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Decision 92-08-046 August 11, 1992

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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Southern California Water Company for authority pursuant to Public Utilities Code Section 851 to sell, and, if necessary, lease back its headquarters property in Los Angeles, California (U 133 M)	}	Application 88-12-020
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ORDER DENYING REHEARING OF DECISION (D.) 92-03-094

An application for rehearing of D.92-03-094 has been filed by Southern California Water Company (SoCalWater). In D.92-03-094 issued April 6, 1992, the Commission concluded that SoCalWater's decision to sell and lease back its Old General Office for a limited time was reasonable, as were the terms of that sale and the interim leaseback. The primary contested issues in that proceeding concerned the allocation between ratepayers and shareholders of the gain-on-sale of the old headquarters and the question of rate recovery for the revenue requirement deficiency. The Commission determined that due to retroactive ratemaking considerations, SoCalWater would not be allowed rate recovery of the revenue requirement deficiency arising from the undercollection of revenues associated with the leaseback and the undercollection of revenues due to the differences in costs between its old and new offices. The gain-on-sale was allocated in accordance with the "enduring enterprise" principle.

In its application for rehearing, SoCalWater asserts that the decision is in error with respect to the conclusions relating to gain-on-sale and the treatment of the revenue

requirement deficiency. We have considered all the allegations of error in the application and the response filed by the Division of Ratepayer Advocates (DRA) and are of the opinion that good cause for granting rehearing has not been demonstrated.

The first allegation set forth by SoCalWater relates to its request for an adjustment in its revenue requirement to account for a revenue requirement deficiency. This deficiency is made up of two components. The first is the amount associated with the memorandum account SoCalWater was ordered to maintain by D.89-04-079. By that interim decision we ordered the utility to track the ownership cost revenues collected and the actual costs incurred with regard to the leaseback. The second component of the revenue deficiency consists of the dollars associated with the ownership cost differential between the New General Office and the Old General Office. In May, 1990, as it began occupation of its new facilities, SoCalWater began incurring ownership costs, associated with its New General Office and other production and warehouse facilities. However, until the effective date of D.92-03-094, in March, 1992, SoCalWater continued to collect in Commission-authorized rates, the revenues associated with ownership of the Old General Office. This delay in inclusion in rate base of the New General Office and other facilities has resulted in a revenue deficiency for SoCalWater, which is now at issue.

In D.92-03-094, we denied relief for the revenue deficiency associated with the ownership cost differential between the New General Office and the Old General Office on the basis of retroactive ratemaking considerations. In its application for rehearing, SoCalWater argues that our decision constitutes an erroneous application of the principles prohibiting retroactive ratemaking. We have concluded, upon reconsideration, that SoCalWater's arguments should be rejected.

It is well established that ratemaking is done on a prospective basis. The specific bar against retroactive ratemaking stems from the clear and unambiguous language of Public Utilities Code § 728. As stated therein:

"Whenever the commission, after a hearing, finds that the rates... demanded, observed, charged, or collected by any public utility for or in connection with any service, product, or commodity... are insufficient, unlawful, unjust, reasonable,... the commission shall determine and fix, by order, the just, reasonable, or sufficient rate... to be thereafter observed and in force."
(Emphasis added.)

The California Supreme Court has repeatedly affirmed the prohibition against retroactive ratemaking (see, e.g., PT&T v. PUC (1965) 62 Cal. 2d 634; City of Los Angeles v. PUC (1972) 7 Cal. 3d 331).

As we set forth clearly in D.92-03-094, there are several established regulatory procedures available for a utility to recover its ownership costs for new plant additions in response to the interregnum that frequently exists between a utility's expenditure of funds and the Commission's formal action to recognize those expenditures in rates. Either the costs can be estimated in a rate case before the new plant goes into service and rates authorized prospectively, or the Commission can grant advance authorization for the utility to book these ownership costs into a memorandum or balancing account for later recovery, after any necessary review of the reasonableness of the costs. The Commission's consistent practice is not to authorize increased utility rates to account for previously incurred expenses, unless, before the utility incurs those expenses, the Commission has specifically authorized the utility to book those expenses into a memorandum or balancing account for possible future recovery in rates.

In the instant case, as we have already discussed in D.92-03-094, SoCalWater failed to avail itself of either of these

regulatory procedures: More specifically, the utility failed to seek authorization to book these costs in a memorandum account. On rehearing, SoCalWater argues that the Interim Decision was the substantive equivalent of the establishment of such an account. This argument can be summarily dismissed. The Interim Decision authorized the sale and temporary leaseback of the old headquarters and deferred all ratemaking consequences to a second phase. It did not, however, authorize the utility to book these costs into an account for possible later recovery. This difference is critical. With the use of a memorandum account, claimed revenue requirements are booked as they are incurred, pursuant to Commission authorization. Without such an account, SoCalWater had no basis for recovery of such past expenses.

SoCalWater further argues that it was its understanding as well as the understanding of the CACD staff that deferral of ratemaking treatment was accompanied by a preservation of its right to seek later recovery for this revenue deficiency. This argument can also be rejected. Whatever this understanding was, it is not determinative of the underlying legal issue now presented. Establishment of a memorandum account would have preserved SoCalWater's right to seek later recovery.

The second main argument raised by SoCalWater in its application for rehearing disputes the Commission's treatment of the gain-on-sale of the Old General Office. We concluded in D.92-03-094, relying on the principle of the "enduring enterprise," that the gain-on-sale from this transaction should remain within the utility's operations, rather than being distributed in the short run directly to either ratepayers or shareholders. This principle, foreshadowed by the 1989 Redding decision (32 CPUC 2d 233; D.89-07-016), provides that any gain-on-sale should remain within a utility's operations, to the extent that the asset liquidated is replaced with another asset or obligation, while at the same time the utility's obligation is neither relieved nor reduced. Applying this principle to the

instant case, the Commission concluded that the gain-on-sale should remain in SoCalWater's utility operations to the benefit of ratepayers as long as the utility's obligations exist. In order to implement this policy, SoCalWater was ordered to apply the net after-tax gain-on-sale against its rate base.

SoCalWater argues in its application for rehearing that rather than using the "enduring enterprise" theory, the Commission should rely on the language of D.90-11-031, in which shareholders were allocated a portion of the gain-on-sale resulting from the sale of the headquarters of Southern California Gas Company. This argument should also be rejected. As we expressly stated in D.90-11-031, an allocation of gain-on-sale between ratepayers and shareholders was warranted due to case-specific circumstances. In the Southern California Gas Company decision the Commission warned against mechanistic repetition of the results of that case and emphasized that the issue should be approached on a case-by-case basis. SoCalWater has failed to show that in the instant case, we are compelled to follow the allocation adopted in D.90-11-031.

The issue of the proper ratemaking treatment of the gain from the sale of SoCalWater's headquarters has been extensively covered in testimony, briefs, and in our discussion in D.92-03-094. SoCalWater has failed to point to any factual or legal error regarding our determination. We conclude that we did not err in our treatment of the gain-on-sale.

We have considered all the allegations of error in the application and are of the opinion that good cause for rehearing has not been demonstrated.

A.88-12-020

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THEREFORE, IT IS ORDERED that rehearing of D.92-03-094
is denied.

This order is effective today.

Dated August 11, 1992 at San Francisco, California.

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

Commissioner John B. Ohanian,
being necessarily absent, did
not participate.

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


NEAL J. SHULMAN, Executive Director