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Decision 92-02-036 February 5, 1992

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Pacific Bell (U-1001-C), a corporation, for authorization to increase rates due to the adoption of generally accepted accounting principles for compensated absence expenses.

ORIGINAL

Application 90-11-031
(Filed November 19, 1990)

ORDER MODIFYING DECISION 91-10-018 AND DENYING REHEARING

Pacific Bell has filed an application for rehearing of Decision (D.) 91-10-018 (the Decision), in which the Commission denied Pacific Bell's request to increase its rates by approximately $282 million, plus interest, to reflect its projected 1988 compensated absence expense. The Division of Ratepayer Advocates and Toward Utility Rate Normalization have filed responses in opposition. We have carefully considered all of the issues and arguments raised in the application for rehearing and the responses and are of the opinion that sufficient grounds for granting rehearing have not been shown. We will, however, modify the Decision to further explain our reasons for denying Pacific Bell's application to increase rates.

Pacific Bell has attached to its application for rehearing opinion letters it obtained from five major accounting firms about the issue in this case, as well as Pacific's letter soliciting those opinions. Pacific concedes, as it must, that these letters are not now part of the record in this case. Thus, the Decision did not err by failing to consider them.

As we have previously admonished Pacific Bell when it attempted to introduce new evidence in an application for rehearing: "Parties have an obligation to introduce their

evidence at an appropriate point in the proceedings." (D.87-04-078, mimeo at 2.) Moreover, "[a]n application for rehearing is not an appropriate vehicle for attempting to introduce new evidence." (D.88-12-101, General Telephone, mimeo at 2.)

Nor do the letters that Pacific Bell has submitted show any good cause for reopening the proceeding to receive them in evidence. (Compare Rule 84 of the Commission's Rules of Practice and Procedure (Petition to Set Aside Submission prior to Decision).) These letters merely repeat the position already taken in the proceeding by Pacific Bell's witnesses, including Mr. Hetler. The Decision, as modified today, agrees with Pacific that Mr. Hetler's testimony should be considered on its merits. However, as explained in our modified Decision, we find the position taken by Mr. Hetler and Pacific Bell's other witness unconvincing. Even if the letters Pacific has attached to its application for rehearing were introduced into evidence, they would be unconvincing when weighed against the contrary evidence referred to in our modified Decision. Moreover, it appears that the five accounting firms whose opinions Pacific solicited were not aware of certain important aspects of Pacific Bell's vacation policy. As explained in our modified Decision, these aspects of Pacific Bell's vacation policy further support our conclusion to deny Pacific Bell's application to increase rates.

None of the other issues raised by Pacific Bell in its application for rehearing require further discussion at this point. We will address them in our modifications to the Decision.

Therefore, good cause appearing,

IT IS ORDERED that D.91-10-018 is modified as follows:

1. The first sentence under the heading "Issue" on page 4 is modified to read:

> The issues in this proceeding are whether Pacific Bell's projected 1988 compensated absence impact satisfies the GAAP requirements for booking as a 1987 liability,

and whether Pacific Bell is entitled to recover such cost pursuant to D.87-12-063.

2. In the third sentence in the first paragraph on page 7, a comma is inserted immediately following the word "increments" the first time that word appears.

3. The second sentence in the third paragraph on page 9 is modified to read:

> Therefore, we review Pacific Bell's written administrative instructions, as well as testimony about how Pacific Bell administers vacation, to determine its vacation policy.

4. The second sentence in the first paragraph on page 10 is deleted.

5. The following language is added at the end of the second paragraph on page 10:

> Thorne also testified that the intent of the SI (which he did not draft) is to say that an employee becomes eligible on January 1st for the full amount of the employee's vacation for that year, and will not become eligible for any additional vacation during that year. While the SI does say that, it says more than just that.

6. The fourth paragraph on page 10 is replaced by the following:

> The way in which Pacific Bell grants vacation to its newer employees supports the statement in SI No. 106 that where an employee "becomes eligible for 2 weeks vacation beginning in January 1988. The two-weeks vacation is actually vacation to be earned in 1988." In other words, Pacific Bell's actual practice in granting vacation supports the conclusion that employees are granted vacation on January 1 of each year for work to be performed during that calendar year.
>
> Pacific Bell's witness Thorne testified about a hypothetical Pacific Bell employee who began work on January 1, 1987. Consistent

with Pacific Bell's vacation policy, after six months employment the employee was able to take one week of vacation. After the second six months employment -- at the end of 1987 -- the employee could take another week of vacation. Then, on January 1, 1988 the employee was granted an additional two weeks vacation time. And, on January 1, 1989, the employee was granted yet another two weeks of vacation.

According to Pacific Bell, the two weeks the employee received in 1987 plus the two weeks granted on January 1, 1988, (a total of 4 weeks) were all earned in and attributable to 1987, the first year of employment, while only the two weeks granted on January 1, 1989 were earned in and attributable to work during 1988. This does not make sense, that an employee earns more vacation time during the employee's first year of employment than during later years. It is much more reasonable to conclude, as does SI No. 106, that the vacation granted on January 1, 1988, was vacation "to be earned" during 1988; in other words, that the vacation time granted on January 1, 1988 was attributable to work the employee was expected to perform during 1988. Under this more plausible analysis, the above employee earned two weeks vacation during each of the employee's first three years of employment.

There was also testimony about an actual Pacific Bell employee who began work on April 1, 1986. This employee, as an upper-level manager, was granted 4 weeks of vacation time during 1986, the manager's first year of employment. The manager was also granted an additional 4 weeks vacation during 1987. From this pattern it becomes clear that the further vacation granted the manager on January 1, 1988 was attributable to work the manager was expected to perform during 1988, not to work already performed for which the manager had already received 4 weeks vacation per year. And no matter how many years this manager continues in Pacific Bell's employ, the vacation granted the manager on January 1 of each year will continue to be the vacation earned in and attributable to work expected to be performed during that year, not

vacation earned in the previous year and attributable to work already performed.

The above-cited examples, as well as other testimony about how Pacific Bell administers its vacation policy, show that Pacific Bell's actual practice in granting vacation is to grant its employees vacation on January 1 of each year for work to be performed during the remainder of the calendar year, and not to grant its employees vacation on January 1 for work already rendered. The fact that that is Pacific Bell's vacation policy is further substantiated by Pacific Bell's written SI No. 106 policy, its lack of an AI vacation policy, and the presence of written union contracts which adopt Pacific Bell's vacation policy as spelled out in SI No. 106.

7. The last two sentences in the first partial paragraph at the top of page 11 are replaced by the following:

On the other hand, Pacific Bell's written instructions state that employees earn vacation at the beginning of the year for work to be performed during that year. There is no contradiction between the material in Appendix A on which Hetler relies and Pacific Bell's written policy. As explained above, the vested vacation rights Pacific Bell employees receive each January 1 are based on service expected to be rendered in that year, they are not based on service rendered in the preceding year.

Hetler's testimony also ignores an important part of the example from Appendix A on which he relies. Paragraph 12, Appendix A of SFAS No. 43 states, in pertinent part:

> if new employees receive vested rights to two weeks' paid vacation at the beginning of their second year of employment with no pro rata payment in the event of termination during the first year, the two-weeks' vacation would be considered to be earned by work performed in the first year and an accrual for vacation pay would be required for new employees during their

first year of service . . . (Emphasis added.)

The above example makes sense. If an employee receives no vacation in the event the employee leaves during the first year of employment, it seems reasonable that the vacation granted at the beginning of the second year of employment is in return for the work already performed during the first year. However, at Pacific Bell, contrary to the above example, employees who leave during their first year of employment do receive pro rata payment for vacation pay earned during that partial year. (Indeed, even Pacific Bell employees who do not leave during their first year of employment, receive vacation during their first year.) In short, the above example is simply not applicable.

Moreover, the point of Paragraph 12 seems to be that rights need not be vested in order to be accrued. The point of that paragraph is not, as Pacific Bell would have us believe, that all vested rights necessarily relate to service already rendered and therefore require prior accrual. For all the above reasons, Hetler's testimony -- that GAAP requires the vacation Pacific Bell grants on January 1 to be accrued during the preceding year -- is not convincing.

8. The first full paragraph on page 11 is replaced by the following:

According to Hetler, in instances where there is controversy, or ambiguity exists in the accounting literature, Coopers & Lybrand's local office consults with a partner in its national research group in New York. In this particular instance, Hetler's firm did consult with the national office to confirm that Pacific Bell's vacation policy meets the statement criteria. However, Hetler did not know what Pacific Bell documents his national office reviewed prior to expressing its opinion. Absent testimony regarding the underlying documents that Coopers & Lybrand's national office relied on, we place very little weight on Hetler's consultation with his national office.

> Pacific Bell contends that just because its employees were not required to work beyond January 1, 1988 in order to be paid for the vacation granted them on that date, the vacation was attributable to work already performed. Pacific Bell focuses on only one aspect of its vacation policy and ignores all other aspects. In light of all the evidence presented about Pacific Bell's vacation policy -- including Pacific's written instructions and testimony about its actual practice in granting vacation time -- we find that the overwhelming weight of the evidence establishes that the vacation granted Pacific Bell's employees on January 1, 1988 was attributable to work expected to be performed in the future.

9. The first sentence in the last, partial paragraph at the bottom of page 11 is replaced by the following:

> It has never been our intention to allow a utility to recover through rates projected vacation costs prior to the time that services are expected to be rendered. This is consistent with the requirements of SFAS No. 43.

10. The following language is added on page 12 immediately above the heading "Request for Finding of Eligibility":

> Pacific Bell argues that by denying recovery of its projected 1988 compensated absence expense, we will return its accounting for vacation pay to a cash basis. That is not true. Under cash basis accounting, vacation pay is not booked until the vacation is taken. However, by Resolution F-627, we permitted Pacific Bell to recover the cost of vacations earned, but <u>not yet taken</u> by the end of 1987. As explained above, GAAP requires no more.

11. A new Finding of Fact No. 2A is inserted on page 15 following Finding of Fact No. 2.

> 2A. Pacific Bell's projected 1988 compensated absences expense represents

Pacific Bell's cost of employees' vacation vested on January 1, 1988.

12. A new Finding of Fact No. 7A is inserted on page 15 following Finding of Fact No. 7.

7A. Pacific Bell's vacation policy can be established by reference to its written SI instructions, its lack of an AI vacation policy, the presence of written union contracts which adopt Pacific Bell's vacation policy as spelled out in SI No. 106, and its actual practice in granting vacation to its employees, including newer employees.

13. Finding of Fact No. 11 on page 15 is modified to read:

The way in which Pacific Bell grants vacation to its newer employees shows the accuracy of the statement in SI No. 106: that where an employee "becomes eligible for 2 weeks vacation beginning in January 1988. The two-weeks vacation is actually vacation to be earned in 1988."

14. The following Findings of Fact are inserted on page 15 following Finding of Fact No. 11:

11A. Pacific Bell's actual practice in granting vacation shows that employees are granted vacation on January 1 of each year for work expected to be performed during the remainder of that calendar year, not for services already rendered.

11B. The vacation granted on January 1 is <u>not</u> earned in and attributable to employment during the previous year. <u>If</u> that were the case, employees would earn more vacation time during their first year of employment than during later years, which does not make sense.

11C. The example contained in Paragraph 12, Appendix A of SFAS No. 43 does not apply to Pacific Bell's situation. Contrary to that example, Pacific Bell employees who leave during their first year of employment do

receive pro rata payment for vacation pay earned during that partial year.

11D. The overwhelming weight of the evidence establishes that the vacation granted Pacific Bell's employees on January 1, 1988 was attributable to work expected to be performed during 1988.

11E. There was conflicting expert testimony about the proper accounting treatment of the vacation granted to Pacific Bell employees on January 1, 1988.

11F. Because the vacation granted to Pacific Bell employees on January 1, 1988 was not "attributable to employees' services already rendered," pursuant to SFAS No. 43 the cost of that vacation should not have been accrued during 1987.

11G. Pacific Bell's projected 1988 compensated absence expense should not have been booked as a liability before the end of 1987, and therefore is not properly a part of Pacific Bell's embedded compensated absences liability as of December 31, 1987. Accordingly, the Commission's prior decisions do not authorize an increase in Pacific Bell's rates to recover its projected 1988 compensated absence expense, and there is no justification for such a rate increase.

15. The following sentence is added at the end of Finding of Fact No. 12 on page 16:

This is consistent with SFAS No. 43.

IT IS FURTHER ORDERED that:

16. Rehearing of D.91-10-018 as modified herein is denied.

This order is effective today.

Dated February 5, 1992, at San Francisco, California.

DANIEL Wm. FESSLER
President
JOHN B. OHANIAN
PATRICIA M. ECKERT
NORMAN D. SHUMWAY
Commissioners

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

NEAL J. SHULMAN, Executive Director