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Decision No. 90315 MAY 22 1979

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's own motion into the effect of the enactment of the Revenue Act of 1978 on the rates of the California public utilities and transportation companies subject to the ratemaking power of the Commission named in Appendices A and B attached hereto.	OII No. 33 (Filed December 12, 1978)

(For appearances see Appendix A.)

INTERIM OPINION

This Order Instituting Investigation (OII) was issued for the purposes of determining the effect of the Revenue Act of 1978 on the federal corporate income taxes allowable for rate-making purposes, and the corresponding effect, if any, which said Act should have upon rates set by the Commission and charged by the respondents to the public.

On November 7, 1978, President Carter signed into law HR-13511, the Revenue Act of 1978 (or "the Revenue Act"). HR-13511 became effective on January 1, 1979. The Revenue Act reduces the federal income tax rates assessed on corporations, including companies regulated by the California Public Utilities Commission.

Certain public utilities and pipeline companies listed on Appendices A and B to OII No. 33 were made respondents. The respondents listed in Appendix A thereto (except The Pacific Telephone and Telegraph Company (PT&T)) and the communication companies listed in Appendix B are utilities which had no rate proceedings on file and awaiting decision as of December 12, 1978, or had not been authorized step rate increases in recent decisions. The utilities specifically excluded as respondents were listed in Appendix C to the OII.

On or before December 22, 1978, each respondent listed on Appendix A was ordered to file with the Commission a report setting forth the estimated amount of the reduction, pursuant to the Revenue Act of 1978, of federal corporate income taxes last adopted by the Commission in the decision or resolution setting the present rates. The report also was required to include a calculated rate reduction based on the method set forth in Appendix D. Complete working papers supporting all calculations were required to be made available to the staff concurrently with the filing of such reports. Each respondent listed in Appendix A was encouraged to file by December 27, 1978, an advice letter requesting a rate reduction, to become effective on January 1, 1979, reflecting reductions in federal income taxes presently included in rates. The rate reductions were to conform to the standards set out in Appendix D.

Ordering Paragraph 9 directed that after January 1, 1979, all rates collected by respondents to cover federal corporate income tax expenses shall be collected subject to refund, rate adjustment, or balancing account treatment pending further order of the Commission.

Duly noticed public hearings were held before Administrative Law Judge Mallory in San Francisco on January 22, and February 15, 16, and 21, 1979, and the matter was submitted subject to the filing of concurrent briefs.

Evidence was presented by the Commission staff (staff), by Pacific Power and Light Company (PPL), Pacific Gas and Electric Company (PG&E), and General Telephone Company of California (General). Motions to be dismissed as a respondent in the proceeding were filed by PPL, Southern Pacific Pipeline Company (SPPL) and San Diego Pipe Line Company (SDPL). In addition, Standard Pipeline Company (Standard) presented in Exhibit 4 an income statement indicating that no federal income taxes were incurred by Standard in 1977 and 1978.

Communication Utilities

Staff Exhibits 2, 8, and 9 concern communication utilities. PT&T is named as a respondent in Appendix A to OII No. 33 and, as such, was directed to furnish a report stating the estimated reduction of federal income taxes resulting from the Revenue Act of 1978 based on the federal income computation adopted as reasonable in PT&T's last general rate proceeding (Decision No. 88232 dated December 13, 1977, in Application No. 55492). PT&T also was directed to revise its station-to-station statewide toll rate schedule to produce a reduction in revenues equal to the estimated tax savings. The telephone companies named as respondents in Appendix B to OII No. 33 were directed to file a concurrence in the toll rates filed by PT&T, or file written reasons for not concurring.[1/] For those telephone utilities whose toll rate settlement reduction would exceed their intrastate federal corporate income tax reduction, the difference in revenues may be made up by an appropriate advice letter filing to increase service connection charges.

1/ Those respondents named in Appendix B to the OII which have a standing toll rate concurrently on file are not required to file a concurrence by the order in OII No. 33.

PT&T advised the staff that it would experience an increase in the employer's share of Social Security (FICA) taxes concurrently with the federal corporate tax reduction, and asked the staff to give consideration to the FICA tax increase as an offset to the federal income tax reduction.

Staff Exhibit 2 contains the following computations showing the effect of toll rate reductions:

Company	Federal Tax Rate Reduction - Only	Federal Tax Rate Reduction And Social Security Increase
	(Dollars in Thousands)	
Pacific Telephone	$14,297	$ 8,246
General Telephone	4,012	2,314
Continental Telephone	760	438
All Others	409	236
Total	$19,478	$11,234

PT&T and the independent telephone utility respondents objected to the filing of rate reductions at this time. Staff Exhibit 2 contains the following recommended alternatives for the Commission to consider to ensure that ratepayers receive the benefits of the federal tax revisions:

(a) An immediate toll rate decrease. The Commission would determine PT&T's revenue requirement in its disposition of PT&T's current request for increased rates in Application No. 58223 (PT&T's current general rate increase application). The revenue windfall collected between January 1, 1979, and implementation of the toll rate decrease would be returned to the ratepayers in the form of a one-month negative surcharge (credit) applicable to the intrastate message toll charges for that month.

(b) No rate reduction until disposition of Application No. 58223. Any overcollection in toll revenues from January 1, 1979, would be passed through to the ratepayers in the form of a one-month negative surcharge (credit) as in (a) above.

We will adopt the second alternative. The record is complete in Application No. 58223, and the Commission's Regulatory Lag Plan anticipates a decision will be issued by July 14, 1979. The data submitted therein gives effect both to the income tax and FICA tax changes effective January 1, 1979. Alternative rate spread proposals were submitted by our staff in that proceeding which deal with the subject matter under consideration herein. Full consideration can be given to federal income reductions (and FICA tax increases) in Application No. 58223 in the context of all other pertinent rate setting considerations. Any windfall overcollections also can be dealt with in the rate levels established therein without undue delay and without adverse effect on telephone utility customers or prejudice to the independent telephone utilities named in Appendix B of the OII.

In view of our conclusions stated above, that portion of OII No. 33 dealing with telephone utilities will be consolidated with Application No. 58223 and OII No. 21 for consideration therein.

Energy and Water Utilities

The majority of the utilities named as respondents in Appendix A of the OII have voluntarily placed into effect, by advice letter, the rate reductions contemplated in OII No. 33. These utilities and other utilities which should have been excluded in this proceeding as well as those which have indicated their intent to comply with the provisions of this OII are listed in Appendix B hereto. Those utilities who have not done so are listed in Appendix C hereto.

The staff's Exhibit 1 contains the amount of the annual revenue reductions for each of these utilities (or districts) determined in the manner provided in the OII. PPL and PG&E presented evidence in opposition to the reduction in rates contemplated by our order.

Pacific Power and Light Company

PPL, among other things, pointed out that it had attempted to file a formal application in October 1978 requesting a general rate increase on an adjusted historical year basis. PPL's witness testified that PPL was informally advised by the staff that the Commission would consider only a filing based on future test year estimates, and that PPL should revise its application on that basis. PPL presented evidence to show that its current earnings are unsatisfactory to it. PPL contends that historical test year operating results are acceptable as a basis for rate adjustments by all other state and federal jurisdictions under which it operates, and that if a filing prepared on that basis was accepted when offered PPL would have been listed in Appendix C (rather than Appendix A) and would not have had to comply with the order to reduce rates.

PPL was advised in connection with its last rate increase order (Decision No. 87071 dated March 9, 1977, in Application No. 56395) that historical test year expenses may not be accepted in its next general rate increase application; therefore, it was on notice that it should present data on a future test year basis.

PPL also raised the issue of appropriate offsets to the federal tax reduction. The staff agreed that the amount of the increased FICA taxes that became effective concurrently with the tax reduction could be used as an offset. The staff disagreed with the contention of PPL that other changes in expenses mandated by governmental action since the date of its last general increase (Decision No. 87071, supra) also should be used, such as federal and state unemployment taxes, postal rates, federal black lung taxes on coal mining operations, royalty payments on federal coal leases, and severance, extraction, and impact taxes for coal mining

operations.[2/] PPL presented evidence to show that the total annual increased revenue requirement from all of the aforementioned expense increases is $323,000, compared to the $108,000 revenue requirement decrease proposed by the staff as a result of the Revenue Act of 1978.

PPL further contends that it has not earned its allowed rate of return in any quarter since Decision No. 87071 became effective. PPL argues that because the mandated increases documented above exceed the tax reduction, and because it has failed to earn its authorized rate of return, the Commission staff has not sustained the necessary burden of proof to accomplish its recommended rate reduction.

We agree with our staff that only concurrent tax increases should serve as offsets to the tax reduction. PPL's Exhibit 4 shows an FICA offset of $71,000. However, this amount represents the annual effect of accumulated increases in FICA for the years 1975 through 1979. The record does not disclose the annual increase in FICA taxes resulting solely from January 1, 1979, FICA tax revision. The data supplied in Exhibit 4 cannot be used as the appropriate FICA offset on the basis adopted.

Pacific Gas and Electric Company

PG&E's current gas and electric rates were established pursuant to Decision No. 89316 dated September 6, 1978. PG&E presented, in its Exhibit 13, data designed to show that its gas and electric departments have not earned the last authorized rate of return for these departments, and that its earnings would be

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2/ PPL generates electricity in nearby states. The principal energy source for its electric generation is coal.

further decreased if rates were reduced to reflect the federal tax reduction. PG&E urges that other expense items such as negotiated union wage increases be considered as offsets to the tax reduction. In line with our prior discussion only the concurrent FICA tax increase should be an offset to the tax reduction. Special means have been established for the recapture of major expense increases of gas and electric utilities, such as ECAC and GCAC procedures. This proceeding is in the nature of a special procedure for reducing revenue requirements when a major expense item is reduced.

At the suggestion of our staff, the appropriate revenue reductions to offset the federal income tax reduction for PG&E's gas department are being considered in PG&E's current SAM proceeding (A.58470) which is under submission.

The record does not disclose the amount of FICA tax offset to the federal tax income reduction that is appropriate for PG&E's electric department. PG&E will be directed to file appropriate rate reductions for its electric department that reflect the net revenue requirement reduction resulting from the concurrent federal tax reduction and FICA tax increase.

Pipelines

Five pipeline corporations are named as respondents in Appendix A. They were directed in Ordering Paragraph 4 of OII No. 33 to file with the Commission "a report setting forth the estimated amount of the reduction, pursuant to the Revenue Act of 1978, of federal corporate income taxes last adopted by the Commission in the decision or resolution setting the present rates."

The report was also to set forth a calculated rate reduction in cents per barrel. Complete working papers supporting all calculations were required to be made available to the staff concurrently with the filing of said report.

Responses filed by SDPL and SPPL were to the effect that neither of them had had their current rates approved by the Commission in formal rate proceedings; therefore, they could not comply with the directive in Ordering Paragraph 4 quoted above.

The Commission's Transportation Division staff, in Exhibit 3, presented evidence to show the amount of rate reduction resulting from the tax decrease based on financial reports for the year 1977 filed with the Commission.

The staff strongly urged that SDPL and SPPL be ordered to reduce their rates to give effect to the tax reduction. SDPL and SPPL oppose that recommendation on the basis that the order in OII No. 33 specifically provided the manner in which the decreases were to be calculated and no other basis, such as that proposed by the staff, can be used.

Orderly procedure and due process require that an OII be so drawn as to fully inform the respondents named therein of the action contemplated by the Commission and the manner in which that action is to be accomplished. (Constitution of the State of California, Article XII, Section 2.) Failure to properly provide a basis for a reduction in rates with which the pipeline corporations could comply is a deficiency that can only be remedied by the issuance of an amended or a new OII.

Cross-examination of the staff witness indicated a lack of sufficient detail in the financial reports for our staff to properly evaluate the effect of the tax reduction on the pipeline corporations. The staff witness did not make an in-depth study of

pipeline operations and services and was not certain concerning the validity of the financial reports with respect to components of federal and state income tax data included in the financial reports. In general rate increase proceedings we carefully scrutinize the federal income tax component of the expenses adopted in the rate proceeding. That careful scrutiny must be also given to the financial data of pipeline corporations to be used in determining any rate reductions appropriate here. The financial reports of SDPL and SPPL show large accruals for deferred federal and state income taxes. The proper treatment of such tax deferrals for rate-making purposes must be determined in advance of any determination of the amount of rate reduction that should be ordered for those companies.

Should the Commission staff inform us that the necessary detailed analyses of SDPL and SPPL revenues and expenses have been completed, we will consider issuing a new OII for the purpose of determining the effect on the pipeline corporations of the Revenue Act of 1978. We will dismiss those pipeline corporations as respondents in this proceeding.

The three small pipeline companies also should be dismissed as respondents in Appendix A to OII No. 33. There is no current financial report on file for Four Corners Pipe Line Company (Four Corners), as that company's initial tariff was filed effective May 1, 1978. No reduction in rates was proposed for Four Corners by the staff. Standard showed a net loss of $481,000 for the year 1977. No current financial statement is on file for Vallecito Pipeline Company (Vallecito). The tariffs of both Standard and Vallecito became effective more than 20 years ago. Because the rates have remained on file for such a long period, the staff recommended that no rate reductions be ordered for these companies.

Other Respondents

None of the other respondents listed in Appendix A of OII No. 33 offered evidence, although some made statements or filed briefs opposing the action proposed in OII No. 33. Respondents listed in Appendix C are those which have not made advice letter filings, and which will be directed to make such filings based on the annual gross revenue reductions set forth in the staff's Exhibit 1.

FICA Offset

By our directives herein we have authorized, after hearing, specified utilities to offset the annual amounts of federal tax reduction by the amount of the concurrent FICA tax increase. Many of the respondents that submitted advice letter filings in response to this OII did not consider the FICA offset in determining the levels of their reduced rates. We will authorize such respondents to make new advice letter filings which give effect to the concurrent FICA tax increase, subject to staff approval.

In all other respects, our actions in this proceeding parallel those taken in OII No. 19 (see interim Decision No. 90000 issued February 27, 1979). We iterate that this is not a general rate proceeding. We established our jurisdiction over the subject matter of this OII on December 12, 1978, the date of issuance of the OII. The tax reductions which concern us are for the year 1979. We have consistently held that we may reduce rates based on a significant change in a single item of expense in the same manner that we have established procedures for granting rate increases similarly based on a single item of expense.

Findings of Fact

1. With the exception of pipeline corporations, all of the respondents listed in Appendix A to OII No. 33 have filed the report required in Ordering Paragraph 4 of that OII setting forth the estimated amount of the reduction of federal corporate income taxes pursuant to the Revenue Act of 1978 based on the data adopted in the utility's last general rate proceeding. Such calculations have been approved by the staff as set forth in its Exhibit 1 herein.

2. The majority of the respondents listed in Appendix A to OII No. 33 also have voluntarily made advice letter filings requesting a rate reduction to reflect the reduction in federal income taxes presently included in rates.

3. Hearings have concluded in which all respondents and interested parties had opportunity to offer evidence.

4. Several respondents presented evidence in opposition to the rate reductions contemplated in OII No. 33.

5. It is just and reasonable that the federal income tax reductions accruing to respondents named in Appendix A pursuant to the Revenue Act of 1978 should be passed through to ratepayers in the form of lowered rates, except as specified in subsequent findings.

6. The employer's share of the FICA taxes was increased on January 1, 1979. Such increase in FICA taxes should serve as an offset to the concurrent reduction in federal income taxes pursuant to the Revenue Act of 1978.

7. Most respondents described in Finding 2 submitted advice letter filings which were not predicated on the FICA taxes described in the above finding and, thus, the rate reductions are in excess of those found reasonable herein.

8. The deduction of other changes in operating expenses mandated by governmental action which became effective prior to the change in federal income taxes is improper and will not be considered herein.

9. The manner in which OII 33 was drafted and practical considerations militate against pipeline corporations remaining in Appendix A to OII No. 33.

10. For respondents listed in Appendix C hereto the revenue overcollected since January 1, 1979, and the date of implementation of the rate decrease ordered herein is unreasonable and should be refunded to the ratepayers in the form of a one-time negative surcharge (credit).

11. The decrease in rates ordered by this decision is justified and reasonable; the present rates of respondents listed in Appendix C hereto are unjust and unreasonable to the extent they exceed the rates resulting from our order herein.

12. Issues concerning the reduction in federal income taxes pursuant to the Revenue Act of 1978 and the concurrent increase in FICA taxes, as well as changes in intrastate toll rates for PT&T and independent telephone companies, have been raised in PT&T's general rate increase proceeding in Application No. 58223 and consolidated OII No. 21. That proceeding is under submission and a final decision therein is due on or before July 14, 1979, pursuant to our Regulatory Lag Plan (Resolution A-4693).

Conclusions of Law

1. The Commission has ratemaking jurisdiction over each respondent with respect to the Revenue Act of 1978, and the resulting decrease in each utility's federal income tax liability for ratemaking purposes.

2. This is a special proceeding not constituting general ratemaking and is not violative of the rule against retroactive ratemaking. The actions taken herein are consistent with the actions taken in Decision No. 90000 dated February 27, 1979, in OII No. 19.

3. Uniform ratemaking considerations require that the respondents which have not voluntarily filed advice letters reducing rates, as more specifically listed in Appendix C hereto, should be ordered to do so. Such respondents should be authorized to offset the amount of the reduced revenue requirement from the lowered tax rate by the increase in the revenue requirement resulting from the concurrent increase in FICA taxes.

4. Respondents listed in Appendix A to OII No. 33 that have voluntarily reduced rates as a result of advice letters filed before the date of this order should be authorized to refile such advice letters to give effect to increased FICA taxes.

5. Pipeline corporations should be removed from Appendix A to OII No. 33 and a new OII should be issued should our staff advise that it is prepared to proceed.

6. OII No. 33 should be consolidated with Application No. 58223 and OII No. 21 (now under submission) for implementation of rate reductions and revenue credits for overcollections flowing from the Revenue Act of 1978 upon the revenue requirements of PT&T and the telephone corporations listed in Appendix B to OII No. 33.

7. Implementation of rate reductions and revenue credits for over-collections flowing from the Revenue Act of 1978 upon the revenue requirement of PG&E (Gas Department) will be accomplished in the decision in Application No. 58470.

8. The following order should become effective on the date hereof so that the federal tax reductions stemming from the Revenue Act of 1978 can be reflected in utility rates as soon as possible.

INTERIM ORDER

IT IS ORDERED that:

1. Respondents listed in Appendix C to this order shall, within twenty days after the effective date of this order, file tariffs which will reduce their rates to the extent of the amounts shown in Exhibit 1 to this proceeding for such utilities, less the amount of increased employer's share of Social Security (FICA) taxes effective January 1, 1979. The increase in FICA shall be determined on a basis comparable to that used to determine the reduction in federal income taxes, namely, the difference between the adopted test year payroll at the 1978 rate and base and the 1979 rate and base. Such reductions shall be made in the manner designated in Appendix D to OII No. 33.

2. Respondents listed in Appendix A to OII No. 33 that have voluntarily reduced their rates in compliance with OII No. 33 may make new advice letter filings giving effect to the increase in the employer's share of FICA that became effective January 1, 1979, if such advice letters are received within thirty days after the effective date of this order. The increase in FICA should be determined in the same manner as stated in Ordering Paragraph 1 above.

3. Pipeline corporations are deleted as respondents from Appendix A to OII No. 33.

4. OII No. 33 is consolidated with Application No. 58223 and OII No. 21 for implementation of rate reductions and revenue credits for overcollections flowing from the Revenue Act of 1978 on the revenue requirements of The Pacific Telephone and Telegraph Company and the toll rates of that company and the independent companies listed in Appendix B to OII No. 33.

5. The revenue overcollected by the respondents listed in Appendix C hereto since January 1, 1979, and the date of implementation of the rate decrease ordered by Ordering Paragraph 1 above shall be refunded within sixty days from the effective date of this order to the ratepayers in the form of a one-time negative surcharge (credit).

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 22nd. day of MAY, 1979.

President

Commissioners

APPENDIX A

LIST OF APPEARANCES

Respondents: William V. Caveney, for Southern California Water Company; Pillsbury, Madison & Sutro, by Noel Dyer, Attorney at Law, for Standard Pipeline Company; Thomas D. Clarke and David B. Follett, by David B. Follett, Attorney at Law, for Southern California Gas Company; Malcolm H. Furbush, Robert Ohlbach, and Shirley Woo, Attorneys at Law, for Pacific Gas and Electric Company; George M. Galloway, Attorney at Law, and Fredric D. Reed, for Pacific Power and Light Company; Orrick, Herrington, Rowley & Sutcliffe, by Robert J. Gloistein and James F. Crafts, Jr., Attorneys at Law, for Continental Telephone Company of California; Donald Houck, for California Water Service Company; William R. Johnson, for Citizens Utilities Company of California, Sacramento County Water District, and Washington Water and Light Company; Patrick T. Kinney, Attorney at Law, for Sierra Pacific Power Company; A. M. Hart, H. R. Snyder, Jr., and Kenneth K. Okel, Attorneys at Law, by Kenneth K. Okel, for General Telephone Company of California; Jeffrey R. Pendergraft, Attorney at Law, for Four Corners Pipe Line Company; Robert O. Randall, for Southwest Suburban Water Company; Walter J. Sleeth, Attorney at Law, for The Pacific Telephone and Telegraph Company; Carol Harris, Attorney at Law, for Southern Pacific Pipeline, Inc.; F. R. Pfrommer, Attorney at Law, for San Diego Pipe Line Company; Dinkelspiel, Pelavin, Steefel & Levitt, by Alvin H. Pelavin and Douglas P. Ley, Attorneys at Law, for Calaveras Telephone Company, Capay Valley Telephone System, Inc., Dorris Telephone Company, Ducor Telephone Company, Evans Telephone Company, Foresthill Telephone Co., Inc., Happy Valley Telephone Company, Hornitos Telephone Co., Livingston Telephone Company, Mariposa County Telephone Company, Inc., Pinnacles Telephone Co., The Ponderosa Telephone Co., Sierra Telephone Company, Inc., The Siskiyou Telephone Company, and the Volcano Telephone Company.

Interested Parties: Ed Perez, Attorney at Law, for the City of Los Angeles; William Shaffran, Attorney at Law, for the City of San Diego; Victor A. Silveira, for California Independent Telephone Association; Leonard L. Snaider, Attorney at Law, for the City of San Francisco; and Frank Spellman, for himself.

Commission Staff: Robert Cagen, Attorney at Law.

APPENDIX B

The following respondent utilities named in Appendix A to OII No. 33 have (a) complied with the intent and purpose of OII No. 33, (b) have indicated their intent to comply in the next advice letter or rate application proceeding, or (c) should have been included in Appendix C of OII No. 33. The utilities (or districts or departments thereof) named below are **dismissed** as respondents in **Appendix A of OII No. 33:**

Energy Utilities

Sierra Pacific Power Company

Water Utilities

California-American Water Co. (all districts)
California Water Service Co. (all districts)
The Campbell Water Company
Citizens Utilities Company of California (Sacramento County Water District)
East Pasadena Water Company
Fruitridge Vista Water Co.
Pacific Gas and Electric Company (all water districts)
Park Water Company (all districts)
San Gabriel Valley Water Co.
Washington Water & Light Company

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APPENDIX C

The following utilities named as respondents in Appendix A to OII No. 33 have not filed advice letters requesting rate reductions pursuant to Ordering Paragraph 5 of OII No. 33 or otherwise complied with the intent of OII No. 33.

Energy Utilities

Pacific Gas and Electric Company
  Electric Department
Pacific Power and Light Company
Southern California Water Co.
  Bear Valley Electric District

Water Utilities

Southern California Water Co.
  Arden - Cordova District
  Borston District
  Bay District
  Big Bear District
  Central Basin District
  Cowan Heights District
  Culver City District
  Desert District
  Orange County District
  Pomona Valley District
  San Dimas District
  San Gabriel Valley District
  Santa Maria District
  Simi Valley District
  Southwest District
  Wrightwood District
Southwest Suburban Water Company
  San Jose - Whittier District