

Decision 96-11-019 November 6, 1996

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Pacific Bell for an Exemption Pursuant to Public Utilities Code Section 853(b) for, in the Alternative, Authority Pursuant to Public Utilities Code Section 851 for the Lease and Sale of Assets to Pacific Telesis and Affiliates. Application 95-12-054 (Filed December 15, 1995)

ORIGINAL

... certain assets to them in accordance with applicable rules of the Commission. Pacific seeks exemption or approval of the

INTERIM OPINION

... proposed sale of those assets to Telesis. Pacific also seeks exemption or approval of the lease of those assets, and approval of the

1. Summary

Today's decision disposes of most of the issues raised in the above-captioned application. Pursuant to Public Utilities (PU) Code § 851, Pacific Bell (Pacific) is granted the authority sought in the application to lease and sell certain of its assets to Pacific Telesis (Telesis). We are holding for further and further consideration the requested approval of the lease and sale of our assets to a new subsidiary, Pacific Telesis Legal Group (PTLG).

Pacific had also sought a blanket exemption from the requirements of § 851 where Pacific was proposing to sell or lease utility property to Telesis or affiliated entities. Specifically, pursuant to the requested exemption, Pacific would no longer need Commission approval before a transfer of property under such circumstances. We deny this request for blanket exemption.

3 Pacific indicates that it follows applicable rules of this Commission and of the Federal Communications Commission when it enters agreements for the lease or sale of assets to affiliates. Regarding the applicable rules, Pacific cites Decision (D.) 86-01-026, 20 CPUC2d 237 (1986), D.87-12-067, 27 CPUC2d 1 (1987), and 47 CFR §§ 64.902 and 32.27. In addition, Pacific has followed its own "Category III Below-the-Line Affiliate Guidelines," adopted 1 Unless otherwise noted, all code sections cited are citations to the PU Code.

Decision 95-11-019 November 1, 1995

2. Background

The application, which is unprotected, concerns several existing and proposed leases and certain proposed sales of assets. A summary of the application follows.

In a process that began in 1994, Pacific's Corporate Communications, Public Affairs, Corporate Television, and General Business Legal Groups have transferred to Telesis. Since the transfer of the first two of these groups, Pacific has leased certain assets to them in accordance with applicable affiliate transaction rules.³ Pacific seeks exemption or approval of the lease of those assets, and also seeks exemption or approval of the proposed sale of those assets to Telesis. Pacific also seeks exemption or approval of the lease to Telesis of certain assets used by the Corporate Television Group.

Finally, Pacific seeks exemption or approval of the sale to PTLG of most of the assets, with one exception, used by Pacific's former Legal Department. The exception is certain modular furniture at Pacific's San Ramon Valley facility, which is currently leased to Telesis and which Pacific proposes to lease in the future to PTLG. Pacific seeks exemption or approval of these leases. Again, Pacific represents that the respective sales and leases are in compliance with applicable rules.

² The General Business Legal Group became part of PTLG on January 1, 1996.

³ Pacific indicates that it follows applicable rules of this Commission and of the Federal Communications Commission when it enters agreements for the lease or sale of assets to affiliates. Regarding the applicable rules, Pacific cites Decision (D.) 86-01-026, 20 CPUC2d 237 (1986), D.87-12-067, 27 CPUC2d 1 (1987), and 47 CFR §§ 64.902 and 32.27. In addition, Pacific has followed its own "Category III Below-The-Line Affiliate Guidelines," adopted pursuant to the Commission's Order 92-072072.

leases follow the applicable affiliate transaction rules. We will address in a separate decision the proposed transactions with PTLG.

Pacific summarizes allowable compensation under the affiliate transaction rules as follows. Regarding leases, Pacific would receive the market rate or the fully distributed costs plus 10%, whichever is higher. Regarding sales, Pacific would receive the higher of market price or net book value plus incremental transaction costs.

According to Pacific, the transfers summarized above will create an efficient business structure. In particular, centralization of the External Affairs Department at Telesis will result in economies of scale that benefit the entire corporation, including Pacific and Pacific Bell (Directory). The sales and leases that are the subject of this application help effectuate these transfers.

3. Discussion

3.1 Denial of Exemption

In relevant part, § 851 says that a public utility, such as Pacific, may not sell, lease, or otherwise dispose of or encumber the whole or any part of its line, plant, system, or other property necessary or useful in the performance of its duties to the public...without first having secured from (this Commission) an order authorizing it so to do. However, the Commission is authorized to make certain exemptions from § 851. Specifically, § 853(b) provides in part as follows:

"The commission may...by order or rule...exempt any public utility or class of public utility from (the requirement of prior approval) if it finds that the application thereof with respect to the public utility or class of public utility...

We reject Pacific's request for a blanket exemption

4 Pacific notes an exception to this rule regarding a lease to its affiliate, Pacific Bell (Directory), which would pay fully distributed costs only.

utility is not necessary in the public interest. The commission may establish rules or impose requirements deemed necessary to protect the interest of the customers or subscribers of the public utility or class of public utility (so) exempted...."

Pacific urges the Commission to create a blanket exemption pursuant to § 853(b) to cover the type of transactions this application involves. Pacific advances four arguments in support of the requested exemption:

1. The interests of Pacific's customers are protected, without active Commission oversight of these transactions, by virtue of (a) Pacific's adherence to internal corporate guidelines and the affiliate transaction rules (see note 3 above and accompanying text), and (b) the reports that Pacific files with the Commission regarding transactions with affiliates.
2. Pacific's customers are indifferent to lease or sale of assets to affiliates because such transactions, under current regulation, do not directly affect rates. Instead, payments for such transactions are booked above-the-line and contribute to Pacific's earnings, which are subject to sharing with Pacific's ratepayers if a specific threshold is reached.
3. The current regulatory environment gives Pacific incentives to operate efficiently. (Pacific does not say how this assertion supports the requested exemption.)
4. The Commission has noted the increasing competition in electric and telecommunications services, and has indicated it may relax its regulation of these types of utilities.

We reject Pacific's request for a blanket exemption regarding sale or lease of assets to its affiliates. Fundamentally, Pacific misconstrues § 853(b). The statute does not authorize us to exempt a class or classes of transfers per se from

the requirements of § 851. Rather, the statute allows us to exempt a "public utility or class of public utility." The increasing competition in electric and telecommunications services does not in itself justify exempting either electric or telecommunications utilities, as a class, from the requirements of § 851. Indeed, in such an environment, transfers between a utility and its affiliates may raise concerns about competitive impacts, beyond the traditional regulatory concern that the utility receive appropriate compensation for the transferred property. None of the arguments made by Pacific address competitive impacts.

We have previously rejected a request from Pacific for a blanket § 853(b) exemption for lease transactions. See D.95-04-046. Pacific has not produced any new arguments or shown any change of circumstances that would incline us to reconsider that recent precedent. As we noted in D.95-04-046, Pacific's arguments are more suitably advanced as reasons why the lease transactions in question should be approved pursuant to § 851. We now turn to our § 851 analysis.

3.2 Approval of Certain Transactions

One of the landmarks of public utility regulation is the requirement that a utility receive prior Commission approval before transferring assets used in providing utility service. The requirement has several purposes. The requirement helps the Commission to ensure that the utility receives a reasonable price for its assets, and that the transfer does not compromise quality or continuity of service. More recently, as various elements of traditional "bundled" service in many utility industries have been unbundled and opened to competition, the competitive impacts of proposed transfers have come under heightened regulatory scrutiny. For example, we are concerned that the intended consumer benefits of

increased competition not be diluted or thwarted by transfers from the incumbent utility to affiliates.

The question we must address is whether anything about the proposed transactions raises concerns, such as those we describe above. If, authorizing the transactions would compromise the public interest in receiving dependable, reasonably priced, and high quality telecommunications services, then pursuant to § 851, we should impose conditions or altogether deny the requested authority. Based on Pacific's representations, we see no such concerns here.

As Pacific notes, the affiliate transaction rules (see notes 3 above and accompanying text) are designed to ensure that payments from Telesis and affiliates for lease or sale of assets are at or above market levels. Pacific should adhere to those rules, and its applications for authority to make such transfers should document its compliance. The instant application contains such documentation. We conclude that the price terms of the proposed transactions are adequate from the standpoint of protecting the interests of the utility and its ratepayers.

Pacific's application is sketchy regarding non-price terms and considerations, such as competitive impacts. Our concerns in this regard lead us to deal separately with the proposed lease and sale of assets to PTLG. Regarding the other affiliates, however, the application contains sufficient information to support granting the requested authority.

The assets subject to lease or sale herein are basically office furnishings and equipment. Some (but not all) of the assets are currently useful for Pacific's services; however, are the kind of property whose control would confer unique advantages on Pacific's affiliates. The assets do not include, for example, intellectual property, rights-of-way for poles or cable, or transfer bottleneck facilities on Pacific's system. As noted earlier, we have received no protests to this application.

In short, we find no competitive or other concerns that should bar us from granting the requested authority as to the proposed leases and sales of assets used by Pacific's former Corporate Communications, Public Affairs, and Corporate Television Groups.

3.3. Ruling Regarding Transactions with PTLG

By ruling dated September 16, 1996, the assigned Commissioner and Administrative Law Judge requested information related to Pacific's dealings with PTLG. As described in the application, PTLG could provide legal services to any member of the Telesis corporate family, not just to Pacific in some circumstances - the related company could actually be in competition with Pacific. Such circumstances may raise concerns regarding ratepayer protection and prevention of anti-competitive conduct. The ruling seeks information to satisfy ourselves that Pacific is appropriately addressing these issues.

There is no need, however, to delay our disposition of most of the transactions while we deliberate on Pacific's response to this ruling. Accordingly, we issue today's interim decision granting the requested authority as to the proposed leases and sales of assets used by Pacific's former Corporate Communications, Public Affairs, and Corporate Television Groups.

4. Conclusion

The authority granted in today's decision is limited to the specified assets. We deny Pacific's request for exemption from § 851 review of such transactions in the future; indeed, we find that Commission review of transactions with utility affiliates is no less important under the current regulatory framework than it was under more traditional rate based and rate-of-return economic regulation. Finally, we remind Pacific that § 851 requires

of aspects of the competitive nature of service. More recently, proposed transfers have come under heightened regulatory scrutiny.

application for Commission approval before a proposed lease, sale, or other transfer or encumbrance of utility property. Findings of Fact: The application, which is unopposed, concerns several existing and proposed leases and certain proposed sales of Pacific's assets that are used by groups formerly within Pacific but now transferred to Telesis.

Pacific indicates that it follows applicable rules of this Commission and of the Federal Communications Commission when it enters agreements for the lease or sale of assets to affiliates. In addition, Pacific has followed its own "Category III Below-The-Line Affiliate Guidelines," adopted pursuant to D-92-07-072.

Under the affiliate transaction rules as they apply to leases, Pacific would receive the market rates or the fully distributed costs plus 10%, whichever is higher. Regarding sales, Pacific would receive the higher of market price or net book value plus incremental transaction costs. The affiliate transaction rules are designed to ensure that payments to Pacific from Telesis and affiliates for lease or sale of assets are at or above market levels.

According to Pacific, the proposed transfers will create an efficient business structure. In particular, centralization of the External Affairs Department at Telesis will result in economies of scale that benefit the entire corporation, including Pacific and Bell Directory.

The requirement that a utility receive prior Commission approval before transferring assets used in providing utility service has several purposes. The requirement helps the Commission to ensure that the utility receives a reasonable price for its assets, and that the transfer does not endanger quality or continuity of service. More recently, the competitive impacts of proposed transfers have come under heightened regulatory scrutiny.

6. The assets subject to lease or sale herein are basically office furnishings and equipment. Some (but not all) of the assets are currently useful for Pacific's services; none, however, are the kind of property whose control would confer unique advantages on Pacific's affiliates.

PTLG could provide legal services to any member of the Telesis corporate family; not just to Pacific. Such lease and sale are in the public interest. Conclusions of Law

1. (Pursuant to § 853(b)) the Commission is authorized to make certain exemptions from § 851. Section 853(b) does not authorize exemption of a class or classes of transfers from the requirements of § 851.

The increasing competition in telecommunications services does not in itself justify exempting telecommunications utilities as a class from the requirements of § 851.

3. Pacific should adhere to the affiliate transaction rules, and its applications for authority to make such transfers should document its compliance.

4. No competitive or other concerns bar the granting of the requested authority as to the proposed leases and sales of assets used by Pacific's former Corporate Communications, Public Affairs, and Corporate Television Groups.

5. It is appropriate to issue an interim decision granting the requested authority as to the proposed leases and sales of assets used by Pacific's former Corporate Communications, Public Affairs, and Corporate Television Groups.

6. There is no need for a public hearing.

7. In order to avoid undue delay and complication in Pacific's business planning, today's decision should be made effectively immediately.

INTERIM ORDER

IT IS ORDERED that Pacific Bell (Pacific) is authorized to lease certain assets (listed in Exhibit A of Pacific's application) to Pacific's former Corporate Communications and Public Affairs Groups, which are now a part of Pacific Telesis (Telesis) and to sell these assets to Telesis. Such lease and sale shall comply with the affiliate transaction rules, as set forth in Decision D1 86-01-026, D 87-12-067, and D 92-07-072 of this Commission and in the regulations of the Federal Communications Commission codified in Title 47 of the Code of Federal Regulations 28.2 to 28.299.

Pacific is authorized to lease certain assets (used by Pacific's former Corporate Television Group and listed in Exhibit B of Pacific's application) to Telesis. Such lease shall comply with the affiliate transaction rules, as specified in Ordering Paragraph 1.

3. Pacific's request for exemption from the requirements of Public Utilities Code Section 851 is denied.

4. This docket shall remain open for further consideration of Pacific's request for authorization to lease and sell certain assets to the Pacific Telesis Legal Group. This order is effective today.

Dated November 6, 1996, at San Francisco, California.

P. GREGORY CONLON

DANIEL Wm. FESSLER

JESSIE J. KNIGHT, JR.

HENRY M. DUQUE

JOSIAH L. NEPPER

Commissioners