

Decision 93699 Nov. 3, 1981

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application)
of THE PACIFIC TELEPHONE AND)
TELEGRAPH COMPANY, a corporation,)
for an order authorizing it to)
enter into a financial lease or)
leases pertaining to certain)
personal property.)

Application 60928
(Filed September 23, 1981;
amended October 7,
and 29, 1981)

O P I N I O N

The Pacific Telephone and Telegraph Company (Pacific) requests an order from the Commission which will allow the firm (a) to sell certain computer equipment to the Utilities Leasing Corporation (ULC), (b) to leaseback this same equipment plus additional computer equipment from ULC, and (c) to enter into a "Corporate Lessor" agreement with Foremost - McKesson, Inc. with respect to a separate set of computer equipment. Pacific specifically requests the Commission to either:

1. Dismiss the firm's application for lack of jurisdiction or
2. Issue an ex parte order authorizing the firm to sell utility property listed above in accordance with Public Utilities (PU) Code Section 851 and to enter into the two proposed agreements with ULC.

Notice of the filing of the application and the amendment appeared on the Commission's Daily Calendars of September 23, 1981 and October 9, 1981. No protests have been received.

The property involved in the proposed transactions consists of a mechanized White Pages Directory listing retrieval system. This equipment is used to reduce directory assistance operator work time with a corresponding reduction in the cost of providing directory assistance services and an improved response time to subscribers' requests for directory listings. The other portion of the property consists of automated tape libraries, associated tape devices, tape control units, disk storage control devices, and additional IBM 3032 computer system memory. The automated tape libraries relieve computer personnel from most tape handling and speed up the tape mounting and dismounting process. The tape disk and memory equipment provide for growth and replacement of obsolete equipment.

Pacific has submitted to the Commission two distinct proposed agreements. These agreements are referred to by the applicant as the Traditional Lease and the Corporate Lessor Lease and are attached as amendments to the application as Exhibits F and G, respectively.

As part of the Traditional Lease transaction Pacific would sell to ULC approximately \$3 million of computer equipment which Pacific has already purchased and possesses. ULC would purchase an additional \$5 million of computer equipment directly from the manufacturer. Under the lease agreement, Pacific would lease all this equipment from ULC. The lease terms would be for either five or seven years for each of the several equipment schedules. Title to the equipment, under the lease, would be held by the lessor, ULC. The lease contains an option to renew but no purchase option.

PU Code Section 851 provides, in pertinent part, that:

No public utility...shall sell...mortgage, or otherwise encumber the whole or any part of its...property necessary or useful in the performance of its duties to the public...without first having secured from the commission an order authorizing it to do so.

Because Pacific proposes to sell computer equipment which is admittedly necessary and useful to the company, it must obtain prior approval from the Commission.

Based upon the information in the application, it is our finding that the proposed sale will not hinder Pacific's ability to serve its customers. The applicant contends that the sale and proposed leaseback is in the public interest because it will reduce the need for increasing capital expenditures and the resulting

pressure on increased debt and/or equity financing at a time when capital costs are at very high levels. For these reasons, we have determined that the sale of utility property proposed in connection with the Traditional Lease should be authorized under PU Code Section 851.

A second issue involves Commission approval of the Traditional Lease itself. In its application, Pacific notes that the Commission has, in three previous cases, dismissed applications in which a utility proposed to enter into an agreement as a lessee. Pacific's Decision (D.) 85874, dated May 25, 1976 in Application (A.) 56467 (Decimus), Southern California Edison Company, 82 P.U.C. 719 (1977) (nuclear fuel lease), and Pacific D.83333, dated August 20, 1974 in A. 55095 (lease of improved real property). The applicant relies upon the Decimus decision because that case involved the lease of computer equipment.

In the cited decisions, the Commission held that, generally, it does not have jurisdiction over transactions in which a utility is a lessee. For the reasons stated in those opinions, we find that it is not necessary for Pacific to obtain Commission authorization to enter into the Traditional Lease. We note that the

present case is distinguished from those cited because it involves the sale of utility-owned property and therefore dismissal of the application would be inappropriate.

The second proposed transaction, involving the "Corporate Lessor Lease", is radically different than the first transaction. This transaction also involves computer equipment which Pacific has already purchased and possesses, in this case nearly \$14 million worth of equipment. Foremost - McKesson, Inc., would purchase an additional nearly \$4 million of equipment for use by Pacific. The transaction is framed in the format of a sale and leaseback, superficially like the Traditional Lease, but the similarity ends there.

The Corporate Lessor Lease has been drafted to take advantage of investment tax credits recently enacted in the federal Economic Recovery Tax Act of 1981, P.L. 97-23, 95 STAT 172. This statute expands the opportunity for investment tax credits in leases and drastically redefines what constitutes a lease for the purposes of the statute. See P.L. 97-34, Section 201 (a) (amending Section 168 (f) (8)), 1981 U.S. CODE CONGRESSIONAL & ADMIN. NEWS No. 6 at pp 45-47 (statute), 252-54 (Sen. Rep. No. 97-144), and 393-95 (H. Conf. Rep. 97-215). The statute also allows for the claiming of tax credits for sale/leasebacks on equipment purchased in 1981 prior to enactment of the statute

even if the lease was entered into after enactment of the statute. Because of a deadline set in the statute for completion of such transactions, Pacific has requested expedited consideration of this application.

The changes embodied in the Economic Recovery Tax Act of 1981 do not alter the Commission's statutory authority or its responsibilities. Specifically, the characterization of a transaction as a lease under the federal tax law does not mandate similar characterization by the Commission. In the present case, the terms of the proposed Corporate Lessor Lease are so different from the proposed Traditional Lease, or other customary lease agreements, that the Commission chooses not to characterize it as a lease notwithstanding the provisions of the federal tax law.

Under the proposed Corporate Lessor Lease, Pacific, the "lessee", would retain title throughout the lease periods to all the equipment covered under the lease. (Exhibit G, Section 2, page 4.) During the lease periods, all that will be transferred to Foremost - McKesson, Inc. the "lessor", is a security interest in the equipment. The lease periods are either five or seven years for each of five equipment schedules. At the end of each lease period, Pacific would have an option to purchase all of the equipment in the schedule for \$99 per schedule, or a total of \$495. Given the facts

that Pacific will retain title to the equipment during the lease period and that it has the option at the end of the lease period to purchase over \$17 million of computer equipment for less than \$500. we cannot characterize this transaction as a sale and leaseback analogous to the Traditional Lease discussed above.

Functionally, the Corporate Lessor Lease operates like a loan. In exchange for approximately \$14 million to be provided by Foremost - McKesson, Inc. to Pacific, Pacific would give Foremost - McKesson, Inc. a security interest in the computer equipment and would make "lease" payments as described in the agreement.

The PU Code provides that a utility must obtain authorization from the Commission prior to encumbering utility property. This statutory requirement is contained in PU Code Section 851. In addition, PU Code Section 818 provides in pertinent part that:

No public utility may issue...evidences of indebtedness payable at periods of more than 12 months after the date thereof, unless...it shall first have secured from the commission an order authorizing [the indebtedness].

Based upon the above analysis, we have determined that the proposed Corporate Lessor Lease is an "evidence of indebtedness" within the meaning of PU Code Section 818. Accordingly, the Commission has jurisdiction to review the proposed Corporate Lessor Lease independently under both PU Code Section 851 and Section 818.

As noted above, Pacific's purposes in entering into the Corporate Lessor Lease is to reduce the need for increasing capital expenditures and to take advantage of the investment tax credits available under the Economic Recovery Tax Act of 1981. Based upon information supplied by Pacific, the Revenue Requirement Division has determined that the cost of this capital to Pacific will be 16.5% per year taking into consideration the tax benefits. Because this is lower than the rate generally available on capital markets, the Division has no objection to Pacific entering into the proposed transaction. However, the Division reserves the right to reconsider the reasonableness of any expenditures resulting from this transaction in future rate proceedings.

In a letter dated October 14, 1981, Pacific requests the Commission find that the usury provisions set forth in the California Constitution, Article XV, Section 1 do not apply to either of the two proposed transactions. Under the plenary powers granted to the Legislature by Article XII, Section 5 of the

California Constitution, the Legislature is authorized to confer additional consistent powers upon this Commission as it deems necessary and appropriate, unrestricted by any other provisions of the California Constitution. The Legislature has conferred upon this Commission the authority to regulate the creation by public utilities of all evidences of indebtedness, including the assumption by public utilities of any obligation or liability as guarantor, and to prescribe restrictions and conditions as it deems reasonable and necessary (PU Code Sections 816 et seq.). Under the plenary powers granted to the Legislature in Article XII, Section 5 of the California Constitution, it conferred upon this Commission comprehensive and exclusive power over the creation by public utilities of all evidences of indebtedness, including the assumption by public utilities of any obligation or liability as guarantor, and the California usury Law cannot be applied as a restriction on this Commission's regulation of such guarantees by public utilities. Thus, if the usury limitation contained in Article XV, Section 1 of the California constitution is exceeded, but the transaction is authorized by this Commission, applicant utility its assignees, or successors in interest will have no occasion to and cannot assert any claim or defense under the California Usury Law. Persons collecting interest under Pacific's obligations and liabilities as guarantor are not subject to the California Usury Law sanctions.

Findings of Fact

1. Pacific Telephone and Telegraph Company (Pacific), a California corporation, operates as a public utility under the jurisdiction of this Commission.

2. Pacific proposes to sell to the Utilities Leasing Corporation certain computer equipment described in Exhibit F (Traditional Lease) which is currently owned by Pacific.

3. Pacific proposes to sell to Foremost - McKesson, Inc. a security interest in certain computer equipment described in Exhibit G (Corporate Lessor Lease) in exchange for approximately \$14 million. Pacific will also agree to a series of "lease" payments to Foremost - McKesson, Inc. over a seven year period as part of this transaction.

4. The availability of both the Traditional Lease and the "Corporate Lessor Lease" as means of financing Pacific's use of the property reduces the need for increasing capital expenditures and the resulting pressure on increased debt and/or equity financing at a time when capital costs are at very high levels.

5. There is no known opposition and no reasons to delay granting the authority requested.

Conclusions of Law

1. A public hearing is not necessary.
2. The Commission has jurisdiction under P.U. Code Section 851 to authorize the sale of utility property described in the Traditional Lease.
3. The Commission does not have jurisdiction over the Traditional Lease described in Exhibit F to the amendment to the application filed October 7, 1981.
4. The Commission has jurisdiction under both PU Code Section 851 and Section 818 to authorize Pacific to issue a security interest to Foremost - McKesson, Inc. and to enter into the agreement described in Exhibit G to the amendment to the application filed October 7, 1981 (Corporate Lessor Lease) with Foremost - McKesson, Inc.
5. In accordance with P.U. Code Section 1904(b), Pacific must pay to the Commission a fee for a certificate authorizing the issuance of evidences of indebtedness as part of the Corporate Lessor Lease.
6. The authorization granted herein is for the purpose of this proceeding only and is not to be construed as indicative of the amount of expenditures, if any, under the Leases which

shall be approved as proper operating expenses in current or subsequent proceedings for the determination of just and reasonable rates.

7. The application should be granted to the extent set forth in the order which follows.

O R D E R

IT IS ORDERED that:

1. The Pacific Telephone and Telegraph Company (Pacific), on or after the effective date of this order, is authorized to sell the property described in Exhibit F (Traditional Lease) to the amendment to the application filed October 7, 1981 in accordance with the terms and conditions set forth in this amendment to the application.

2. Pacific is authorized to enter into an agreement substantially in the form of the document described in Exhibit G (Corporate Lessor Lease) to the amendment to the application filed October 7, 1981. This authorization will become effective immediately when Pacific pays \$14836.50 to the Commission, the fee set by P.U. Code Section 1904(b).

3. Except as set forth in paragraph two, this order will become effective immediately.

Dated Nov. 3, 1981, at San Francisco, California.

JOHN E. BRYSON
President
RICHARD D. GRAVELLE
LEONARD M. GRIMES, JR.
VICTOR CALVO
PRISCILLA C. GREW
Commissioners

I certify that this decision was approved by the above Commissioners today

Joseph E. Bobbitt

