MAIL DATE
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Decision 98-06-084 June 18, 1998

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Investigation on the Commission's own motion to consider policies and procedures applicable to the possible over-assessment by the State Board of Equalization of property owned by Commission regulated utilities.

ORIGINAL

I.92-03-052
(Filed March 31, 1992)

ORDER MODIFYING DECISION 95-06-053 AND DENYING REHEARING

Pacific Bell (PacBell) and GTE California, Inc. (GTEC) have filed applications for rehearing of Decision (D.) 95-06-053 (the Decision) in which the Commission resolved two issues relating to the possible Z-factor treatment of certain property tax savings realized by PacBell and GTEC. In particular, the Decision determined that: (i) the events that caused the property tax savings were exogenous; and (ii) the property tax savings were not reflected in the economywide inflation factor. In their applications for rehearing, PacBell and GTEC challenge the Commission's conclusion that the property tax savings were caused by exogenous events.

More specifically, the utilities contend that the Commission erred by basing this conclusion solely on hearsay evidence contained in a memo written by Deputy Attorney General Robert D. Milam to the Executive Director of the State Board of Equalization (the Milam memo). The Division of Ratepayer Advocates (DRA), since re-named the Office of Ratepayer Advocates, responded in opposition to the applications for rehearing. DRA argues that the Milam memo

comes within several exceptions to the hearsay rule, and that there is non-hearsay evidence that further supports the Commission's conclusion that the property tax savings were caused by exogenous events. As explained below, we agree that the Milam memo comes within an exception to the hearsay rule and that there is non-hearsay evidence to support the Commission's conclusion. Therefore we will deny the applications for rehearing.[1]

The utilities' property taxes are based on assessments made by the State Board of Equalization (the Board) and are collected by the counties in which the utilities' property is located. In 1991, in a suit brought by AT&T, a trial court ruled that AT&T was entitled to a property tax refund because the Board had not properly accounted for AT&T's deferred tax reserve. Thereafter, in 1992, the Board, the counties who actually collect the taxes, and a number of utilities, including PacBell and GTEC, entered into a settlement requiring the utilities' future property taxes to be calculated in a way that takes greater account of the utilities' deferred tax reserves, but does not provide as much tax relief as would have been provided by applying the trial court's decision in the AT&T case.

The Decision relies on the following statement in the Milam memo to conclude that the trial court's decision in the AT&T case drove the Board to sign the settlement.

> It is this issue [the accounting for the deferred tax reserve] which is the reason for this agreement because a Court of Appeal decision upholding the trial court's determination would be devastating financially for the counties.

[1] Because we conclude that the Milam memo comes within an exception to the hearsay rule, and that non-hearsay evidence corroborates the evidence contained in the Milam memo, we have no occasion to decide whether the Commission can legally base a finding on uncorroborated hearsay evidence that does not fall within an exception to the hearsay rule.

As Mr. Milam did not testify in the Commission's proceedings, it is undisputed that the Milam memo is hearsay evidence. (See Evidence Code sec. 1200(a).)

The hearsay rule generally bars the use of hearsay evidence in a court trial. (See Evidence Code sec. 1200.) However, hearsay evidence is admissible in Commission proceedings. (See Public Utilities Code sec. 1701(a) ("the technical rules of evidence need not be applied" in Commission hearings).) Moreover, hearsay evidence is admissible even in court if it falls within an exception to the hearsay rule. (See Evidence Code secs. 1200(b), 1220 - 1370.) It appears that the above-quoted portion of the Milam memo falls within the "official record" exception to the hearsay rule.

California Evidence Code section 1280 ("record by a public employee") provides:

> Evidence of a writing made as a record of an act, condition or event is not made inadmissible by the hearsay rule when offered to prove the act, condition, or event if:
>
> The writing was made by and within the scope of duty of a public employee;
>
> The writing was made at or near the time of the act, condition, or event;
>
> The sources of information and method and time of preparation were such as to indicate its trustworthiness.

Here, the Milam memo was clearly prepared by a public employee, as Mr. Milam was a Deputy Attorney General in the California Department of Justice. Indeed, Milam's memo was prepared in observance of his official duty pursuant to California Government code section 948 (a). Under Government Code section 948 (a), the Board could only approve the settlement upon the recommendation of Milam, its attorney: "[t]he head of the state agency concerned,

upon recommendation of the Attorney General or other attorney authorized to represent the state, may settle, adjust, or compromise any pending action ... " (emphasis added). The Milam memo contained his recommendation to the Board to settle pursuant to section 948.

Furthermore, the Milam memo records the conditions surrounding the proposed settlement and was made sufficiently close in time to the settlement as it was prepared on or about April 24, 1992 and the settlement agreement is dated May 1, 1992.[2]

California Court of Appeal decisions which have discussed the official records exception have held that in some instances reports which contain conclusions of the official are not admissible. (Pruett v. Burr (1952) 118 Cal. App. 2d 188, 201.) However, "the inclusion of conclusions and opinions in a record does not render it inadmissible per se. The overriding consideration is whether the record is trustworthy." (People v. Flaxman (1977) 74 Cal. App. 3d Supp. 16, 20 (citations omitted).) Trustworthiness is established if the record is made by public employees who are under a duty to observe the facts and report and record them correctly. (Gananian v. Zolin (1995) 33 Cal. App. 4th 634, 640.)

Applying the above law to the facts, the Milam memo is not inadmissible, even though it contains Milam's conclusions, because it is trustworthy. Milam was under a statutory duty to report his recommendation and conclusion that the Board should enter into the settlement. Thus, Milam's memo -- stating that the reason for the settlement is that a court of appeal decision upholding the trial court in AT&T would be financially devastating for the counties -- would be admissible in court under the hearsay exception for official records.

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[2] Indeed, one of the reasons why we find the Milam memo to be persuasive evidence is that the memo was prepared at the time of the settlement as part of the settlement process, and not at a later date for the purpose of influencing the Commission's determination of the Z-factor issue.

Perhaps more importantly, even if the Milam memo does not come within an exception to the hearsay rule, there is other corroborating, non-hearsay evidence to support the Commission's conclusion that the property tax savings were caused by exogenous events, namely the court decisions in the Union Pacific and AT&T cases. This evidence is contained in the testimony of PacBell's and GTEC's own witnesses in this proceeding. We will modify the Decision to discuss this evidence.

PacBell and GTEC raise a number of other arguments in their applications for rehearing. For the most part, these additional arguments simply disagree with the Commission's interpretation of the evidence. However, there is ample evidence to support the Commission's conclusion that the property tax savings were caused by exogenous events. Moreover, the utilities have not shown that it is unlawful for the Commission to look beyond the settlement to see what led to the settlement, and to conclude that the property tax reductions were actually caused by the decision in the AT&T case, as well as the decision against the Board in the Union Pacific case.

Because these additional arguments do not establish any legal error they do not require any extended discussion. These arguments, however, do suggest a few changes that ought to be made to the Decision to avoid some minor inaccuracies and inconsistencies, and we will modify the Decision accordingly.

We turn now to address GTEC's petition to set aside submission. About 5 months after it filed its application for rehearing, GTEC petitioned to set aside submission to allow the introduction of a letter by Matt Fong, who was a member of the Board at the time the Board approved the settlement. DRA filed a response opposing GTEC's petition which argued that the petition was untimely. Rule 84 of the Commission's Rules of Practice and Procedure provides in pertinent part:

> After conclusion of hearings, but before issuance of a decision, a party to the proceeding may . . . file with the Commission . . . a petition to set aside submission and reopen the proceeding for the taking of additional evidence (emphasis added).

GTEC, however, moved to set aside submission after the Decision was issued. Accordingly, its petition to set aside submission in order to receive additional evidence intended to change the outcome of the Decision was untimely, and will be denied.

Finally, we address the next steps that should be taken in this proceeding. The Decision resolved the Commission's treatment of only two of a number of Z-factor criteria that are relevant in this property tax savings investigation. At the time the Commission issued the Decision, it was reviewing the proper analysis of some of the other Z-factor criteria in its investigation into the accounting of PBOPs (post-retirement benefits other than pensions). The Decision therefore reserved determination of the remaining Z-factor criteria in the instant proceeding until after the Commission issued a decision in the PBOPs case (I.90-07-037). The Decision said that the Commission would order briefing on the Z-factor issue in this proceeding after the PBOPs decision was issued.

Although the PBOPs proceeding has been resolved, no further briefing has yet been ordered in this case, due to the pendency of these applications for rehearing. Now that we are denying the applications for rehearing, we will require the briefs contemplated by the Decision to be filed within 60 days. These briefs should not reargue whether the events that caused the property tax savings were exogenous. That issue has been decided by D.95-06-063 and this decision. However, we expect that the briefs will address the issue of whether and how the control PacBell and GTEC had over the property tax change due to their participation in the settlement should affect our Z-factor determination. In making arguments about this "control" factor, parties are not precluded from making

arguments they have previously made in their briefs about the Z-factor issues in this case. However, the parties should address how their recommended resolution of this "control" factor is consistent with the Commission's decisions in I.90-07-037.

CONCLUSIONS OF LAW:

1. The portion of the Milam memo upon which D.95-06-053 relies appears to fall within the "official record" exception to the hearsay rule.

2. Even if the Milam memo does not come within an exception to the hearsay rule, there is other corroborating, non-hearsay evidence to support the Commission's conclusion that the property tax savings were caused by exogenous events, namely the court decisions in the Union Pacific and AT&T cases.

3. GTEC's petition to set aside submission was untimely and should be denied.

4. The further briefing contemplated by D. 95-06-053 should now be ordered.

Therefore, **IT IS ORDERED** that Decision 95-06-053 is modified as follows:

1. The first full sentence in the portion of footnote 4 appearing on page 5 is modified to read as follows:

> "The "Z" factor can be either positive or negative, for certain exogenous events causing cost increases and decreases, respectively."

2. The second sentence in the second paragraph on page 5 is modified to read as follows:

> "The Z-factor is an adjustment for certain cost changes beyond management's control."

3. Beginning on page 14 and continuing on page 15, the first five sentences following the blocked and indented paragraph are replaced with the following, and footnote number 14 is deleted and not used:

> "This memorandum is persuasive evidence that the trial court's decision in the AT&T case drove the Board to sign the settlement with the counties and the regulated utilities. The point of the memorandum is that if a Court of Appeal were to uphold the AT&T trial court's finding that 100% of the DTR should be deducted from the HCLD, then the counties would be facing a significant financial impact. Pacific Bell argues that the reason for the settlement was the pending property tax refund lawsuits filed by Pacific and GTEC.[12] However, as DRA notes, only some of the utilities to which the settlement applies had filed lawsuits.[13] Therefore, we conclude that the Board determined that a settlement would be preferable to taking further risks in court, given the setbacks in the AT&T and Union Pacific court cases."

4. The fifth and sixth full sentences on page 15, beginning with the words "This settlement also prevented the parties ..." should be replaced with the following:

> "Hence, although the court cases did not change the state tax laws governing the calculation of property taxes, the court decision in AT&T resulted in a change in one of the methods by which such taxes are calculated."

5. The following language is inserted after the end of the first partial paragraph on page 15:

> "That the counties and the Board entered into the settlement because of the AT&T decision is further corroborated by the testimony of GTEC and PacBell witnesses Thomas N. Tiscione and James W. Barnes, both of whom were cross-examined. Their testimony as to the chronology of events leading up to the settlement talks indicates that despite the utilities' efforts, dating back to 1986 and even before that, to

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12 Pacific Bell's Reply Brief, p. 15.

13 DRA's Reply Brief, p. 5, referring to Milam memo, page 8.

obtain reassessments from the Board, the Board and the counties only took serious interest in changing the assessment practices beginning in September and October of 1991. In other words, the Board and the counties took interest in settlement negotiations with PacBell and GTEC after the AT&T and Union Pacific decisions in February and June of 1991 respectively.

"Pacific's Executive Tax Representative James W. Barnes testified that Pacific attempted for many years to convince the Board to correct the Board's flawed valuation models. Pacific went as far as to file a property tax refund lawsuit in 1989. Despite these extensive attempts, the Board and the counties did not indicate an interest in settlement negotiations until September and October of 1991. At the hearing, Barnes testified that, 'as we approached the counties and the board, they became more serious, more interested, if you will, at a specific point in time.' His prefiled testimony specifically referred to a September 4, 1991 meeting at which the counties' representative indicated some interest in the possibility of settlement. He also described a meeting on October 3rd that led to the initial settlement negotiation meeting on October 23, 1991.

"In addition, GTEC Tax Director Thomas N. Tiscione's testimony also supports our conclusion that the Board (and the counties) entered into the settlement because of the AT&T and Union Pacific decisions. In his prepared testimony, Tiscione describes GTEC's efforts to obtain reassessments, and tax refunds from the counties, for the tax years 1981 - 1986, 1990 and 1991. Although GTEC had petitioned for reassessment as early as 1986, the Board did not initiate an evaluation of its challenged assessment methodologies until September of 1991. A subcommittee of the Board then held meetings, involving representatives of the counties and the utilities as well, which ultimately led to the settlement negotiations. Our determination from this testimony is that only after the AT&T and Union Pacific decisions was the Board willing to

> reevaluate its assessment methodology and were the Board and the counties willing to participate in a settlement of the issues which PacBell and GTEC had been attempting to litigate for a number of years."

6. Findings of Fact Nos. 18 and 19 on page 22 are modified to read as follows:

> "18. The settlement adopted the principle of the trial court decision in AT&T that in valuing the utilities' property HCLD should be adjusted to reflect DTR.
>
> "19. Although Pacific and GTEC voluntarily signed the settlement with the Board and the counties, the principles adopted in the settlement had been predetermined by the AT&T case."

7. An additional Finding of Fact, numbered 19A is added on page 22, following Finding of Fact No. 19:

> "19A. The chronology of events leading up to the settlement talks, and the testimony of Pacific's and GTEC's own witnesses, indicates that, despite the utilities' efforts, dating back to 1986 and even before that, to obtain reassessments from the Board, the Board and the counties only took serious interest in changing the Board's assessment practices beginning in September and October of 1991, after the AT&T and Union Pacific decisions (in February and June of 1991 respectively)."

8. Conclusion of Law No. 2 on page 23 is modified to read as follows:

> "2. The settlement, to which Pacific and GTEC were parties, necessarily adopted the principle of adjusting the HCLD valuation method to reflect DTR, because the court's decision in AT&T found the HCLD method previously used by the Board (which did not reflect any adjustment for DTR) illegal."

IT IS FURTHER ORDERED that the applications for rehearing of Decision 95-06-053 filed by Pacific Bell and GTE California, Inc. are denied.

IT IS FURTHER ORDERED that the petition to set aside submission filed by GTE California, Inc. is denied.

IT IS FURTHER ORDERED that within 60 days of the effective date of today's order, the parties to this proceeding may file concurrent briefs detailing how the Z-factor policies adopted in I.90-07-037 affect the outcome of the Z-factor issue in this investigation. The parties may comment on the issue of whether and how the control Pacific Bell and GTEC had over the property tax change due to their participation in the settlement with the Board should affect our consideration for granting a Z-factor adjustment.

This order is effective today.

Dated June 18, 1998, at San Francisco, California.

RICHARD A. BILAS
President
P. GREGORY CONLON
HENRY M. DUQUE
Commissioners

I will file a dissent

/s/ JESSIE J. KNIGHT, JR.
Commissioner

/s/ JOSIAH L.NEEPER
Commissioner

I.92-03-052
D.98-06-084

Commissioners Josiah L. Neeper and Jessie J. Knight, Jr., Dissenting:

We dissent from the majority's decision because we believe that Pacific's and GTEC's applications for rehearing, alleging legal errors, have substantial merit. D.95-06-053 committed legal error by wrongly concluding that property tax savings were caused by a single cause, the AT&T and Union Pacific cases, which it deemed were outside the influence of Pacific Bell and GTEC. There is no record evidence to support that conclusion. The majority's decision on the rehearing request further propagates that error by its denial of the application and failure to correct an egregious error .

We reach this conclusion based on two key facts presented in the record of this case: (1) an AT&T Court of Appeals decision did not *by itself* cause a change in the method the State Board of Equalization uses to determine property values for GTEC and Pacific. The Court of Appeals decision did not even exist. Further, a settlement of the AT&T case vacated the trial court's decision; and (2) the settlement agreement first reached between utilities (including GTEC and Pacific in exchange for their agreement to cease their fight for refunds), and counties, and then presented to SBE for consideration as to whether it should join in, caused the tax calculation change for GTEC and Pacific. Evidence abounds that shows the settlement was the result of active efforts by GTEC, Pacific and others. That makes it not an exogenous but an endogenous event.

The settlement could not have been reached without agreement by GTEC and Pacific Bell. All parties gained and lost by the settlement. Counties gained and utilities lost as there were no refunds. Utilities gained and counties lost by the forward looking change for determining property values which would reduce property taxes for utilities. Neither the AT&T Case nor the Union Pacific Case dictated or caused such a settlement. Therefore, the record does not support a conclusion that the change as it occurred was "clearly beyond the control of the utilities."

Criteria for Determination of Exogenous Factors

The criteria to determine whether certain costs and savings should be considered for annual rate adjustments was established first in the 1989 New Regulatory Framework (NRF) decision and later in 1994 by a decision which modified NRF.

The first NRF decision gave a brief, clear, controlling definition of what can be an exogenous factor. It said that "only exogenous factors which are not reflected in the economy wide inflation factor and which are clearly beyond the utility's control should be reflected in the Z factor treatment." (33 Cal. P.U.Code 2d at 228, COL 28 Emphasis supplied.).

As a starting point of what could qualify as an exogenous factor, the Commission accepted, among others, changes in federal and state tax laws, mandated jurisdictional separations, changes to interLATA toll pooling arrangement or accounting procedures. To demonstrate what would not qualify as exogenous factors the Commission identified cost changes due to labor strikes or contracts, normal cost of doing business, or general economic conditions. (For example, we observe that strikes can be avoided by settlement between management and unions and therefore are not exogenous.)

The 1989 NRF decision articulated the controlling test of "clearly beyond the utility's control" in defining exogenous. In the 1994 NRF decision the Commission established a more detailed set of 9 different criteria all of which the utility must meet to get Z-factor treatment: (1) the cost is the result of an exogenous event; (2) the event occurred after implementation of NRF(January 1 1990) (or, if pre-NRF, the event caused costs which the initial Phase II decision ordered to be flowed into rates); (3) the cost is clearly beyond management's control; (4) the cost is not a normal cost of doing business; (5) the event has a disproportionate impact on telephone utilities; (6) the cost is not reflected in the economy wide inflation factor (GDPPI), or at least that the portion of the cost is reflected in the inflation factor; (7) the item has a major impact on the utility's costs; (8) actual costs can be used to measure the impact of the change, or the impact can be measured with reasonable certainty and minimal controversy, and (9) the costs proposed for Z factor treatment are reasonable." (55 Cal.P.U. Code 2d, at 41)

In Decision 95-06-053, the subject of the rehearing, the Commission attempted to establish the foundation for determining that the property tax cost changes would qualify for exogenous factor treatment. It reached its result by concluding (1) that the AT&T and Union Pacific cases were exogenous factors; (2) the settlement agreement between Pacific, GTEC, the counties and the State Board of Equalization necessarily adopted the principle of reducing historical cost less depreciation (HCLD) by deferred

tax reserve (DTR) because the court decisions "found the HCLD illegal"; (3) the settlement applied only to the state's regulated utilities, affected them disproportionately and was not reflected in GNPPI.

In reaching this result the majority decision considered two of the nine criteria set forth in D94-06-011; namely, whether the event that caused the property tax savings was exogenous, and whether the property tax savings were reflected in the GNPPI, items number 1 and 6 in the above criteria, respectively. There is no explanation as to why *only* these two criteria should be applied or why the other seven criteria should not be applied in this case. To get Z-factor treatment there must be a record on which findings are made to meet each of the 9 criteria, conclusions to the same end, and articulated rationale for findings and conclusions. This was not done in either the original decision or the current decision on rehearing.

The Commission's central conclusion in D.95-06-053 that "*the court cases led the Board to pursue the settlements with the assesses, including Pacific Bell and GTEC*" was entirely based on a memorandum written by Robert D. Milam (Deputy Attorney General) to the State Board of Equalization's executive director. The decision states that the Milam memo is "conclusive evidence" that led it to conclude that the trial court's decision (Union Pacific v. the SBE) and the AT&T case "drove the board to sign the settlement with the counties." This conclusion and rationale does not deal in any way with (1) what drove the utilities to pursue settlement; (2) what drove either the SBE or the utility to agree to the terms of the agreement - prospective but no retrospective application of an agreed tax rate treatment; and (3) the fact that no settlement of the litigation was possible without the utilities choosing to settle rather than litigate to decision.

Rehearing Application of Pacific and GTEC

Pacific's and GTEC's allege that the decision exclusively relied on the Milam memo to decide whether the property tax change was caused by an exogenous event; that this evidence was "incompetent hearsay" and therefore the Commission can not rely on it.

Further they allege the following: (1) the Milam memo was received against the objections of GTEC and Pacific. (2) The decision misrepresents the Milam memo saying that the passage quoted in the decision does not state that the AT&T case drove the Board to sign the settlement; (3) the decision misapplied the Z-factor criteria

because (a) the property tax cost was the result of a settlement, which was not an exogenous event, (b) in determining what causes the settlement the decision unlawfully focuses on the motivation of one single party (the SBE) and ignores what motivated the counties and the utilities to sign the settlement; (4) the decision is inconsistent with efficiency incentives inherent in the NRF.

GTEC filed a late motion to set aside submission to introduce into evidence a letter written by Matt Fong in which he disagrees with the Commission's conclusion on what circumstances led to the settlement. DRA opposed GTEC's motion. The motion was denied.

Discussion

A useful purpose of an application for rehearing is to alert us to errors in our decisions so that we can correct them. The errors alleged by GTEC and Pacific require us to closely examine the conclusions reached and test the premises upon which those conclusions were established in light of the record, relevant Commission rules and policies.

The Milam Memo

Central in Pacific's and GTEC's allegation of error is that the Commission relied on incompetent and inadmissible evidence, referring to the Milam memorandum. We believe that this memorandum is inadmissible; however, we will put aside this issue on the presumption that it is admissible, in order to focus on whether the Milam memo provides record support for the rationale that underlies the fundamental conclusion reached by the majority decision. That rationale is:

> "This memorandum is conclusive evidence that the trial court's decision in the AT&T case drove the Board to sign the settlement with the counties and the regulated utilities."

The reference made to the Milam memo on which the decision exclusively relies in fact describes a second different but related reason the SBE should consider in deciding whether to settle:

> "The agreement was negotiated primarily by the counties which are principally affected, and since their money is directly at stake, they are in superior position

to the Board to determine their own future. If successfully completed, the agreement provides potential certainty for the counties and the utilities involved for the next eight years. Such certainty has value for the counties, the utilities, and the Board."

In this part Milam's recommendation clearly establishes that "certainty" of outcome was a motivator to the counties, the utilities and the SBE. It also establishes the counties as well as SBE were important in the negotiated settlement. Another, third, motivation existed as described by DRA's witness who stated that "there was a desire to settle all pending litigations[sic] from different utilities...So that would be another event that would drive the settlement." (Gilbert 1 Tr. 57)

Another, fourth, motivation for SBE settling is stated in the Milam memo. Milam's recommendation that SBE join the proposed settlement was based in part on the "potential financial disaster" that will result if the "currently filed cases" including those of GTEC and Pacific are decided against the Board. This is not fear of only an Appellate Court decision in AT&T. This is fear of a decision in the GTEC/Pacific litigation the very case being settled if the Milam recommendation is accepted. In his recommendation, Milam states that:

> "To the extent that the agreement constitutes the settlement of pending lawsuits, and given the potential financial disaster facing the counties if the currently filed cases are decided against the Board and the counties, this office recommends, under Government Code 948, that the Board settle those cases by the use of the formula contained in the agreement." (Milam Memo Page 13)

Nonetheless, neither the Memo nor the record in any other respect produced any evidence that the SBE played any active role in formulating the terms of the settlement. The memo says the SBE did not. The SBE role was to join an already existing settlement. The record does show SBE signed the document along with counties and utilities. The Memo says the counties played the primary role in negotiating the settlement. The Memo, for its part, does not and could not speak to what if any action the SBE took following its recommendation since the Board had not acted on the settlement prior to the receipt of the memo.

The fundamental basis for D.95-06-053's qualification of tax cost changes for Z factor treatment is the Union Pacific decision and the AT&T trial court decision. These events, according to the Decision, are the only material causes that made the Board to settle with the assessees. The negotiators of the settlement, the management of Pacific Bell and GTEC, and the Board of SBE are viewed as automatons having no choice but settlement rather than litigation and no choice as to the terms. The view is that the AT&T case compels the parties to settle and compels the terms of the settlement. The decision has committed legal errors as a result thereof. It is legal error because there is no basis in the record that decisions of the courts in other cases caused SBE, much less Pacific and GTEC, to settle at all, rather than fight, and much less to settle on the major terms of the settlement.

To conclude that the court case and AT&T case caused the settlement presumes a single (two cumulative event) causation rationale in which these two events in concert caused a settlement to occur; and that apparently the SBE's decision was driven by a single interest "...that a settlement would be preferable to taking further risks in court, given the setbacks in the AT&T and Union Pacific court cases." (D.95-06-053, page 15) However, the decision does not provide and the record does not contain any basis as to what caused or motivated the SBE to act on the settlement. If it was motivated by the Memo, then any one of four different motivations, or only combination of the four may have been the motivation of the SBE.

Pacific's Allegation of Error that the Decision Misapplied The Z-factor Criteria Has Merit

The decision concludes that the AT&T and Union Pacific cases, and not anything within the control of GTEC and Pacific, caused the cost change and that the two events were exogenous. Such a conclusion is legal error. The AT&T trial court decision did not change the law. The court's decision was based on Rule 3 (d) and Rule 8. The court's decision did not change Rule 3(d) or Rule 8. Those rules were still in effect when the settlement was reached and thereafter. There was no appellate decision that affirmed the limited life model. The AT&T trial court decision never went into effect and never went to Court of Appeal since the parties made a settlement. In fact an important element of the AT&T agreement for SBE was that parties' agreed to vacate the trial court's decision so that it would have no precedential effect.

As far as the Union Pacific case is concerned, the Court of Appeal's ruling was more limited in its scope than the Santa Fe trial court decision even though it concluded that "lacking support for the assumption, the Board legally erred in using the composite life model." It should be noted that the composite limited life model was not found to be in violation of Rule 8 (c) as a matter of law. In contrast to this, the Santa Fe decision found the SBE model to be in direct violation Rule 8 (c) and thus invalidated it. The Santa Fe could then be better seen as the "initiating case" than the Union Pacific case..

However, none of these cases changed the law or the Rule. And neither the AT&T case nor Union Pacific case could have been the "initiating event" for cost changes because these decisions were no more than what other prior cases demonstrated. For example, as just mentioned the Santa Fe case (1986) and the Comstat case (1975) which happened before the NRF was established showed that taxpayers could successfully challenge the State Board of Equalization and could invalidate the models used by the SBE as a matter of law.

There is in the settlement a 25% discount factor that only arises in the settlement context. Thus it can only be viewed as in the control of the utility.

The Decision's Analysis and Disposal of A Key Criteria Was In Error

The third criteria in D.94-06-011 states that the cost must be clearly beyond management's control to qualify for Z- factor treatment. The decision commits a legal error in its misreading of the record to reach the conclusion that "it must find that the trial court's decision was the event that caused the Board to change the manner in which it calculated property taxes,".[1]

It is clear that cost changes were a direct result of the settlement agreement. The settlement resulted from an agreement by and among three independent parties: the counties, the utilities, and the Board. It is also true that GTEC and Pacific were among those that had pending law suits against the SBE and the suits the Milam refers to as "currently filed cases." The decision also acknowledges this much by saying that "GTEC and Pacific voluntarily entered into the settlement agreements"[2] and that "..the

[1] D.95-06-053, page 15
[2] Id.

signing of the settlement was within the control of the LECs' management, and was not as a result of an exogenous event."

But then defying logic and the record of the case the decision concludes that "...we do not believe that the *simple action* of participating in a settlement transfers the control of a specific cost onto the utilities' management."[3] *(Italics supplied)* There is nothing in the record to support this assertion. In fact, neither the counties nor the Board could have entered the settlement to avoid the AT&T case. The AT&T case as explained above was a separate agreement and its disposition ensured that an appellate decision would not be adverse or establish harmful precedent to the counties.

To the contrary, the record supports a result that had GTEC, Pacific, and others not filed law suits seeking refunds from the counties, and had they not voluntarily entered into the settlement, regardless of the results of the Union Pacific case and the AT&T case, the Board would be assessing their properties in the same old way using the same old assumptions and methods. This implies that the settlement is the determinative event for what followed in changes of cost calculation for the signatories. And this event was substantially under management's control.

Furthermore, the process of settlement negotiation in this indicates that the settlement was not a unilateral act by the counties, or by the SBE; nor was it without issues of controversy or an impasse. As GTEC's witness (Dunn) describes, the utilities and the counties had at one point reached an impasse which might have led to a breakdown of the negotiation.[4] One of these situations arose when utilities proposed a year-by-year settlement by which for each year the SBE assessed their property by the settlement methodology, they would abandon a year's worth of property tax refund. The counties refused.

Dunn provides a second example in which GTEC was ready to stop negotiating unless a proposed assessment to impose taxes for earlier years was removed.[5] All of these issues were ultimately resolved to reach settlement through the active participation and negotiations among the parties including GTEC and Pacific showing the give and take that all party settlements typically involve.

Analysis of The Decisions Findings and Conclusions

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[3] Id.
[4] Exhibit 9, Dunn Page 21-22
[5] Id.

D.95-06-053 relies for its foundation on some key findings of fact and conclusion of law which the majority decision continues to uphold. In the following summary we present these key FOFs and COLs and the respective results of our review:

Finding of Fact 17 states that the AT&T and Union Pacific cases "caused changes to the way property taxes are calculated."

This finding is baseless. Nothing in the record of AT&T or Union Pacific case mandated that the SBE change the way it calculates property taxes. In fact had this been the case, the settlement that followed in which GTEC and Pacific participated would have been unnecessary. But clearly that is not the case as the GTEC and Pacific settlement resulted in only a 25% reduction of deferred tax reserves (DTR) rather than the AT&T's case 100% reduction.

Finding of Fact 18 states that "[t]he settlement adopted in principle the Union Pacific or[sic] the AT&T valuation approaches addressed in the courts."

There is nothing in the record that supports this finding. From the logical construct of the statement it appears that the settlement adopted the valuation approach of either AT&T's case or Union Pacific's. But Union Pacific's case did not adopt an evaluation approach that even remotely resembles that of the settlement's. Therefore, the approach adopted must be from AT&T's case. But AT&T's case valuation approach required 100% deduction of DTR from historical cost less depreciation (HCLD), which greatly differs from the 25% deduction agreed upon in the settlement. Therefore the settlement did not adopt either valuation approach. **Conclusion of Law 2 states that "[t]he settlement, of which GTEC and Pacific were parties, necessarily adopted the principle of adjusting the HCLD valuation method by DTR because the court decisions found the HCLD method previously used by the Board illegal."**

This conclusion is grossly in error for at least two reasons. First, it is wrong to state that the GTEC and Pacific settlement "necessarily adopted the principle" from the AT&T and Union Pacific cases since (as noted above) the two cases had different reduction rates (100% versus 25%). Second, the Union Pacific case did not, as will be explained later, address the issue of deducting deferred taxes from the HCLD.

Finding of Fact 19 states that "[a]lthough Pacific and GTEC voluntarily signed the settlement with the Board, the principles adopted in the settlement had been predetermined by the Union Pacific and AT&T cases."

There is no evidence whatsoever in the record that supports the finding that the principle of the GTEC/Pacific cases was predetermined by the Union Pacific and AT&T cases. The applicability of both cases was limited to only the parties of each case. Moreover, the AT&T case, when it was settled, applied only to AT&T, and contained an agreement by the parties that they vacate the decision and that it shall have no precedential effect. The Union Pacific case does not even apply to the settlement with respect to the issues it addressed.

Conclusion of Law 1 states that "[T]he AT&T and Union Pacific cases were exogenous events. [However, the decision omits a necessary second COL that should have followed this conclusion as the discussion of the decision states "We must find that the trial court's decision was the event that caused the Board to change the manner in which it calculated property taxes using the HCLD method." (page 15.)]

The first sentence is obvious and indisputable. In so far as GTEC's and Pacific's management control of these events was concerned the AT&T and Union Pacific cases were truly exogenous, and irrelevant. But it takes an impossible leap of logic to go from there to conclude that these events caused changes in tax savings for GTEC and Pacific. To do this is not only to commit legal error (as there is no evidence to support such a conclusion) but to defy common sense, and the logic of cause and effect.

The decision's convenient avoidance of finding the obvious conclusion that the settlement agreement (which is not an exogenous event) caused property tax changes and that without it the event would not have occurred, is a glaring factual and legal error.

For all the above reasons we dissent from the majority decision

/s/ Josiah L. Neeper
Josiah L. Neeper
Commissioner

/s/ Jessie J. Knight, Jr.
Jessie J. Knight, Jr.
Commissioner

San Francisco, California
June 18, 1998

I.92-03-052
D.98-06-084

Commissioners Josiah L. Neeper and Jessie J. Knight, Jr., Dissenting:

We dissent from the majority's decision because we believe that Pacific's and GTEC's applications for rehearing, alleging legal errors, have substantial merit. D.95-06-053 committed legal error by wrongly concluding that property tax savings were caused by a single cause, the AT&T and Union Pacific cases, which it deemed were outside the influence of Pacific Bell and GTEC. There is no record evidence to support that conclusion. The majority's decision on the rehearing request further propagates that error by its denial of the application and failure to correct an egregious error .

We reach this conclusion based on two key facts presented in the record of this case: (1) an AT&T Court of Appeals decision did not *by itself* cause a change in the method the State Board of Equalization uses to determine property values for GTEC and Pacific. The Court of Appeals decision did not even exist. Further, a settlement of the AT&T case vacated the trial court's decision; and (2) the settlement agreement first reached between utilities (including GTEC and Pacific in exchange for their agreement to cease their fight for refunds), and counties, and then presented to SBE for consideration as to whether it should join in, caused the tax calculation change for GTEC and Pacific. Evidence abounds that shows the settlement was the result of active efforts by GTEC, Pacific and others. That makes it not an exogenous but an endogenous event.

The settlement could not have been reached without agreement by GTEC and Pacific Bell. All parties gained and lost by the settlement. Counties gained and utilities lost as there were no refunds. Utilities gained and counties lost by the forward looking change for determining property values which would reduce property taxes for utilities. Neither the AT&T Case nor the Union Pacific Case dictated or caused such a settlement. Therefore, the record does not support a conclusion that the change as it occurred was "clearly beyond the control of the utilities."

Criteria for Determination of Exogenous Factors

The criteria to determine whether certain costs and savings should be considered for annual rate adjustments was established first in the 1989 New Regulatory Framework (NRF) decision and later in 1994 by a decision which modified NRF.

The first NRF decision gave a brief, clear, controlling definition of what can be an exogenous factor. It said that "only exogenous factors which are not reflected in the economy wide inflation factor and which are clearly beyond the utility's control should be reflected in the Z factor treatment." (33 Cal. P.U.Code 2d at 228, COL 28 Emphasis supplied.).

As a starting point of what could qualify as an exogenous factor, the Commission accepted, among others, changes in federal and state tax laws, mandated jurisdictional separations, changes to interLATA toll pooling arrangement or accounting procedures. To demonstrate what would not qualify as exogenous factors the Commission identified cost changes due to labor strikes or contracts, normal cost of doing business, or general economic conditions. (For example, we observe that strikes can be avoided by settlement between management and unions and therefore are not exogenous.)

The 1989 NRF decision articulated the controlling test of "clearly beyond the utility's control" in defining exogenous. In the 1994 NRF decision the Commission established a more detailed set of 9 different criteria all of which the utility must meet to get Z-factor treatment: (1) the cost is the result of an exogenous event; (2) the event occurred after implementation of NRF(January 1 1990) (or, if pre-NRF, the event caused costs which the initial Phase II decision ordered to be flowed into rates); (3) the cost is clearly beyond management's control; (4) the cost is not a normal cost of doing business; (5) the event has a disproportionate impact on telephone utilities; (6) the cost is not reflected in the economy wide inflation factor (GDPPI), or at least that the portion of the cost is reflected in the inflation factor; (7) the item has a major impact on the utility's costs; (8) actual costs can be used to measure the impact of the change, or the impact can be measured with reasonable certainty and minimal controversy, and (9) the costs proposed for Z factor treatment are reasonable." (55 Cal.P.U. Code 2d, at 41)

In Decision 95-06-053, the subject of the rehearing, the Commission attempted to establish the foundation for determining that the property tax cost changes would qualify for exogenous factor treatment. It reached its result by concluding (1) that the AT&T and Union Pacific cases were exogenous factors; (2) the settlement agreement between Pacific, GTEC, the counties and the State Board of Equalization necessarily adopted the principle of reducing historical cost less depreciation (HCLD) by deferred

tax reserve (DTR) because the court decisions "found the HCLD illegal"; (3) the settlement applied only to the state's regulated utilities, affected them disproportionately and was not reflected in GNPPI.

In reaching this result the majority decision considered two of the nine criteria set forth in D94-06-011; namely, whether the event that caused the property tax savings was exogenous, and whether the property tax savings were reflected in the GNPPI, items number 1 and 6 in the above criteria, respectively. There is no explanation as to why *only* these two criteria should be applied or why the other seven criteria should not be applied in this case. To get Z-factor treatment there must be a record on which findings are made to meet each of the 9 criteria, conclusions to the same end, and articulated rationale for findings and conclusions. This was not done in either the original decision or the current decision on rehearing.

The Commission's central conclusion in D.95-06-053 that "*the court cases led the Board to pursue the settlements with the assesses, including Pacific Bell and GTEC*" was entirely based on a memorandum written by Robert D. Milam (Deputy Attorney General) to the State Board of Equalization's executive director. The decision states that the Milam memo is "conclusive evidence" that led it to conclude that the trial court's decision (Union Pacific v. the SBE) and the AT&T case "drove the board to sign the settlement with the counties." This conclusion and rationale does not deal in any way with (1) what drove the utilities to pursue settlement; (2) what drove either the SBE or the utility to agree to the terms of the agreement - prospective but no retrospective application of an agreed tax rate treatment; and (3) the fact that no settlement of the litigation was possible without the utilities choosing to settle rather than litigate to decision.

Rehearing Application of Pacific and GTEC

Pacific's and GTEC's allege that the decision exclusively relied on the Milam memo to decide whether the property tax change was caused by an exogenous event; that this evidence was "incompetent hearsay" and therefore the Commission can not rely on it.

Further they allege the following: (1) the Milam memo was received against the objections of GTEC and Pacific. (2) The decision misrepresents the Milam memo saying that the passage quoted in the decision does not state that the AT&T case drove the Board to sign the settlement; (3) the decision misapplied the Z-factor criteria

because (a) the property tax cost was the result of a settlement, which was not an exogenous event, (b) in determining what causes the settlement the decision unlawfully focuses on the motivation of one single party (the SBE) and ignores what motivated the counties and the utilities to sign the settlement; (4) the decision is inconsistent with efficiency incentives inherent in the NRF.

GTEC filed a late motion to set aside submission to introduce into evidence a letter written by Matt Fong in which he disagrees with the Commission's conclusion on what circumstances led to the settlement. DRA opposed GTEC's motion. The motion was denied.

Discussion

A useful purpose of an application for rehearing is to alert us to errors in our decisions so that we can correct them. The errors alleged by GTEC and Pacific require us to closely examine the conclusions reached and test the premises upon which those conclusions were established in light of the record, relevant Commission rules and policies.

The Milam Memo

Central in Pacific's and GTEC's allegation of error is that the Commission relied on incompetent and inadmissible evidence, referring to the Milam memorandum. We believe that this memorandum is inadmissible; however, we will put aside this issue on the presumption that it is admissible, in order to focus on whether the Milam memo provides record support for the rationale that underlies the fundamental conclusion reached by the majority decision. That rationale is:

> "This memorandum is conclusive evidence that the trial court's decision in the AT&T case drove the Board to sign the settlement with the counties and the regulated utilities."

The reference made to the Milam memo on which the decision exclusively relies in fact describes a second different but related reason the SBE should consider in deciding whether to settle:

> "The agreement was negotiated primarily by the counties which are principally affected, and since their money is directly at stake, they are in superior position

> to the Board to determine their own future. If successfully completed, the agreement provides potential certainty for the counties and the utilities involved for the next eight years. Such certainty has value for the counties, the utilities, and the Board."

In this part Milam's recommendation clearly establishes that "certainty" of outcome was a motivator to the counties, the utilities and the SBE. It also establishes the counties as well as SBE were important in the negotiated settlement. Another, third, motivation existed as described by DRA's witness who stated that "there was a desire to settle all pending litigations[sic] from different utilities...So that would be another event that would drive the settlement." (Gilbert 1 Tr. 57)

Another, fourth, motivation for SBE settling is stated in the Milam memo. Milam's recommendation that SBE join the proposed settlement was based in part on the "potential financial disaster" that will result if the "currently filed cases" including those of GTEC and Pacific are decided against the Board. This is not fear of only an Appellate Court decision in AT&T. This is fear of a decision in the GTEC/Pacific litigation the very case being settled if the Milam recommendation is accepted. In his recommendation, Milam states that:

> "To the extent that the agreement constitutes the settlement of pending lawsuits, and given the potential financial disaster facing the counties if the currently filed cases are decided against the Board and the counties, this office recommends, under Government Code 948, that the Board settle those cases by the use of the formula contained in the agreement." (Milam Memo Page 13)

Nonetheless, neither the Memo nor the record in any other respect produced any evidence that the SBE played any active role in formulating the terms of the settlement. The memo says the SBE did not. The SBE role was to join an already existing settlement. The record does show SBE signed the document along with counties and utilities. The Memo says the counties played the primary role in negotiating the settlement. The Memo, for its part, does not and could not speak to what if any action the SBE took following its recommendation since the Board had not acted on the settlement prior to the receipt of the memo.

The fundamental basis for D.95-06-053's qualification of tax cost changes for Z factor treatment is the Union Pacific decision and the AT&T trial court decision. These events, according to the Decision, are the only material causes that made the Board to settle with the assessees. The negotiators of the settlement, the management of Pacific Bell and GTEC, and the Board of SBE are viewed as automatons having no choice but settlement rather than litigation and no choice as to the terms. The view is that the AT&T case compels the parties to settle and compels the terms of the settlement. The decision has committed legal errors as a result thereof. It is legal error because there is no basis in the record that decisions of the courts in other cases caused SBE, much less Pacific and GTEC, to settle at all, rather than fight, and much less to settle on the major terms of the settlement.

To conclude that the court case and AT&T case caused the settlement presumes a single (two cumulative event) causation rationale in which these two events in concert caused a settlement to occur; and that apparently the SBE's decision was driven by a single interest "...that a settlement would be preferable to taking further risks in court, given the setbacks in the AT&T and Union Pacific court cases." (D.95-06-053, page 15) However, the decision does not provide and the record does not contain any basis as to what caused or motivated the SBE to act on the settlement. If it was motivated by the Memo, then any one of four different motivations, or only combination of the four may have been the motivation of the SBE.

Pacific's Allegation of Error that the Decision Misapplied The Z-factor Criteria Has Merit

The decision concludes that the AT&T and Union Pacific cases, and not anything within the control of GTEC and Pacific, caused the cost change and that the two events were exogenous. Such a conclusion is legal error. The AT&T trial court decision did not change the law. The court's decision was based on Rule 3 (d) and Rule 8. The court's decision did not change Rule 3(d) or Rule 8. Those rules were still in effect when the settlement was reached and thereafter. There was no appellate decision that affirmed the limited life model. The AT&T trial court decision never went into effect and never went to Court of Appeal since the parties made a settlement. In fact an important element of the AT&T agreement for SBE was that parties' agreed to vacate the trial court's decision so that it would have no precedential effect.

As far as the Union Pacific case is concerned, the Court of Appeal's ruling was more limited in its scope than the Santa Fe trial court decision even though it concluded that "lacking support for the assumption, the Board legally erred in using the composite life model." It should be noted that the composite limited life model was not found to be in violation of Rule 8 (c) as a matter of law. In contrast to this, the Santa Fe decision found the SBE model to be in direct violation Rule 8 (c) and thus invalidated it. The Santa Fe could then be better seen as the "initiating case" than the Union Pacific case..

However, none of these cases changed the law or the Rule. And neither the AT&T case nor Union Pacific case could have been the "initiating event" for cost changes because these decisions were no more than what other prior cases demonstrated. For example, as just mentioned the Santa Fe case (1986) and the Comstat case (1975) which happened before the NRF was established showed that taxpayers could successfully challenge the State Board of Equalization and could invalidate the models used by the SBE as a matter of law.

There is in the settlement a 25% discount factor that only arises in the settlement context. Thus it can only be viewed as in the control of the utility.

The Decision's Analysis and Disposal of A Key Criteria Was In Error

The third criteria in D.94-06-011 states that the cost must be clearly beyond management's control to qualify for Z- factor treatment. The decision commits a legal error in its misreading of the record to reach the conclusion that "it must find that the trial court's decision was the event that caused the Board to change the manner in which it calculated property taxes,".[1]

It is clear that cost changes were a direct result of the settlement agreement. The settlement resulted from an agreement by and among three independent parties: the counties, the utilities, and the Board. It is also true that GTEC and Pacific were among those that had pending law suits against the SBE and the suits the Milam refers to as "currently filed cases." The decision also acknowledges this much by saying that "GTEC and Pacific voluntarily entered into the settlement agreements"[2] and that "..the

[1] D.95-06-053, page 15
[2] Id.

signing of the settlement was within the control of the LECs' management, and was not as a result of an exogenous event."

But then defying logic and the record of the case the decision concludes that "...we do not believe that the *simple action* of participating in a settlement transfers the control of a specific cost onto the utilities' management."[3] *(Italics supplied)* There is nothing in the record to support this assertion. In fact, neither the counties nor the Board could have entered the settlement to avoid the AT&T case. The AT&T case as explained above was a separate agreement and its disposition ensured that an appellate decision would not be adverse or establish harmful precedent to the counties.

To the contrary, the record supports a result that had GTEC, Pacific, and others not filed law suits seeking refunds from the counties, and had they not voluntarily entered into the settlement, regardless of the results of the Union Pacific case and the AT&T case, the Board would be assessing their properties in the same old way using the same old assumptions and methods. This implies that the settlement is the determinative event for what followed in changes of cost calculation for the signatories. And this event was substantially under management's control.

Furthermore, the process of settlement negotiation in this indicates that the settlement was not a unilateral act by the counties, or by the SBE; nor was it without issues of controversy or an impasse. As GTEC's witness (Dunn) describes, the utilities and the counties had at one point reached an impasse which might have led to a breakdown of the negotiation.[4] One of these situations arose when utilities proposed a year-by-year settlement by which for each year the SBE assessed their property by the settlement methodology, they would abandon a year's worth of property tax refund. The counties refused.

Dunn provides a second example in which GTEC was ready to stop negotiating unless a proposed assessment to impose taxes for earlier years was removed.[5] All of these issues were ultimately resolved to reach settlement through the active participation and negotiations among the parties including GTEC and Pacific showing the give and take that all party settlements typically involve.

Analysis of The Decisions Findings and Conclusions

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[3] Id.
[4] Exhibit 9, Dunn Page 21-22
[5] Id.

D.95-06-053 relies for its foundation on some key findings of fact and conclusion of law which the majority decision continues to uphold. In the following summary we present these key FOFs and COLs and the respective results of our review:

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There is no evidence whatsoever in the record that supports the finding that the principle of the GTEC/Pacific cases was predetermined by the Union Pacific and AT&T cases. The applicability of both cases was limited to only the parties of each case. Moreover, the AT&T case, when it was settled, applied only to AT&T, and contained an agreement by the parties that they vacate the decision and that it shall have no precedential effect. The Union Pacific case does not even apply to the settlement with respect to the issues it addressed.

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