatory jurisdiction of the Commission when:

- a. the property sold comprises a distribution system;
- b. the distribution system consists of part or all of the utility operating system ("system") within a geographically defined area;
- c. the components of the system are or have been included in the rate base of the utility; and
- d. the sale of the system is concurrent with the utility being relieved of and the municipality or other public agency assuming the public utility obligations to the customers within the area served by the system.

2. All gas, electric and water public utilities subject to the jurisdiction of the Commission are made respondents to this proceeding and are invited to present their comments.

3. All other interested parties are also invited to comment on the subject of this proceeding.

4. Pursuant to Rule 7 of the Commission's Rules of Practice and Procedure, an original and twelve copies of each party's comments shall be filed with the Docket Office of the Commission no later than 40 days after the effective date of this Order Instituting Rulemaking.

5. After the filing deadline, the assigned Administrative Law Judge shall serve commenting parties with a list of commentors.

6. No later than 10 days after the date that the list of commentors is mailed, all parties who filed comments shall serve their comments on all other commenting parties.

7. No later than 30 days after the date that the list of commentors is mailed, any commenting party may file with the Docket Office an original and twelve copies of a response to the comments of other parties.

8. The Executive Director shall cause a copy of this Order Instituting Rulemaking to be sent by regular mail to:

- a. all gas, electric and water public utilities subject to the jurisdiction of the Commission,

- b. the service list of Application No. 88-02-034 (the pending Application of PG&E), and
- c. the service list of Application 83-04-37 (the City of Redding case, D.85-11-018, modified by D.86-02-056).
- d. the service list of Application 85-12-050 (PG&E's last test year rate case).

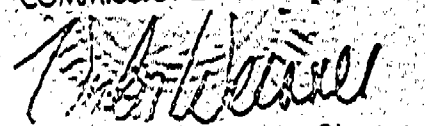
This Order is effective today.

Dated November 23, 1988, at San Francisco, California.

STANLEY W. HULETT  
President  
FREDERICK R. DUDA  
G. MITCHELL WILK  
JOHN B. OHANIAN  
Commissioners

Commissioner DONALD VIAL abstained

I CERTIFY THAT THIS DECISION  
WAS APPROVED BY THE ABOVE  
COMMISSIONERS TODAY.

  
Victor Weisser, Executive Director

AS