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Decision 00-01-021 January 6, 2000

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.	Investigation 92-03-052 (Application for Rehearing filed July 25, 1995)

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OPINION

Summary

Based on our analysis of the Z-factor criteria set forth in Decision (D.) 94-06-011 and affirmed in D.97-04-043, we find that cost impacts from the property tax settlement agreement are not eligible for Z-factor treatment. Accordingly, it is no longer necessary for Pacific Bell and GTE California Incorporated (GTEC) to collect rates subject to refund or to maintain a California Property Tax Memorandum Account (CPTMA) for the purpose of flowing through property tax savings to their ratepayers.

Jurisdiction

Rule 14 of the Commission's Rules of Practice and Procedure sets forth the Commission authority and procedure to open an investigation on its own motion. Pursuant to Rule 14, this investigation was opened to consider the impact of a possible change in the way the State Board of Equalization (Board) assessed property owned by California's regulated utilities and of a possible over-assessment by the Board of property owned by Commission regulated utilities.

Background

Upon issuance of this investigation, named respondents were ordered to collect future rates subject to refund for the purpose of flowing through to ratepayers property tax savings available under a settlement agreement or resulting from other changes in the method of calculating property tax assessments. Named respondents were also ordered to establish a California CPTMA to record decreased revenue requirements to fully reflect any decrease in property taxes available under a settlement agreement or resulting from any similar changes in assessment methods.

On May 1, 1992, approximately two months after this investigation was opened, a settlement agreement was entered into between the Board, the Attorney General of California, the 58 California Counties, and 27 state-assessed regulated utilities. Subsequently, on July 14, 1993, this settlement agreement was validated by the Sacramento County Superior Court in its Judicial Council Coordination Proceeding No. 2785.

The terms of the settlement agreement provided for the Board to value 27 state-assessed regulated utilities on the basis of their respective Historical Cost Less Depreciation (HCLD) indicators less 25% of Deferred Tax Reserve (DTR). The DTR deduction was phased in over a three-year time period to minimize financial hardships to the California counties. The result of this agreed upon equation is known as the "Calculated Property Value" (CPV) and applicable for each fiscal year beginning in 1992-1993 and ending in 1999-2000. Prior to this settlement agreement, the Board selected different valuation approaches to assess the utilities' property each year. In those prior years that the Board selected the HCLD valuation approach, there was no DTR deduction.

An interim decision found that the property tax assessment event was exogenous and not reflected in the economy-wide inflation factor of Pacific Bell and GTEC.[1] That decision also required Pacific Bell and GTEC to continue tracking property tax assessment cost impacts in the CPTMA pending resolution of the Z-factor criteria being re-examined in the non-related Post Retirement Benefits other than Pensions (PBOPs) Investigation ((I.) 90-07-037).

Pacific Bell and GTEC filed applications for rehearing of D.95-06-053 on July 25, 1995, alleging that the Commission erred in concluding that the events

[1] D.95-06-053, 60 Cal PUC2d 389 at 395-397, 399, and 400 (1995).

that caused the property tax assessment savings were exogenous. The rehearing requests were denied approximately three years later. However, that decision affirmed that the events that caused the property tax savings were exogenous and property tax savings were not reflected in the economy-wide inflation factor.[2] Pacific Bell and GTEC were ordered, and interested parties invited, to file concurrent briefs detailing how the Z-factor criteria re-examined in our investigation into PBOPs affect the outcome of the Z-factor issue in this investigation. This order addresses and resolves the remaining Z-factor issue.

Concurrent Briefs

Pacific Bell, GTEC, and the Office of Ratepayer Advocates (ORA)[3] filed concurrent briefs on the Z-factor issue. Pacific Bell and GTEC asserted that their CPTMAs should be dissolved because their respective property tax savings do not satisfy the required Z-factor criteria set forth in D.94-06-011[4] and affirmed in D.97-04-043.[5] ORA took the opposing position that the utilities' property tax savings satisfied the Z-factor criteria and, as such, should be afforded Z-factor treatment.

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[2] D.98-06-084, mimeo., p. 1, (June 18, 1998).

[3] Although ORA did not participate in this proceeding, the Commission's Division of Ratepayer Advocates (DRA) did. By action of the Executive Director, DRA ceased to exist as a staff unit on September 10, 1996, and the functions performed by DRA were transferred to a new organization named the Commission's ORA.

[4] 55 Cal PUC2d 1 at 36-41 (1994).

[5] Re Investigation into the Matter of Post-Retirement Benefits Other Than Pensions, D.97-04-043, mimeo., p. 38, (April 9, 1997).

Z-Factor Criteria

A Z-factor was designed to compensate utilities positively or negatively for exogenous cost changes to the extent that such cost changes are not fully reflected in the economy-wide index of inflation used in generating the price cap. Under the price cap mechanism adopted by the Commission in its New Regulatory Framework Decision, NRF Decision or Phase II Decision, criteria were established to identify the types of cost that should be treated as a Z-factor. At that time, we determined that only exogenous factors not reflected in the economy-wide inflation factor and which are clearly beyond the utility's control should be reflected in the price cap filing as a Z-factor.[6]

A comprehensive framework for Z-factor analysis was subsequently developed from a review of the NRF Decision and other Z-factor orders. This subsequent analysis established the need to satisfy nine criteria before an event is qualified to be a Z-factor.[7] If the event fails to satisfy any one of the nine criteria, it does not qualify for Z-factor treatment.

Our re-examination of the Z-factor criteria in the PBOP investigation affirmed that the Z-factor treatment for PBOP reasonably satisfied the nine criteria.[8] Although we authorized Z-factor treatment to continue for property tax

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[6] 33 Cal PUC2d 43 at 228 (1989).

[7] 55 Cal PUC2d 1 at 36 (1994).

[8] Re Investigation on the Commission's Own Motion into the Matter of Post-Retirement Benefits Other Than Pensions, Decision 97-04-043, mimeo., p. 38, (April 9, 1997).

savings and certain other costs if such savings and costs satisfied the nine criteria, we began to phase out the Z-factor mechanism in 1998.[9]

In our order denying Pacific Bell and GTEC's property tax rehearing applications, we affirmed that the property tax event satisfied the Z-factor criteria, in that the cost was the result of an exogenous event and not reflected in the economy-wide inflation index. Hence, we only need to determine whether the property tax event has satisfied the remaining seven criteria for Z-factor treatment. The remaining criteria under consideration in this proceeding are whether the:

a. Event occurred after the New Regulatory Framework (NRF) was implemented or, if pre-NRF, the event caused costs which the initial Phase II decision ordered to be flowed into rates;
b. Cost is beyond management's control;
c. Cost is not a normal cost of doing business;
d. Event has a disproportionate impact on telephone utilities;
e. Item has a major impact on the utility's overall cost;
f. Impact can be measured by actual cost with reasonable certainty and minimal controversy; and,
g. Costs are reasonable.

A. Did the Event Occur after NRF was implemented?

To be eligible for Z-factor treatment an event should have occurred after NRF was implemented. An exception to this rule applied to events that occurred prior to the implementation of NRF if the Commission specifically ordered in the initial Phase II decision that the pre-NRF change should flow into

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[9] Re Third Triennial Review of the Regulatory Framework, D.98-10-026 mimeo., p. 93 (O.P.1), (October 8, 1998).

rates. However, if a Commission decision simply extended a utility practice in effect at the time of the startup revenue requirement adopted in the Phase II decision, the costs associated with the extension of that practice are not considered new costs and thus may not be considered for Z-factor treatment.[10]

The only party that addressed whether the property tax event occurred after the January 1, 1990 NRF effective date in its concurrent brief was ORA. The settlement agreement did not formally begin until October 1991, the terms of which did not commence until the fiscal years 1992-1993 through 1999-2000. It was not until July 14, 1994 that the settlement agreement was validated by the Sacramento County Superior Court. As to the start up revenue requirement impact, there was no prior modification to Pacific Bell's or GTEC's start up revenue requirement or subsequent Z-factor adjustments to address property tax expense changes resulting from the May 1, 1992, settlement agreement.

These property tax events occurred after the January 1, 1990 date that NRF was implemented, and thus clearly satisfy the requirement that the property tax event occur after NRF was implemented.

B. Are the Costs Beyond Management's Control?

While the Commission's initial Z-factor determination focused on whether an event was within management's control, this analysis moved forward to focus on the NRF utility's ability to control the impact of an event. The characteristics of a controllable event were set forth in D.94-06-011. As explained in that decision, there may be circumstances in which an outside entity initiates an event which imposes upon a NRF utility specific costs which can be

[10] 55 Cal PUC2d 1 at 37 (1994).

objectively determined and which cannot be significantly affected by any action of utility management. On the other hand, there will be circumstances in which an outside event requires the utility to take some action, but does not impose specific objectively determinable costs or wholly limit the utility's response to the event. In the latter circumstances, the utility may have the ability to respond to the event in a manner that limits the financial impact of the event. In sum, the utility may be able to control, and thus lessen, the adverse impact.[11]

For example, natural disasters such as earthquakes and floods are events beyond a NRF utility's management control. Nevertheless, we concluded in Resolution T-15160, dated December 16, 1992, that the opportunity to purchase disaster insurance to mitigate the resulting cost impact from a natural disaster is well within the control of a NRF utility. Not only does a NRF utility's management have the discretion to comparison shop for the best price; it can also negotiate the level of insurance coverage and deductibles that it might pay. Hence, the Commission denied Z-factor recovery for expenses incurred from natural disasters.

Pacific Bell and GTEC relied on their settlement negotiation activities to substantiate that property tax costs resulting from the settlement agreement were not beyond management control. Pacific Bell and GTEC explained that the terms of the settlement agreement reflected a negotiation process which resulted in significant compromises by the settlement participants and a different outcome from the AT&T and Union Pacific decisions. For example, the final settlement

[11] 55 Cal PUC2d 1 at 37 (1994).

agreement not only dismissed Pacific Bell's and GTEC's pending tax claims,[12] it also resolved future years' assessments, while the AT&T and Union Pacific cases resolved only prior years' assessments.

Unlike the AT&T case providing for a 100% DTR deduction for one year, the utilities' management negotiated a property tax assessment formula to provide for a 25% DTR deduction phased-in over a three-year time period and use of the same formula for a eight-year time period. The DTR phase-in deduction was negotiated to minimize financial hardships that the California counties would incur for loss of property taxes.[13] The California Counties estimated that they would experience a $1.1 billion aggregate reduction in property taxes over the eight-year time period of the settlement agreement if the AT&T Case rate base valuation was applied to the signatory state-assessed regulated utilities of the settlement agreement.

Pacific Bell concluded that its negotiation activities resulted in a settlement agreement within its management control that significantly differed from the AT&T and Union Pacific decisions. In support of its position, Pacific Bell cited a prior Commission acknowledgment that "the signing of the settlement was within the control of the LECs management and was not, as a result, an exogenous event."[14]

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[12] Pacific Bell had tax claims pending for the 1984-85 through and including 1989-90 tax years. GTEC had tax claims pending for the 1981-82 through and including 1986-87, 1990-91, and 1991-92 tax years.

[13] See County of Sacramento vs. All Persons Interested, etc. (June 17, 1987) Complaint for Validation No. 527739, Sacramento County Superior Court.

[14] 60 Cal PUC2d 389 at 396 (1995).

GTEC also concluded that its management had controllable recourse in this event because it chose to negotiate a settlement agreement and exercised discretion to evaluate the risks and rewards of the proposed settlement agreement. Also, GTEC's management voluntarily decided to accept the settlement agreement. Hence, its management discretion and control was instrumental in the settlement agreement process and, as such, does not satisfy the "cost beyond management control" criteria.

ORA disputed Pacific Bell and GTEC claims that the settlement agreement was not beyond management's control. ORA took the position that irrespective of Pacific Bell's direct involvement in the settlement agreement, no single utility's management was able to control the methodology used and endorsed by the trial court, or the specific application of that methodology.

ORA acknowledged that there was a difference between the 100% DTR deduction approved in the AT&T's trial court decision and the partial DTR deduction approved in the settlement agreement. However, ORA reasoned that it was the AT&T's trial court endorsement of the validity of a DTR deduction that made the settlement agreement beyond Pacific Bell and GTEC's management control. This was because the trial court's DTR methodology endorsement prompted and formed the basis of Pacific Bell and GTEC's negotiations and settlement agreement. Hence, ORA concluded that the property tax costs should be found to have satisfied the criteria that this event was beyond management control.

There is no dispute that Pacific Bell and GTEC's management had no control over the nature of the outcome of the AT&T and Union Pacific Cases. However, similar to the criteria set forth in the disaster insurance resolution, Pacific Bell and GTEC had management discretion to comparison shop for the best deal they could litigate or negotiate to their financial advantage. Pacific Bell and GTEC also had the option to withdraw from their property tax litigation and continue with the yearly assessment valuation process, as set forth in our subsequent discussion of "actual cost with reasonable certainty and minimal controversy."

Irrespective of management options, the utilities exercised their management prerogative to negotiate and sign a compromise which vacated their pending suits and complaints against the Board, phased in only a percentage of the DTR deduction granted to AT&T, and locked in a specific assessment methodology for the next eight years. Each of these activities individually impacted property tax cost. Clearly, the management of Pacific Bell and GTEC had exercised management control to mitigate the financial impact of this event through the settlement process. We conclude that the financial impact of the settlement agreement was within the management control of Pacific Bell and GTEC. The property tax cost change was not beyond the utilities' management control.

C. Are the Costs Not a Normal Cost of Doing Business?

A key NRF benefit to ratepayers is that they are no longer responsible for making NRF utilities whole for each cost increase exceeding the inflation index used in the annual price cap filings. To the extent that costs at issue are simply normal business costs, the mere fact that they are changing does not make them eligible for Z-factor treatment.[15]

To determine normal business costs, it is important to determine whether an event changes cost for all businesses and whether its effects are

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[15] Id., at 38.

captured in the normal cost of doing business. For example, all companies, as part of their normal cost of doing business, are impacted by across the board changes such as tax laws, which are, therefore, are not considered Z factors. Extensions of existing costs are, in essence, normal costs of doing business and thus ineligible for Z-factor treatment.

Although Pacific Bell did not address whether the property tax event satisfied the non-normal cost of doing business criteria in its brief, GTEC did. GTEC acknowledged that the PBOP re-examination of the Z-factor criteria found that even though PBOP costs were a normal cost of doing business for unregulated firms, such costs were not a normal cost for Pacific Bell and GTEC. This was because the NRF start-up revenue requirement did not reflect the pending PBOP accounting change.

In contrast to its PBOPs cost, GTEC represented that its property tax costs were included in its NRF start-up revenue requirement and were not impacted by a formula change that would make any property tax cost change comparable to the PBOPs cost change. GTEC concluded that this property tax event was a normal cost of doing business because GTEC must, as must all property owners, pay property tax every year irrespective of how a utility's valuation is calculated.

ORA relied on a different aspect of the PBOPs decision that identified the PBOPs accounting change as a normal cost of business for unregulated firms, because PBOPs had no effect generally on prices of these unregulated firms. Unlike unregulated firms, Pacific Bell and GTEC were unable to adjust their prices to reflect the true economic costs of PBOPs absent Commission authorization. Accordingly, it was this distinction in pricing flexibility between the regulated and unregulated competitive firms that determined PBOPs costs from an accounting change to be outside of the normal course of business for Pacific Bell and GTEC.[16]

With respect to the property tax savings being addressed in this decision, ORA concluded that Pacific Bell and GTEC similarly could not reflect the property tax savings without Commission authority and that regulated utilities were the only entities impacted by the property tax savings. Hence, the property tax cost savings resulting from the settlement agreement should not be found to be a normal cost of doing business.

Even though property tax is applicable to all businesses that own property, the settlement agreement only applied to 27 California utilities. The settlement agreement applied only to property owned by 27 of California's telephone, gas, electric, and multi-county water utilities regulated by this Commission.[17] Similar to the situation addressed in our PBOPs decision, Pacific Bell and GTEC were unable to adjust their prices to reflect the true economic costs of the settlement agreement absent Commission authorization. Hence, the cost impact of this event was not a "normal cost of doing business."

D. Does the Event have a Disproportionate Impact on Telephone Utilities?

In the Phase II decision we stressed that there should be no double counting between Z-factor adjustments and the inflation index. Essentially, the disproportionate impact test is simply a restatement of the requirement that the cost at issue be something other than a normal cost of business. If an event of

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[16] Re Investigation on the Commission's Own Motion of Post-Retirement Benefits Other Than Pensions, Decision 97-04-043, mimeo., p. 28.

[17] 60 Cal PUC2d 389 at 400, (1995).

nationwide significance affects all businesses approximately the same, or proportionately, then it would follow that the costs associated with that event are not eligible for Z-factor treatment. This test provides a useful gauge for distinguishing between a utility's specific costs and those costs incurred by firms throughout the economy.[18]

The disproportionate impact test is a critical factor in our framework in the tax law change context. However, we have not stated that the cost, in all circumstances, must fall disproportionately on local exchange carriers in order to be eligible for Z-factor treatment. In the vast majority of circumstances, the requirement that a cost be something other than a normal cost of doing business will rule out Z-factor treatment for costs which do not disproportionately affect local exchange carriers.

GTEC asserted that any property tax cost change would not disproportionately impact the telephone utilities for the following reasons. Water and energy utilities were included as respondents to our investigation. Energy utilities also entered into the settlement agreement. Moreover, the Board applied the calculated property value produced by the settlement formula to the energy utilities as well as to the settling telephone utilities.

However, we previously concluded that the settlement agreement applied only to the state's regulated utilities and that the change in the way property taxes were calculated affected these businesses disproportionately.[19] Although Pacific Bell and GTEC filed applications for rehearing of the decision making this conclusion, the decision which denied the utilities rehearing requests

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[18] 55 Cal PUC2d 1 at 39 (1994).

[19] 60 Cal PUC2d 389 at 400 (1995).

did not re-visit the "disproportionate impact" criteria. Absent a valid reason to revisit the "disproportionate impact" criteria, we affirm our prior conclusion that the settlement agreement had a disproportionate impact on the state's regulated utilities, including telephone utilities.

E. Did the Event have a Major Impact on the Utility's Overall Costs?

Pursuant to the Phase II decision, Z-factor adjustments should only be sought if there were major impacts on the utility's costs. Although major impacts and costs were not defined in the Phase II decision, D.94-06-011 clarified that the cost impact should be based on the utility's overall costs. Hence, an alleged Z-factor event must have a major impact on a utility's overall costs to be eligible for Z-factor treatment.[20]

Neither Pacific Bell nor GTEC believed that the property tax event had a major impact on their costs. Pacific Bell took this position because it could not identify or reasonably quantify the actual cost impact of its property tax cost change. Pacific Bell explained that it could not calculate its cost impact because the Board, prior to the settlement agreement, exercised wide latitude and discretion to select a subjective valuation, did not rely on any one specific valuation approach, and the impact of the valuation approach selected was unpredictable from year to year. Pacific Bell also relied on the Board's counsel cautioning against the use of the Board's staff estimates for this proceeding because such estimates were intended for internal purposes only and included assumptions of how Board members might have voted on various assessments in the absence of the settlement agreement. Absent such quantification, Pacific Bell

[20] 55 Cal PUC2d 1 at 40 (1994).

was not able to determine whether the settlement agreement had a major, let alone any, impact on its cost.

GTEC took the position that the property tax event had no major cost impact because its property taxes actually increased 18.7% in 1990 over 1989 (from approximately $58 million to $68 million) the first full NRF year. Further, this cost increase in property taxes occurred without any permissible revenue offset. Although its property taxes decreased 8.6% in 1991 and 2.8% in the 1992 year of the settlement agreement, the $61 million resultant 1992 level of property tax was above the cost level included in GTEC's NRF start-up cost. Hence, GTEC reasoned that any claimed cost change would only bring its property tax cost down toward the level of property tax costs built into its rates.

Contrary to Pacific Bell's and GTEC's position, ORA took the position that the property tax cost change had a major impact on the utilities' costs because the settlement agreement provided for a HCLD valuation methodology that recognized a deduction for a portion of the utilities' DTR. This DTR deduction would produce a lower assessment value than if the DTR deduction were not included. A lower property value assessment translated to a lower property tax charge to the utilities. The counties estimated that the DTR impact on property tax cost over the settlement agreement's eight-year time period for all 27 utilities included in the settlement agreement totaled approximately $500 million.[21]

Since the issue of materiality does not affect the disposition of the question of whether to permit Z-factor treatment for this particular tax change,

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[21] See County of Sacramento vs. All Persons Interested, etc. (June 17, 1987) Complaint for Validation No. 527739, Sacramento County Superior Court.

and because there is no set Commission policy on the issue of materiality, we decline to reach a conclusion on this issue at this time.

F. Can the Actual Cost Be Determined with Reasonable Certainty and Minimal Controversy?

The Phase II decision stated that actual cost's already incurred should be relied upon to measure impacts of exogenous events, if feasible, and that exogenous costs should be measured relative to the prior year's conditions to the extent possible. If actual costs can be used to measure financial impacts or if, with reasonable certainty and minimal controversy, the financial impacts can be determined, the cost may be eligible for Z-factor treatment.[22]

Pacific Bell and GTE took the position that the actual cost criteria cannot be satisfied because it is impossible to determine the actual cost, or to identify cost with reasonable certainty and minimal controversy. The utilities relied on prior Commission findings to support their position. For example, the Commission previously found that the Board's adopted assessment valuation frequently differed from the Board's Valuation Division recommendation and that it has been common practice for individual Board members to support different value indicators and weightings.[23]

The utilities also cited the yearly valuation process that the Board goes through to substantiate that is impossible to determine the actual cost or to identify cost with reasonable certainty and minimal controversy. This valuation process started each year with the individual utilities being assessed on a unitary

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22 55 Cal PUC2d 1 at 40 (1994).

23 60 Cal PUC2d 389 at 399 (1995).

basis by the Board, based on a January 1st lien date. The individual utilities presented testimony on the capitalization rate to be used in the Board's capitalization earnings approach value indicator in February. By March 1st, the utilities provided the Board's Valuation Division with relevant financial information and presented a recommended valuation. In early May, the utilities presented written testimony and appeared before the Board to present oral testimony on the appropriate value indicators and ultimate assessment value that should be adopted by the Board for the year. The Board's Valuation Division also presented an Appraisal Data Report after its analysis of utility-provided information to the Board for consideration. At a public hearing prior to the end of May, the Board would adopt a final total unitary value for property taxation for each state assessee. The Board's staff then determined the portion of the assessment applicable to each county in which the utility maintained property. Finally, the county tax collectors prepared tax bills based upon their county's respective allocated portion of the Board's total assessment.

ORA took the opposing position that the actual cost criteria can be determined based on a prior NRF decision that stated exogenous costs should be measured relative to the prior year's conditions to the extent possible.[24] Accordingly, ORA compared Pacific Bell's and GTEC's 1991-92 assessed property values established by the Board to the value that would have resulted if the DTR deduction had been in effect at that time. ORA's comparison approach showed that the DTR deduction would have reduced Pacific Bell's 1991-92 property tax expense by approximately $25.4 million and GTEC's by $9.7 million.

[24] The cited reference is 22 CAL PUC2d 43 (1989), at 236, a Southern California Edison Company proceeding which makes no reference to an exogenous event.

Hence, ORA concluded that actual cost is available to measure the financial impact of this property tax event.

Although ORA calculated an impact of the property tax event by adjusting the prior years' condition to include the DTR deduction, there is no evidence to substantiate that actual costs could be measured relative to the prior year's conditions. ORA's method also conflicts with the findings in D.95-06-053. That decision found that the valuation process enables the utilities to present written and oral testimony on the appropriate value indications for use and the ultimate assessment value that the Board should adopt each year. It also found that the reliance of individual Board members on particular valuation approaches and their relative weights would change year to year. Value indicators used by the Board included historical cost less depreciation, stock and debt, reproduction cost, and replacement cost. In other words, the Board did not have a single pre-settlement methodology and exercised considerable discretion in assessing unitary property prior to the settlement agreement.

With the settlement agreement, the Board's valuation discretion has been significantly restricted and requires the Board to use a single methodology for an eight year time period. With the Board's subjective valuation process, it is not feasible to reasonably determine what the utilities' future valuations would have been had the settlement agreement not been reached. Actual cost can not be determined with reasonable certainty and minimal controversy.

G. Are the Costs Reasonable?

The Phase II decision specified that we must evaluate the extent to which external events should be reflected in revenue levels through the Z-factor. This requirement should be similar to the evaluation of these factors undertaken in a general rate case. The need to review the reasonableness of the costs reflected in the Z-factor is noted in D.92-03-080, which indicated, in part, that any major exogenous events beyond the utility's control for which the cost are found to be reasonable, and which are not fully reflected in the economy-wide inflation factor, are recoverable through a Z-factor adjustment.[25]

Pacific Bell and GTEC found that the "reasonable cost" criteria could not be satisfied because of their inability to identify the amount of the cost change with reasonable certainty or minimal controversy. GTEC further disputed whether any tax savings occurred due to the settlement agreement. This is because the State Constitution and state statue requires the Board to assess property at fair market value. Hence, to find that cost savings occurred from the settlement agreement, it would be necessary to find that the Board illegally assessed utility property at less than fair market value or that the Board would have been illegally assessing property at more than fair market value absent the settlement agreement. GTEC concluded that the settlement agreement is consistent with current Board property tax rules and that the utilities' property assessments are within a reasonable range or approximation of fair value. Hence, the reasonable cost criteria should not be applicable in this case.

ORA concluded that the reasonable costs criteria is satisfied because the valuation methodology set forth in the settlement agreement, and the full impact of the appropriate Z-factor adjustment can be determined with reasonable certainty as calculated by ORA.

To the extent that the utilities' property taxes were based on a valuation process utilized by the Board, such property taxes should be found reasonable. However, absent evidence and the ability to determine what the utilities' future

[25] Id. at p. 41.

valuations would have been with reasonable certainty had the settlement agreement not been reached, it is impossible to determine whether the property tax cost change can satisfy the reasonable cost criteria. Hence, we cannot find that the cost from this event is reasonable.

Conclusion

The property tax settlement agreement cost impacts satisfied five of the nine required criteria for Z-factor treatment. The criteria not satisfied were "beyond management control," "major impact on the utilities' overall costs," "actual cost with reasonable certainty and minimal controversy," and "reasonable cost." Z-factor treatment is not applicable because the property tax settlement agreement did not satisfy each of the nine Z-factor criterion.

Comments on Draft Decision

The draft decision of the Administrative Law Judge in this matter was mailed to the parties in accordance with Pub. Util. Code Section 311(g) and Rule 77.1 of the Rules and Practice and Procedure. Comments and reply comments were timely filed by Pacific Bell, GTEC, and ORA. The comments and reply comments filed by the parties to this proceeding have been carefully reviewed and considered. These comments and reply comments resulted in minor changes to the body of this order.

Findings of Fact

1. This investigation was opened on the Commission's own motion pursuant to Rule 14.

2. A Z-factor is designed to compensate the utilities positively or negatively for exogenous cost changes to the extent that such cost changes are not fully reflected in the economy-wide index of inflation used in generating the price cap.

3. There are nine criteria that must be satisfied for an event to qualify for Z-factor treatment.

4. D.98-06-084 affirmed that the property tax event satisfied two of the nine criteria. The satisfied criteria were that the costs were the result of an exogenous event and they were not reflected in the economy-wide inflation index.

5. NRF became effective on January 1, 1990.

6. The settlement agreement did not formally begin until October 1991.

7. The settlement agreement was entered into on May 1, 1992 between the Board, the Attorney General of California, the 58 California Counties, and 27 state-assessed regulated utilities.

8. The Sacramento County Superior Court validated the settlement agreement on July 14, 1993.

9. The terms of the settlement agreement did not commence until the fiscal years 1992-93 through 1999-2000.

10. The characteristics of a controllable event were set forth in D.94-06-011.

11. Pacific Bell and GTEC's management had the option to withdraw from the property tax litigation.

12. Natural disasters such as earthquakes and floods are events beyond a utility management's control. However, the opportunity to purchase disaster insurance to mitigate the resulting cost impact from a natural disaster is within the control of a NRF utility.

13. Pacific Bell mitigated the financial impact of this event through the settlement process.

14. Pacific Bell and GTEC participated in negotiating a settlement agreement.

15. The AT&T and Union Pacific cases resolved only prior year's assessments.

16. The settlement agreement dismissed the utilities' pending tax claims and resolved future years' assessments.

17. The settlement agreement provided for the phase-in of a partial DTR deduction compared to the AT&T case that provided for a full DTR deduction.

18. The settlement agreement provided for a specific assessment methodology to be used for an eight-year time period.

19. The normal cost of doing business is excluded from the Z-factor adjustment.

20. Extension of existing costs are normal costs of doing business.

21. The settlement agreement applied to only 27 California utilities regulated by this Commission.

22. Pacific Bell and GTEC were unable to adjust their prices to reflect the true economic cost of PBOPs absent Commission authorization.

23. Property tax is applicable to all California businesses.

24. D.95-06-053 found that the settlement agreement applied only to the state's regulated utilities and that the change affected these utilities disproportionately.

25. An event having a major impact on a utility's overall cost is eligible for Z-factor treatment.

26. Pacific Bell could not calculate its cost impact because the Board exercised wide latitude and discretion to select a subjective valuation.

27. GTEC's property taxes actually increased 18.7% in 1990 over 1989 without any revenue offset.

28. GTEC's 1998 level of property tax was above the cost level included in its NFR start-up costs.

29. Official notice is taken of Pacific Bell's and GTEC's 1992 Form M annual report filed with the Commission.

30. The financial impact of a major exogenous event subject to the Z-factor adjustment is measured by actual costs with reasonable certainty and minimal controversy.

31. Pacific Bell and GTEC were not able to identify the amount of their property tax cost change.

32. State Constitution and statue requires the Board to assess property tax at fair market value.

33. The reasonable costs of major exogenous events may be recoverable through a Z-factor adjustment.

34. No evidence was presented to identify what the utilities' property tax would have been absent the settlement agreement.

35. Parties dispute whether actual cost differences can be determined and whether alleged cost differences are reasonable.

Conclusions of Law

1. If a cost fails to satisfy any one of the nine criteria listed in D.94-06-011, it does not qualify for Z-factor treatment.

2. The property tax event has satisfied the criterion that the event occurred after NRF was implemented.

3. The property tax event has satisfied the criterion that the impact of the settlement agreement was the result of an exogenous event and not reflected in the economy-wide inflation index.

4. The property tax cost change has not satisfied the criterion that the event was beyond management's control.

5. The cost impact of this event satisfied the criterion that the event was not a normal cost of doing business.

6. The event has satisfied the criterion that it had a disproportional impact on telephone utilities.

7. The event does not satisfy the criterion that the actual cost impact can be determined with reasonable certainty and minimal controversy.

8. We can not find that the cost from this event is reasonable.

9. The settlement agreement does not satisfy each of the nine required criteria for Z-factor treatment.

ORDER

IT IS ORDERED that:

1. Pacific Bell and GTE California, Incorporated (GTEC) property tax cost changes resulting from a May 1, 1992 settlement agreement with the State Board of Equalization, the Attorney General of California, the 58 California Counties, and 27 state-assessed regulated utilities are not eligible for Z-factor treatment.

2. Pacific Bell and GTEC's rates collected subject to refund for the purpose of flowing through to ratepayers property tax savings available under the settlement agreement are final and no longer subject to refund.

3. Pacific Bell and GTEC California Property Tax Memorandum Accounts established upon the issuance of this investigation are no longer applicable and shall be discontinued.

4. Order Instituting Investigation 92-03-052 is closed.

This order is effective today.

Dated January 6, 2000, at San Francisco, California.

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
CARL W. WOOD
LORETTA M. LYNCH
Commissioners

APPENDIX A

TABLE OF ACRONYMS AND ABBREVIATIONS

Board	-	Board of Equalization
CPTMA	-	California Property Tax memorandum Account
CPV	-	Calculated Property Value
D.	-	Decision
DTR	-	Deferred Tax Reserve
GTEC	-	GTE California Incorporated
HCLD	-	Historical Cost less Depreciation
I.	–	Investigation
NRF	-	New Regulatory Framework
ORA	-	Office of Ratepayer Advocates
PBOPs	-	Post Retirement Benefits Other than Pensions

(END OF APPENDIX A)