

L/ltg

Decision 92-04-080 April 22, 1992

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application for Rehearing of
Resolution T-14668, effect of certain } Application 92-01-038
tax law changes on Pacific Bell's costs. } (Filed January 22, 1992)

ORDER DENYING REHEARING OF RESOLUTION T-14668

Pacific Bell (Pacific) has filed an Application for Rehearing of Resolution T-14668 contesting the legality of the Commission's denial of recovery of the investment tax credit ("ITC") and excess deferred tax ("EDT") phase-outs as "Z" factor adjustments as requested in its 1992 Price Cap Advice Letter. "Z" factor adjustments are defined in the Commission's decision that adopted the New Regulatory Framework for Pacific, D.89-10-031, 33 CPUC 2d 43¹ as follows:

"The indexing formula also allows for rate adjustments for a limited category of exogenous factors whose effects will not be reflected in the economywide GNP-PI. While all such costs cannot be foreseen completely, we recognize that the following factors may be reflected in rates as exogenous factors [called Z-factors]: changes in federal and state tax laws to the extent that they affect the local exchange carriers disproportionately, mandated jurisdictional separations changes, and changes to intraLATA toll pooling arrangements or accounting procedures adopted by this Commission." (D.89-10-031, supra, p.182.) Emphasis added.

1. Hereafter D.89-01-031, 33 CPUC 2d 43 will be referred to as D.89-01-031.

Pacific contends that the Resolution is "unlawful" because the Commission's denial of the recovery of the effects of ITC and EDT phase-outs as "Z" factor adjustments is arbitrary and capricious. Pacific asserts that D.89-10-031's definition of "Z" factor adjustments should be interpreted to include exogenous events causing cost changes that arose prior to the institution of the New Regulatory Framework but which have had continuing effect after the framework was put in place. Pacific contends that the ITC and EDT phase-outs are just the type of exogenous events causing cost changes that are beyond management's control and therefore, should receive "Z" factor recovery. In its Application for Rehearing, Pacific also alleges that the Resolution's treatment of the ITC and EDT phase-outs is inconsistent with prior Commission actions and with the treatment of similar items in the Resolution. Finally, Pacific asserts that by denying recovery the Resolution has significantly altered the Commission's adopted criteria for "Z" factor treatment without giving Pacific notice and an opportunity to be heard in violation of Pacific's right to due process, and in violation of Public Utilities Code Section 1708.

Pacific's Application for Rehearing provides the Commission with the opportunity to clarify further the definition of a Z-factor, and the criteria the Commission applies when including a Z-factor in a price cap adjustment. There are two basic requirements which every Z-factor must meet: That the event is exogenous, or beyond management control; and that the event disproportionately affects telephone utilities. In addition, Pacific has raised a further question which is settled in this case: Whether exogenous events which occurred before the adoption of NRF can qualify as new Z-factors.

Pacific maintains that when the Commission in D.89-10-031 used the phrase "changes in federal and state tax laws" (p. 182) the Commission referred both to past and prospective events. Pacific argues that if this is not the case

then the Commission is in effect modifying D. 89-10-031 without hearings and an opportunity to be heard. Pacific implies that they were misled by this phrase to think that both past and future changes were included. Pacific supports its interpretation of this phrase by pointing to the acceptance by the Commission of other Z-factors (the USOAR rewrite, station expensing) which occurred prior to the adoption of NRF and yet are carried forward as Z-factors. Pacific buttresses its argument by stating that the Commission implicitly applied their interpretation in accepting these other pre-NRF Z-factors.

In fact, the phrase "changes in federal and state tax laws" does not carry with it any intrinsic meaning of both "past and future" changes. We disagree that there is any inconsistency in treatment in the Resolution. It is illogical to think that the Commission could look backward and identify every past change in a tax law which might have repercussions today.

The evidence which Pacific cites belies this interpretation. The Z-factors granted in the Resolution (USOAR rewrite, station expensing) were singled out in the NRF decision for special treatment. If in fact Z-factors are intended to include all past and present events which may have an effect on future rates, then it would not have been necessary for the Commission to single out those other items for specific treatment in the NRF decision. Those items would have been covered already by the Z-factor description. In fact, since the Commission did single out these items for separate treatment, far from supporting Pacific argument the Commission's action argues against the company's position. The Commission made an exception for these items because they were otherwise NOT covered by the Z-factor rule. This fact underscores the interpretation that the phrase "changes in federal and state tax laws" does not include "past and future changes" but applies only to exogenous events which occurred after the implementation of NRF.

Pacific argues for consistency between the effects of other pre-NRF events and the effects of TRA-86. But the Z-factors granted in the Resolutions were identified and set apart in the 1990 NRF decision for adjustments into the future. There is no corresponding Commission order requiring adjustments for ITC/EDT phase-outs as a result of TRA-86.

The Commission may not make adjustments for some past events with future consequences and not others. To do that would constitute an inconsistency, but that is not the instant case.

The second facet to the argument concerns the phrase itself - "changes in federal and state tax laws". The word "changes" implies a change from the status quo. When NRF was adopted, TRA-86 was already in effect. To allow a Z-factor as defined by the order, some change from TRA-86 should have occurred. There have been no tax law changes since the order was adopted. Pacific is essentially reacting to changes in its tax bill as a result of existing tax laws. This goes well beyond the description of a Z-factor.

Given this, Pacific wants what amounts to a modification of D. 89-10-031. DRA argues that such a modification should not occur without holding hearings given the inconsistent and controversial methodologies used by Pacific. This position is consistent with the Commission's own position in D.89-10-031 when it said:

"If future cost changes are known with a high degree of certainty, we would be willing to consider inclusion of such cost changes on a forecasted basis we expect local exchange carriers to defer requesting that such changes be recognized in rates until their magnitude can be determined with reasonable certainty and minimal controversy". (Emphasis added.)
D.89-10-031, supra, p. 236.

Therefore, if we were to determine that D. 89-10-031 should be modified to include the effects of TRA-86, notice would have to be given to all interested parties and hearings held.

The second question under consideration is whether or not TRA-86 changed costs for all businesses and therefore its effects are captured in the "normal cost of doing business". Even tax changes which occur after the adoption of NRF do not qualify as Z-factors if these tax changes do not disproportionately affect telephone utilities.

The Commission anticipated in D. 89-10-031 that not every tax law change would be a Z-factor. A key example is the sales tax change which was denied recovery in the Resolutions. This tax law change occurred after NRF, but is not a Z-factor. Pacific did not petition to rehear denial of recovery for sales tax increases. Pacific should recognize the similarity between the three tax issues dealt with in the Resolution, and the consistent logic which denied each recovery request.

Across the board changes in corporate income taxes, sales taxes, state taxes, etc., do not disproportionately affect telephone corporations. These changes affect all companies as part of the normal cost of doing business. As a result, changes in EDT or ITC which affect every corporation are not exogenous factors unique to telephone utilities and therefore would not be considered as Z-factors even if those tax law changes had occurred after 1990.

Given that the Resolution's denial of Z-factor recovery is consistent with the Z-factor criteria decided on in D.89-10-031, Pacific's due process rights have not been violated. We find no legal error, but find instead that Pacific is arguing policy questions. Pacific's Application for Rehearing should be denied.

We have reviewed each and every allegation of error in the Application for Rehearing and believe that no grounds for rehearing are set forth. Having fully considered the issues raised by Pacific, we will deny the Application for Rehearing.

WHEREFORE,

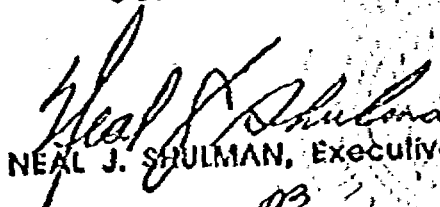
IT IS ORDERED that Pacific's Application for Rehearing of Resolution T-14668 is denied.

This order is effective today.

Dated April 22, 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