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Decision 92-10-057 October 21, 1992

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Pacific Bell (U 1001 C) for Authorization to Transfer Specified Personnel and Assets.	)))))	Application 90-12-052 (Filed December 27, 1990)

ORDER MODIFYING DECISION 92-07-072 AND REJECTING APPLICATION FOR REHEARING AND DENYING PETITION FOR MODIFICATION OF DECISION 92-07-072

On July 24, 1992 the Commission issued Decision (D.) 92-07-072. This Decision approved Pacific's application made under Public Utilities Code section 851 to transfer the personnel and assets of its Information Services Group (ISG) to Pacific Bell Information Services (PBIS), a newly created California Corporation. ISG is a department within Pacific that provides enhanced services such as voice mail, electronic messaging, voice store and forward services. Pacific Bell (Pacific) filed an Application for Rehearing/Petition for Modification of D.92-07-072 on August 21, 1992. Pacific's Application for Rehearing/ Petition for Modification alleges that the Decision inappropriately awards ratepayers the increase in the value (going concern value less net book value) of Pacific's ISG. Pacific also claims that the Decision violates the Federal Communications Commission's (FCC) preemption of state structural separation requirements by prohibiting Pacific from providing certain nontariffed services to PBIS. Finally, Pacific asserts that the Decision establishes new rules for transactions between Pacific and its affiliates without notice. Pacific also requests that the Commission stay Ordering Paragraph 2 until the Commission rules on Pacific's Application for Rehearing/Petition for Modification. Ordering Paragraph 2 requires Pacific and DRA

to each select an appraiser. These two appraisers are then to select a third appraiser who will actually appraise ISG on a "going concern" basis.

The Division of Ratepayers Advocates (DRA) and the California Cable Television Association (CCTA) filed oppositions claiming that Pacific's Application for Rehearing is not timely and should be rejected. Applications for Rehearing are governed by Commission rule 85. DRA and CCTA claim that rule 85 states that an Application for Rehearing must be filed ten days after the date of issuance of a decision that relates to the transfer or encumbrance of utility property pursuant to Public Utilities Code section 851. These parties argue that since Pacific's application to transfer utility property was filed under Public Utilities Code section 851 and its Application for Rehearing was filed after the ten day period specified in Commission rule 85, it should be rejected as untimely.

In response, Pacific filed a "Motion to Accept Response to the Procedural Issue Raised in Opposition to Pacific's Application for Rehearing." In the attached response, Pacific argues that its Application for Rehearing is not subject to the 10-day rule and is instead governed by rule 85's 30-day rule. Pacific asserts the 10-day rule only applies to applications that involve <u>both</u> security transactions <u>and</u> the transfer or encumbrance of utility property. Pacific bases this argument on the fact that Commission rule 85 states:

> "The application shall be filed within 30 days after the date of issuance, or within 10 days after the date of issuance in the case of an order relating to security transactions and the transfer or encumbrance of utility property."

In further response, DRA filed a "Motion to Accept Response of DRA to the Procedural Issue Raised by Pacific Regarding Oppositions to its Application for Rehearing." DRA argues in its pleading that the security transactions and the

transfer or encumbrance of utility property, which are the items subject to the 10-day rule, are meant to be read consecutively. In addition, CCTA filed a "Motion to Accept the Reply of the CCTA to the Motion and Response of Pacific Bell to the Procedural Issue Raised in Opposition to Pacific Bell's Application for Rehearing of Decision No. 92-07-072", raising basically the same point as DRA.

While it is not our ordinary practice to accept pleadings that go beyond the normal pleading cycle of an application for rehearing and response(s) thereto, we will make an exception, limited to this case, and accept Pacific's, CCTA's and DRA's pleadings to allow the full litigation of this key procedural point.

Commission rule 85 finds its statutory basis in Public Utilities Code section 1731(b). This section reads:

> "No cause of action arising out of any order or decision of the Commission shall accrue in any court to any corporation or person unless the corporation or person has filed an application to the commission for a rehearing within 30 days after the date of issuance or within 10 days after the day of issuance in the case of an order issued pursuant to article 5 (commencing with section 816) and article 6 (commencing with section 851) of chapter 4 relating to security transactions and the transfer or encumbrance of utility property."

The reasonable reading of this statute is that the 10-day rule applies to cases involving either article 5 or article 6. This is so because article 5, dealing with stocks and security transactions, and article 6, dealing with the transfer or encumbrance of utility property, raise quite different issues and are not generally dealt with together. Also, in either instance, it is understandable that the Legislature would have recognized a need for aggrieved parties to obtain swift review. It is not reasonable to assume that the statute requires parties to adhere to the 10-day rule only if both article 5 and article 6

are involved.[1] While we reject Pacific's Application for Rehearing as untimely, we will accept the pleading in the alternative as a petition to modify the decision.

Pacific's main assertion in its Petition for Modification is that to give ratepayers the going concern value (less net book value) of ISG results in a double recovery of expenses and confiscation of shareholder property. Pacific makes three claims with respect to the valuation of ISG:

1. There is no evidence that ratepayers funded ISG prior to January 1, 1990;

2. The R&D settlement approved in D.92-07-076 eliminated any right to a ratepayer refund for the increase in ISG's value since January 1, 1990; and

3. The refund ordered in D.92-07-072 is inconsistent with the decision establishing the New Regulatory Framework (NRF) (D.89-10-031, 33 CPUC 2d 43) and violates the rule against retroactive ratemaking.

The first point, that there is no evidence that ratepayers funded ISG prior to January 1, 1990, has been fully litigated by Pacific in this case both in its briefs before the Administrative Law Judge and in its comments on the proposed Decision. Further, Pacific's position is in error. There is ample evidence in the record that ratepayers funded voicemail (a major ISG service) as early as 1983. Pacific has brought no new facts to light on this point nor has it cited legal error. Instead Pacific in its pleading is attempting to relitigate a

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1. See People v. Skinner, 39 Cal. 3d 765, 775 (1985) which held that the "inadvertent use of 'and' where the purpose or intent of a statute seems clearly to require 'or' is a familiar example of a drafting error which may properly be rectified by judicial construction." Also see ABBEY v. Board of Directors, 58 Cal.App. 757, 760 (1922) for the proposition that "[w]henever necessary to arrive at the evident intent of a statute, courts will substitute 'and' for 'or' and vice versa."

factual question that we have already decided. We reject this contention.

Pacific's second point asserts that the R&D settlement eliminated any right to a ratepayer refund for the increase in ISG's value since January 1, 1990 (D.92-07-076). The R&D settlement involved an audit of Pacific by the Commission that revealed that ISG expenses had been accounted for by Pacific as above-the-line expenses when the Commission had ordered Pacific in the NRF Decision, D.89-10-031, to account for these expenses below-the-line. See Ordering Paragraph 8, adopting Conclusion of Law 36, D.89-10-031, 33 CPUC 2d 228, 233. The audit focused on the actual expenses of ISG from 1990 on. In contrast, the instant case deals with the gain in value of ISG as an ongoing business. In D.92-07-072 we acknowledged that some double recovery could have resulted between the refund ordered in the R&D Decision (D.92-07-076) and the treatment of the increase in the value of ISG ordered in D.92-07-072, and invited Pacific to file a petition for modification if it believed any double counting had occurred.

Pacific's current Petition for Modification fails to address this issue directly and instead claims that this matter was fully determined in D.92-07-076 and need not be further litigated. This assertion is directly contrary to the terms that Pacific agreed to in its settlement of the R&D audit. D.92-07-076, Appendix A thereto, at page 11 states the agreement does not dispose of the issue of whether ratepayers should receive any portion of the value of ISG as a going concern, and if so what the amount of the ratepayers' share should be. Clearly that issue was not resolved by D.92-07-076. Pacific's contention is rejected. We still, however, believe that there is a risk that there is some double recovery as between D.92-07-072 and D.92-07-076, and reiterate our invitation to Pacific to file a petition for modification if it believes any double recovery has occurred.

Pacific's third point, that the refund ordered in D.92-07-072 is inconsistent with the NRF Decision and therefore violates the rule against retroactive ratemaking, is equally in error. Pacific's claim that the Commission in the NRF proceeding determined that ratepayers had no interest in Pacific's enhanced services business is contrary to the NRF Decision as well as a number of other Commission decisions. Pacific in its pleading claims that the Commission explicitly found that enhanced services expenses were not included in rates prior to 1990. Pacific supports this contention by citing to the Commission's NRF Decision (33 CPUC 2d at 149). See Pacific's Application for Rehearing/Petition for Modification, p. 8.

Pacific has misunderstood our holding in the NRF Decision on this issue. In that Decision we determined that there was not sufficient evidence in Phase II of the NRF proceeding to pursue in workshops the question of whether enhanced services expenses were included in rates prior to 1990. It is error to claim that our acknowledgement that we did not have enough evidence to pursue the enhanced services issue in workshops related to the NRF proceeding did in any way foreclose the investigation of this matter in future proceedings. D.89-10-031, 33 CPUC 2d at 149. In short, we did not reverse our prior NRF Decision, and no retroactive ratemaking has taken place.

Next, Pacific argues that the Decision's restriction on Pacific to provide nontariffed services to PBIS only if they are "critical and essential", impedes the FCC's policy to encourage Bell Operating Companies to serve consumers through greater efficiencies resulting from integrated operations. Computer III Remand Proceedings, Report and Order, at par.

122.[2] In the instant case, it is Pacific that is structurally separating ISG from Pacific. In setting out the "critical and essential" criteria we are merely setting forth conditions by which this separation may take place. We set forth these conditions, because we believe that it is "reasonable . . . to minimize the potential of cross-subsidization of the competitive subsidiary by the monopoly utility." D.92-07-072, p. 30. The FCC in its Computer III Remand Order has expressly said that preemption of states in this area "should be as narrow as possible to accommodate differing state views while preserving federal goals." Computer III Remand Proceedings, Report and Order, at par. 110. Given the FCC's expressed concern to accommodate state views, the burden is on Pacific to show our restrictions cross over the line and thwart federal goals. Pacific has failed to meet this burden, and we reject this claim.

Pacific raises two arguments that the Decision changes the affiliate transaction rules without notice. First, Pacific complains that the Commission has unreasonably ordered it to compute fully allocated cost as defined by Part 64 of the regulations promulgated by the FCC (47 CRF sec. 64.901, 64.902) and modified by the Commission. Pacific claims that in the past Commission staff has not objected to the use by Pacific of another cost allocation methodology. However, we note that Pacific already has to comply with Part 64 for FCC-regulated transactions. Moreover, we adopted the Part 64 costing rules in D.92-07-072 to avoid having ratepayers cross-subsidize below-the-line activities, and activities for which there is no direct

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2. The Commission is currently appealing the Computer III Remand Decision issued by the FCC. People of the State of California and the Public Utilities Commission of the State of California v. Federal Communications Commission et al. (9th Circuit 1992) No. 92-70083.

ratepayer benefit. Since Pacific has failed to raise any new facts or to allege legal error, the contention is rejected.

Second, Pacific alleges that the Commission is wrong when it asserts in the Decision that the existing rule is that goods and services sold by affiliates to Pacific must be sold at the lower of either market value or fully allocated cost. D.92-07-072, p. 36. According to Pacific its preferred standard that goods and services be sold at list price is the current standard used by Pacific and it should be the Commission rule. In making this assertion Pacific fails to cite to any Commission decision to support its position. In contrast, D.92-07-072 found that D.86-01-026 held that an affiliate should charge the lower of either market value or fully allocated costs. Additionally, the Commission in a recently instituted rulemaking regarding affiliate transactions, stated that:

> "In general, the Commission has required each utility that has captive ratepayers and/or substantial market power to meet the following guidelines:
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> ...Pay its affiliates the lesser of actual cost or fair market value for any goods or services that the utility purchases from the affiliate;..." R.92-08-008, pp. 10-11.

Pacific's contention lacks merit and is rejected.

Finally, in Finding of Fact 27, we noted that Pacific values the assets to be transferred at the adjusted net book value of ISG's assets. In Exhibit B to its application, Pacific calculated adjusted net book value by subtracting depreciation reserve and deferred tax reserve from ISG's assets. We believe this to be the correct method of determining the adjustment to Pacific's rate base. However, Conclusions of Law 6 and 10 and Ordering Paragraphs 1 and 2 could be read to ignore ISG's deferred tax reserves when calculating Pacific's sharable earnings and in determining the gain to be refunded to ratepayers.

Accordingly, we will modify Finding of Fact 27, Conclusions of Law 6 and 10, and Ordering Paragraphs 1 and 2 to explicitly define adjusted net book value as the appropriate concept to be used.

For the reasons stated above, Pacific's Application for Rehearing is rejected as untimely. The Commission has reviewed each and every allegation of the Petition for Modification and believes that no grounds for modification are set forth. Having fully considered the issues raised by Pacific, the Petition for Modification is denied. Given that Pacific has failed to raise any issue that would merit the granting of a modification to the Decision, Pacific's request for a stay of Ordering Paragraph 2 is denied.

WHEREFORE, IT IS ORDERED that:

1. Pacific Bell's Motion to Accept Response to the Procedural Issue Raised in Opposition to Pacific's Application for Rehearing is granted.

2. DRA's Motion to Accept Response of DRA to the Procedural Issue Raised by Pacific Regarding Oppositions to its Application for Rehearing is granted.

3. CCTA's Motion to Accept the Reply to the Motion and Response of Pacific Bell to the Procedural Issue Raised in Opposition to Pacific Bell's Application for Rehearing of Decision No. 92-07-072 is granted.

4. Pacific Bell's Application for Rehearing of D.92-07-072 is rejected as untimely, but is accepted as a Petition for Modification of that decision.

5. Pacific Bell's Petition for Modification of D.92-07-072 is denied.

6. Pacific Bell's Request for Stay of Ordering Paragraph 2 of D.92-07-072 is denied.

7. Finding of Fact 27 is revised to read:

> Pacific values the assets to be transferred at the adjusted net book values of the tangible assets used by ISG, such as operating leases (buildings, furniture, and

office equipment), switching equipment, and computers. Pacific calculated adjusted net book value by subtracting depreciation reserve and deferred tax reserve from asset book value. The value of ISG is approximately $52 million, according to Pacific.

8. Conclusion of law 6 is revised to read:

To the extent that Pacific has included ISG's assets in rate base, it should remove those assets from rate base, using adjusted net book value.

9. Conclusion of law 10 is revised to read:

Pacific should credit ratepayers with the increase in the value of ISG, defined as the difference between its going-concern value and its adjusted net book value.

10. Ordering paragraph 1 is revised to read:

Pacific Bell (Pacific) shall remove the assets (net of depreciation reserve and deferred tax reserve) of Information Services Group (ISG) from its rate base for the purpose of the sharable earnings calculation, regardless of whether the assets of ISG are ultimately transferred to Pacific Bell Information Services (PBIS). Pacific shall file a report within 60 days of this order showing compliance with this ordering paragraph.

11. Ordering paragraph 2 is revised to read:

Regardless of whether the assets of ISG are ultimately transferred to PBIS, Pacific shall credit ratepayers with the difference between the going-concern value of ISG and the adjusted net book value of ISG. ISG shall be valued as a going concern based on the income approach as described in the Division of Ratepayer Advocates's (DRA) testimony in this proceeding. The valuation shall be performed by a qualified independent appraiser. Pacific and DRA shall each choose an

appraiser to represent them; the two appraisers shall jointly choose the appraiser who will value ISG. The appraiser will be independent from both Pacific and DRA, but shall have full access to the ISG books, records, internal memoranda, and all supporting documentation, provided the appraiser has executed appropriate confidentiality agreements with Pacific. The valuation of ISG shall be calculated as of 60 days after the date of this decision. Pacific shall promptly file the appraisal with the Commission, within 30 days after its completion.

This order is effective today.

Dated October 21, 1992, at San Francisco, California.

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

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

NEAL J. SHULMAN, Executive Director