

FEB 19 1998

Decision 98-02-089 February 19, 1998

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Lena Humber,

Complainant,

vs.

North Gualala Water Company,

Defendant.

ORIGINAL

Case 97-05-024
(Filed May 9, 1997)

Vernon W. Humber, Attorney at Law, for
complainant.

Richard J. Henderson and Sara Steck Myers,
Attorneys at Law, and John H. Bower, for North
Gualala Water Company, defendant.

O P I N I O N

Summary

The clarification of Decision (D.) 87-09-026 by D.96-10-037 applies retroactively to all disputes involving the gross-up of taxes for contributions in aid of construction for small water companies. The determining date for the calculation of gross-up taxes is that date the utility presents its post-construction audit to the customer, not the date a pre-construction payment by the customer is made.

Discussion

This complaint is the latest event in a longstanding dispute on the calculation of the "gross-up" charge for tax purposes under a small water utility's main extension rule. The complaint of Lena Humber against North Gualala Water Company (NGWC) was filed on May 9, 1997, protesting an assessment of charges by NGWC for installation of a water main. Concurrently an action in Superior Court was pending by NGWC

against Humber to collect those charges. Administrative Law Judge (ALJ) Rosenthal issued a ruling on July 8, 1997 restraining NGWC from disconnecting service to Humber until further order. He also ordered a prehearing conference (PHC) to be set and directed the parties to be prepared to discuss the issues in the pending proceeding, as well as the status of the Superior Court action and its effect on this case.

At the PHC held in San Francisco on July 24, 1997, both parties were represented by counsel. It was agreed between the parties that there was to be no evidentiary hearing. A Stipulation of Facts, signed by attorneys for both parties, was filed on July 30, 1997. We have appended this stipulation to our decision as Attachment A. Concurrent briefs premised on these stipulated facts were submitted on August 29, 1997. Concurrent reply briefs were filed on September 8, 1997.

In her complaint Humber asked that we enjoin NGWC from pursuing its action in Superior Court. At the PHC, Humber asked that we enjoin the Superior Court from hearing the matter until such time as the Commission has acted on the complaint before it. The ALJ denied both requests. (Tr. 24.)

NGWC asked that the complaint be dismissed. That request was also denied by the ALJ. (Tr. 27.)

NGWC sent a Notice of Intent to Disconnect Utilities to Humber, in accordance with its Tariff Rule 10, warning Humber that unless the disputed amount of \$36,197.91 were deposited with the California Public Utilities Commission (Commission) service to Humber could be discontinued. NGWC renewed its demand for a customer deposit at the PHC. It should be noted that this sum is calculated on accrual-based accounting. If a cash-based accounting procedure is used, which NGWC maintains is inappropriate, NGWC asserts that the sum owed would be \$22,998. Humber has denied the applicability of either of these numbers. As mentioned earlier, the ALJ ordered NGWC not to disconnect service until further order of the Commission. At the PHC, he ruled that Humber should deposit the lesser amount of \$22,998 with the Commission before

continuing with the proceeding. The ALJ emphasized that the amount in question was not to be considered as a prejudgment of the amount actually due, if any, but rather followed the filed tariff requirement of the utility concerning disputed bills and was an amount that NGWC accepted as sufficient pending resolution of the dispute. (Tr. 36-37.) This sum of \$22,998 was promptly deposited by Humber.

This dispute revolves around the taxes that a utility may charge a customer for money contributed for construction to serve that customer. Prior to 1987 the money received from a customer to pay for construction work to allow a utility to serve that particular customer (contributions in aid of construction or CIAC) were not considered taxable to the utility under federal tax provisions. The Tax Reform Act of 1986 revised this concept, requiring the utility to consider CIAC as part of its gross income. Recognizing that this would have ratemaking consequences the Commission instituted an investigation culminating in *Re Tax Reform Act of 1986*, (1987) 25 CPUC2d 299. The Commission decided that the CIAC should be "grossed-up for the full amount of the federal tax" (Id. at 308) in the case of small water companies, such as NGWC. (Stipulation of Facts 6.) The Commission further concluded, "To the extent reasonable the entity causing the taxable event should bear the tax." (Conclusion of Law 3.)

We now focus on what has emerged as the central point of the dispute in this proceeding. In *Re Tax Reform Act of 1986, supra*, the Commission concluded:

"12. If a utility is not in a taxable position in the year that it receives a contribution or refundable advance, there is no tax liability. . . ."
(Conclusion of Law 12.)

Conclusion of Law 12, quoted in part above, was rescinded and replaced with a new Conclusion of Law 12 in D.96-10-037, October 10, 1996, p. 12. This substituted Conclusion no longer contains the language regarding being in a taxable position or the year of receipt. The change wrought by D.96-10-037 was characterized in that decision as a "clarification" (Finding of Fact 2, mimeo. p. 12) and was understood by the parties herein to be a clarification of D.87-09-026. (Stipulation of Facts 13.)

The parties entered into a main extension contract in 1993 and Humber paid advances on construction, engineering, and calculated gross-up to NGWC in 1992 and 1993. (Stipulation of Facts 1 and 2.) NGWC was in a taxable position for income in 1992, 1993, and 1994. (Stipulation of Facts 9.)

On page 2 of her August 28, 1997 brief, Humber points to the "Selected Financial Data Report" of NGWC for 1992 and 1993, on file with the Commission, and advises us that she paid more in gross-up taxes than NGWC paid in total taxes for those years. It should be noted that neither the taxes of NGWC for 1992 and 1993 nor the amount paid by Humber to NGWC for gross-up for those years appears in the Stipulated Facts. Parties were specifically cautioned by the ALJ to include all relevant facts in the stipulation, since that was to be the basis for his decision. (Tr. 40-41.) Nevertheless, we shall accept the tax liability of NGWC for 1992 and 1993 by reference. (Rule 72.) No such reference to our files is given concerning the amount paid by Humber to NGWC as gross-up for those years. Therefore we shall not accept the statement that Humber paid NGWC more in estimated gross-up tax than NGWC paid in total tax for the years 1992 and 1993.

In its effort to respond to Humber's comparison of gross-up taxes she paid and the total tax payment of NGWC in 1992 and 1993, NGWC stated that it did not report any contributions in aid of construction in 1992 and only minimal contributions in aid or construction in 1993 because it is on the accrual basis of reporting. (Reply Brief, p. 5.) We have searched the Stipulation of Facts in vain for the agreed factual basis for this statement. None is to be found, and the statement will be disregarded.

We are now prepared to examine the gravaman of this complaint—whether the gross-up for the CIAC should be calculated based on the year that the payment is received by the utility, which has been called the "cash-based" approach in this proceeding, as contended by Humber, or in the year that the post-construction audit was completed, or "accrual" approach, as contended by NGWC. Humber relies on the quoted language of D.87-09-026, indicating that the year the CIAC is received by the

utility is crucial. (Conclusion of Law 12.) NGWC asserts that the proper year is the year that the final accounting is made of the project and the tax expenses accrued by the utility, not the year that the estimated tax is actually paid to the utility.

Certainly the literal wording of Conclusion of Law 12 in D.87-09-026 gives support to the contention of Humber. NGWC received payment in 1992 and 1993 from Humber. Conclusion of Law 12, before being clarified so as to remove the language on which Humber relies, indicates that a utility must be in a taxable position in the year that the contribution was received. That would indicate that the Commission placed special significance on the receipt of the money by the utility, rather than its effect on the tax liability that the contribution imposed on the utility. It was the post-construction audit conducted by NGWC, completed in 1994, that prompted the claim for additional payments of \$36,842.90. (Stipulation of Facts 2, 4, 5, 6, 8, and 10.)

Contradicting this view would be the concern expressed by the Commission that the gross-up taxes should be attributed to the entity that brought these taxes about. Thus, in D.87-09-026, Conclusion of Law 3, the Commission stated,

"3. To the extent reasonable the entity causing the taxable event should bear the tax." 25 CPUC2d at 336.

As stated in D.96-10-037, which clarified Conclusion of Law 12 of D.87-09-026:

"There are two concepts that pervade D.87-09-026. The first, clearly articulated, is that the person who causes the tax should pay it (25 CPUC2d at 328); the second, clearly implied, is that neither the utility nor the contributor should profit from the tax consequences of the contribution. The tax should be revenue neutral." D.96-10-037, p. 8. (Stipulation of Facts 13.)

It is now our duty to apply these concepts to the contentions before us. First, to the extent that there was a gross-up tax caused by Humber, it is the responsibility of Humber to advance the funds to NGWC for payment of the taxes incurred by NGWC as the result of the extension contribution. Second, Humber can be charged no more than the tax brought about by her project. Despite the inartful language in the original

Conclusion of Law 12, which was clarified by removing the offending language pursuant to D.96-10-037, we cannot agree that receipt of money by the utility is sufficient to shift any unbilled or uncollected costs to the utility or its ratepayers. Similarly, if a subsequent audit identified an overbilling by the utility to the contributing customer, the utility could not successfully assert the language of Conclusion of Law 12 as a basis to retain this overcollection. That is the only fair understanding of the process contemplated for the gross-up of CIAC for tax purposes under the guidelines expressed by the Commission.

Applying these precepts to the present case we note that the Humber project was placed in service on May 10, 1994. (Stipulation of Facts 3.) NGWC conducted a post-construction audit of the Humber project in accordance with its Tariff Rule 15A.6.e. (Stipulation of Facts 4.) This audit was performed and completed in 1994. (Stipulation of Facts 6.) The final cost of the Humber project determined by that audit, including construction and gross-up charges, indicated a balance due to NGWC of \$36,197.91. (Stipulation of Facts 7 and 8.) This, in effect, is following an accrual approach to the process. The crucial date is completion of the post-construction audit, not when payments are recorded. Assuming the audit was performed correctly it would appear that NGWC is entitled to receive, and Humber must pay, \$36,197.91.

In opposing this view, in her opening brief, page 1, Humber argues,

"The principal issue is whether the Defendant North Gualala Water Company (NGWC) can arbitrarily and unilaterally use the date the construction project was finished, as the date that Complainant's payments to NGWC were recorded by NGWC, rather than the actual years that Complainant made payments...."

To further buttress her view that the crucial time is the date that the gross-up tax is collected by the utility, rather than the time of final accounting, Humber quotes from D.87-09-026:

"If the utility is not in a taxable position for the year in which gross up is collected, there is no tax liability." 25 CPUC2d 299, 327. (Emphasis by Humber.)

In placing reliance on the date of receipt of the payment Humber is urging an interpretation which follows the principals of cash accounting, rather than accrual. Certainly the literal wording of D.87-09-026 could lead one to such a conclusion. However, it doesn't take into consideration the problem which occurs after a final audit wherein additional charges or overcharges are determined. (Stipulation of Facts 7.) Under Humber's interpretation of our 1987 decision, since clarified in 1996, there would appear to be no way that a utility or customer could recover these sums discovered only in the post-construction audit. Thus the tax would not be revenue neutral. This would be a violation of the basic guidelines set forth above. If additional money were required, it would have to come from the utility or the other ratepayers of the utility. If too much money had been received, it would be a windfall to the utility.

One further matter should be noted. If, as Humber would have us rule, the date of payment to the utility determines the amount of the gross-up tax chargeable to the contributing customer, the results could be manipulated. A utility might be able to obtain extra funds by timing its billing of the gross-up tax, forcing payment in the most favorable tax year. Should a utility attempt to "game" the tax date we have the ability to correct any misdoing. However, we have no such control over a customer timing his payment. Yet the process is intended to be revenue neutral. We certainly did not have this result in mind when we wrote the unfortunate language, since rescinded, in D.87-09-026, that has created such confusion and dispute.

Humber argues against any retroactive effect being given to the "clarified" version of Conclusion of Law 12 in D.96-10-037 which eliminates the language pertaining to the taxable position of the utility in the year it receives a contribution. (Opening Brief, pp. 3, 4, and 5.) NGWC, not surprisingly, takes the position that a clarification of D.87-09-026 does no more than make clear what the original language was intended to convey. (Opening Brief, pp. 4-14.) On this point, we must agree with

NGWC. We fully intended that the new language of Conclusion of Law 12 be used in any dispute involving the gross-up of contributions of small water companies. At mimeo. page 12 of D.96-10-037, the Commission acknowledges that a change in federal law exempts water companies from taxation on CIAC after June 12, 1996. Yet our decision clarifying this matter was not issued until October 9, 1996. (*Supra*, p. 14.) Since the tax was repealed at the time our clarifying decision was issued it could not have been intended to have future effect, but only be an aid to interpretation of past occurrences.

All that now remains is a determination of the total amount of the gross-up taxes due to NGWC. The Stipulation of Facts does not contain sufficient detail to determine this number, but it was characterized by the attorney for Humber as "... a simple bookkeeping matter...." (Tr. 13.) We will leave this docket open to allow the parties the opportunity to resolve the actual numbers.

Comments on Proposed Decision

A proposed decision was mailed to the parties on January 12, 1998. NGWC filed comments agreeing with the Commission's conclusion that the date for calculation of gross-up taxes is the date the utility presents its post-construction audit to the customer. NGWC disputes our statement that the "Stipulation of Facts does not contain sufficient detail to determine this number." NGWC asserts that Stipulations of Fact 6 and 7 provide us with the required detail.

We disagree. We read these Stipulations as agreements on what the audit shows, not an agreement as to accuracy or validity. Humber should be permitted to examine this audit, as would any customer when presented with a construction bill.

Humber did not file comments on the Proposed Decision or a reply to NGWC's comments.

Judicial review of Commission decisions is governed by Part 1, Chapter 9, Article 3 of the Public Utilities Code. The appropriate court for judicial review is dependent on the nature of the proceeding. This is a complaint case not challenging the reasonableness of rates or charges, and so this decision is issued in an "adjudicatory

proceeding" as defined in § 1757.1. Therefore, it will be subject to judicial review in the Court of Appeal. (See PU Code § 1756(b).)

Finding of Fact

The findings of fact are as stipulated between the parties and contained in Attachment A to this decision.

Conclusions of Law

1. D.96-10-037 rescinded and replaced Conclusion of Law 12 of D.87-09-026.
2. The purpose of rescinding and replacing Conclusion of Law 12 was to clarify what had been diverse interpretations of Conclusion of Law 12.
3. Conclusion of Law 12, as clarified in D.96-10-037, is applicable to all instances involving gross-up taxes due to CIAC for small water utilities, including the dispute in the instant case.
4. A post-construction audit was the proper means to determine the total costs of a project, including any gross-ups for tax purposes attributable to CIAC.
5. In conducting its post-construction audit, NGWC implemented the Commission's guidelines that the person who causes a gross-up tax should pay for it and that neither the utility nor the customer should profit from the consequences of CIAC. The tax should be revenue neutral.
6. In determining the effect of CIAC on gross-up taxes the appropriate date is the date that the final figures are presented by the utility, not the date that any payments are received by the utility.
7. Since this matter was submitted on stipulated facts which acknowledged the fact of a post-construction audit but did not stipulate to the correctness of that audit, no order can be made as to the precise amount of money owed by Humber to NGWC.
8. This is a complaint case not challenging the reasonableness of rates or charges, and so this decision is issued in an "adjudicatory proceeding" as defined in PU Code § 1757.1. Therefore, the proper court for filing any petition for writ of review will be the Court of Appeal.

O R D E R

IT IS ORDERED that:

1. The complaint of Lena Humber is denied.
2. North Gualala Water Company (NGWC) is directed to make available its post-construction audit to Humber within 10 days of the effective date of this order.
3. The parties are directed to notify the Commission within 20 days of the effective date of this order of the result of the inspection of the audit by Humber.
4. The money deposited with the Commission pursuant to the order of the Administrative Law Judge shall be retained pending notification by the parties that the precise contributions in aid of construction (CIAC) gross-up costs have been identified.
5. Should there be a dispute as to the precise amount of money owed to NGWC by Humber the amount not in dispute shall be transferred from the deposit with the Commission to NGWC.
6. If the parties are unable to agree, they may return to the Commission for a final resolution of the accounting.
7. This proceeding shall remain open until the final accounting is resolved.

This order is effective today.

Dated February 19, 1998, at San Francisco, California.

RICHARD A. BILAS
President
P. GREGORY CONLON
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

LENA HUMBER,)
 Complainant,)
 vs.)
 NORTH GUALALA WATER COMPANY)
 Defendant.)

Case 97-05-024
(Filed May 9, 1997)

STIPULATION OF FACTS

Complainant Lena Humber and defendant North Gualala Water Company (NGWC) respectfully submit the following stipulation of facts pursuant to the ruling of Administrative Law Judge Rosenthal made during the prehearing conference of July 24, 1997, in this proceeding. ALJ Rosenthal ruled that such a stipulation must be filed no later than July 30, 1997. It is the parties' understanding that the stipulated facts will be used by the Commission in addressing and resolving those legal issues identified at the prehearing conference and to be addressed by the parties in concurrent opening and reply briefs to be filed on August 30 and September 8, 1997, respectively.

As stipulated by the parties as of the date of this filing, the following facts are not in dispute:

1. On September 29, 1993, NGWC and Complainant entered into a written "Main Extension Contract," consistent with Commission D.93-09-007, for the construction of improvements (i.e., main extension) necessary to provide water service from NGWC's main line to Complainant's commercial property in Gualala.¹

¹ The contract will be the subject of a separate stipulation or will be attached as an exhibit to the parties' briefs.

2. Advances on estimated construction and engineering costs and calculated gross-up on those estimates were paid by Complainant to NGWC in 1992 (\$13,397.50) and 1993 (\$119,847.50).
3. The project was placed in service and water service commenced to Complainant's parcel on May 10, 1994.
4. Pursuant to NGWC Tariff Rule 15, A.6.e., NGWC is required to conduct a post-construction audit of the actual costs of construction due and then to make a refund to or submit additional charges against the applicant depending upon the results of the audit. This tariff provision was incorporated in the 1993 main extension agreement with Complainant.
5. As part of that post-construction audit, NGWC is also required to determine the impact, if any, of additional construction costs on tax gross-up.²
6. A post-construction audit for Complainant's main extension was performed and completed by NGWC on November 30, 1994.
7. That audit, as prepared, calculated that the final construction costs for Complainant's main extension exceeded the original estimate for the project by \$30,019.10 due to additional, unexpected construction costs. These circumstances resulted in an actual cost of construction of \$101,402.10 and a gross-up liability, as estimated by NGWC, of \$68,040.81, with the total charge to Complainant equaling \$169,442.01.
8. With full credit for all pre-construction advances from Complainant of \$133,245.00, the balance due to NGWC from Complainant was determined by NGWC's audit to be \$36,197.91.
9. In 1992, 1993, and 1994, NGWC, Inc., was in a taxable position for income.
10. On December 2, 1994, Complainant was informed by NGWC of the amount (\$36,197.91) still owed to NGWC for construction costs related to the main extension. NGWC Tariff Rule A.6.e. requires payment within 30 days of any difference between the revised construction costs and the advance.
11. On March 5, 1996, the Commission's Consumer Affairs Branch informed Complainant: "In regards to the calculation of gross-up, we find that North Gualala Water Company's method for the purpose of paying income taxes is permitted by the IRS Tax Code and current Commission regulations."

² CIAC creates additional income to the utility and can result in increased income taxes to the utility, which taxes, if not otherwise paid by the contributor, would be passed on in the form of rate increases to ratepayers who do not otherwise benefit from the construction. To ensure that the tax remains revenue neutral, NGWC's tariff rules and Commission decision specifically require NGWC to collect contributions and advances "gross" of federal and state income tax or a "tax gross-up" which charge represents the calculated additional income tax liability to the utility as a result of the CIAC. (See, NGWC Tariff Rule 15, A.6.; D.87-09-026; D.96-10-037.)

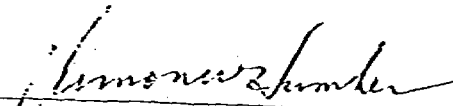
12. On May 16, 1996, NGWC filed a complaint against Complainant for breach of contract related to these construction costs in Mendocino County Superior Court.
13. On October 11, 1996, the Commission issued D.96-10-037 which clarified D.87-09-026. That decision reaffirmed the two purposes of the "gross-up" tax policy adopted in D.87-09-026: (1) "that the person who causes the tax should pay it", and (2) that "neither the utility nor the contributor should profit from the tax consequences of the contribution". In other words, the "tax should be revenue neutral." (D.96-10-037, at p. 8.) To this end, the Commission clarified D.87-09-026 by making clear that the contributor is required to "advance a gross-up based on the utilities' incremental tax rate as determined in its last ratemaking proceeding, but receive a proportionate refund if, in the taxable year, the gross-up exceeded the tax that would have been paid without consideration of a tax loss carry forward or other tax credit." (*Id.*, at p. 9.)
14. Since January 2, 1995, Complainant has failed and refused to pay to NGWC all or any portion of the \$36,197.91 and claims, in her cross-complaint in the Mendocino County Superior Court action, that she is entitled to all or part of the gross-up tax already paid to NGWC.

The parties appreciate the opportunity to respond to the ALJ's ruling. The parties also ask for leave to file any supplemental stipulation of facts which may be reached prior to the due date for briefs in this complaint.

July 28, 1997


Respectfully submitted,

By


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