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Decision 98-07-006 July 2, 1998

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Pacific Bell
(U 1001 C) for Authority Pursuant to Public
Utilities Code Section 851 to Transfer and/or
Lease Assets Used for Research and Development
to Technology Resources, Inc.

ORIGINAL

Application 98-03-019
(Filed March 13, 1998)

OPINION

1. Summary

Pacific Bell seeks Commission approval, pursuant to Public Utilities (PU) Code § 851, to transfer assets used for research and development projects to a research subsidiary of Pacific Bell's parent company. Pacific Bell states that the transfer arrangements comply with affiliate transaction rules of this Commission and of the federal government. The application has been reviewed by the Commission's Office of Ratepayers Advocates (ORA). The application is granted.

2. Background

In Application (A.) 95-10-019, filed on October 4, 1995, Pacific Bell asked the Commission to grant Section 851 authority for a number of space use arrangements with both non-affiliated parties and affiliated parties.

In Decision (D.) 96-04-045, an interim decision, the Commission approved several of the agreements that the utility has with non-affiliated parties but, at the urging of staff investigators, the Commission required additional information on the agreements with affiliates. Among other things, Pacific Bell was required to make a further showing that its charges to affiliates and other parties were proper and that the arrangements met affiliate transaction rules intended to

prevent anticompetitive dealings. Pacific Bell filed the additional information requested and, in D.96-09-069, the Commission approved the space use arrangements between Pacific Bell and its affiliates.

In this application, Pacific Bell seeks authority to transfer or lease assets now used by Pacific Bell for research and development to Technology Resources, Inc. (TRI), an affiliate of Pacific Bell and a subsidiary of SBC Communications, Inc. TRI would provide research and development support services for Pacific Bell and other affiliates of SBC Communications, such as Nevada Bell and Southwestern Bell Telephone Company.

The equipment that would be transferred or leased includes switching, transmission and test devices that Pacific Bell has used in such projects as Frame Relay Service, Cell Relay Service, Network Access Point Services, Switched Multimegabit Data Service, Asymmetric Digital Subscriber Line Service, and other data and network management services.

According to the application, TRI will perform the same functions previously performed by Pacific Bell's internal research and development department. The utility states that all of the leases and transfers will be under affiliate transaction rules adopted by this Commission and by the Federal Communications Commission (FCC), including accounting directives.

3. Nature of Application

The Commission previously has granted Pacific Bell authority to lease and transfer assets to administrative affiliates. In A.95-12-054, the company sought Section 851 authority to lease space and transfer or lease assets to the Pacific Telesis Group and the Pacific Telesis Legal Group. In Interim Decision 96-11-019 and in D.97-04-022, the Commission approved these arrangements. More recently, the Commission in D.98-02-005 approved Pacific Bell's lease and

transfer of office equipment and other assets to affiliate corporations that perform administrative support functions for Pacific Bell and related companies.

Pacific Bell states that the lease and transfer arrangements here are similar to those approved earlier. The assets involved are those currently used by Pacific Bell's internal research and development organization, and they will be used by the separate affiliate to perform the same functions for Pacific Bell.

In accordance with the Commission's direction in D.96-04-045, Pacific Bell has attached exhibits to its application with further details of the proposed leases. Exhibit A is a matrix of the assets to be leased and transferred. Exhibit B contains a description of the asset lease billing process. Exhibits C, D, E and F contain the company's transfer pricing manuals, affiliate transaction policies and reporting requirements, and examples of the utility's transfer pricing schedule for the lease of assets.

The applicant requested that this matter be categorized as a ratesetting proceeding and that no hearing was required. By Resolution ALJ 176-2989, the Commission ratified the preliminary determination that this was a ratesetting proceeding.

4. Affiliate Transaction Rules

Pacific Bell states that when it transfers or leases assets to affiliates, it will do so under affiliate transaction agreements that comply with Commission and FCC affiliate transaction rules. (See, e.g., D.86-01-026, 20 CPUC2d 237 (1986); D.87-12-067, 27 CPUC2d 1 (1987); 47 CFR §§ 64.209, 32.27.) Under the Commission's rules, TRI will pay Pacific Bell the higher of fully distributed cost plus 10% or market rate for lease of the assets, and the higher of net book value or market value for transferred assets.

5. Reasons for the Leases and Transfers

Pacific Bell states that the transaction with TRI will benefit the company and ratepayers. It states:

"TRI's performance of research and development functions for Pacific Bell will enable us to achieve efficiencies, while increasing the scope of research, by sharing the cost of these operations with other affiliate organizations and allowing us to avoid unnecessary excess capacity and duplicate work efforts and lab equipment in Pacific Bell and other SBC affiliates. This will lower our costs in an increasingly competitive marketplace, which will benefit our customers."
(Application, p. 3; footnote omitted.)

Pacific Bell states that the lease and transfer arrangements will not interfere with existing operations. The company states that, because the leases and transfers comply with affiliate transaction rules, the affiliate will not be subsidized by Pacific Bell and the arrangements will not create anticompetitive effects.

6. Comments to Application

The ORA filed comments on this application on April 15, 1998. ORA confirms that the application comports with requirements established by the Commission and applied in similar applications in the past. ORA states that the transfer pricing schedule included in the application indicates that Pacific Bell will apply appropriate pricing to the assets to be transferred or leased, and is similar to the pricing methods previously approved by the Commission. (See D.96-11-019.) However, since copies of the actual lease and transfer documents are not included in the application, ORA urges the Commission to require Pacific Bell to verify that the executed agreements conform to the Commission's affiliate transaction rules.

7. Discussion

PU Code § 851 requires Commission authorization before a utility may "sell, lease, assign, mortgage, or otherwise dispose of or encumber" utility property. The purpose of the section is to enable the Commission, before any transfer of public utility property is consummated, to review the situation and to take such action, as a condition of the transfer, as the public interest may require. (San Jose Water Co. (1916) 10 CRRC 56.)

Another purpose of the Commission's review is to ensure that any revenue from the transaction is accounted for properly, and that the utility's rate base, depreciation, and other accounts correctly reflect the transaction. Under the New Regulatory Framework (NRF), these items do not have the same significance as they did under traditional regulation, but they continue to be an integral part of the calculation of rate of return, which serves as a check on the results of NRF. For this reason, the Commission reviews the accounting of the transaction for conformance with its requirements.

When, as here, the transactions are with a corporate affiliate, the Commission's review also includes consideration of whether the transaction may have anticompetitive effects or result in cross-subsidization of non-regulated entities. (Re Pacific Bell (1992) 45 CPUC2d 109, 125.)

There have been no protests to Pacific Bell's application. ORA has reviewed the application and its exhibits, and it advises that Pacific Bell has complied with Commission requirements in seeking Section 851 approval of these transactions.

Pacific Bell states that the transaction with TRI will lower its costs and in turn will benefit its customers. However, no specific ratepayer benefits have been identified or demonstrated. It is unclear how ratepayers will benefit from lower costs, as Pacific Bell maintains. Under our current form of regulation, the

New Regulatory Framework (NRF), any cost reductions resulting from the actions of utility management are intended to inure to utility shareholders (D.89-10-031, 33 CPUC2d 182), not ratepayers, until such time that utility earnings exceed the established benchmark rate of return which will trigger the sharing mechanism whereby ratepayers will realize some benefit. We note that Pacific Bell has never reached the sharing level since the adoption of NRF.

Despite the lack of any demonstration of direct ratepayer benefit, review of the information provided shows that these transactions will not impair Pacific Bell's ability to serve the public. The company's accounting for the revenue from the transactions appears to be in order. No evidence has been submitted which reveals any anticompetitive effects or cross-subsidization of non-regulated entities from these leases. Accordingly, Pacific Bell has met the requirements for authorization under PU Code § 851. At ORA's suggestion, we will require Pacific Bell to notify our Telecommunications Division in writing when the lease and transfer documents are executed, to state at that time whether the documents conform to our affiliate transaction rules, and to make the leases available for our inspection.

Findings of Fact

1. Pacific Bell seeks Commission approval, pursuant to PU Code § 851, to lease or transfer certain research and development assets to TRI, an affiliated company.
2. Notice of this application appeared on the Commission's Calendar on March 17, 1998.
3. No protests have been filed.
4. This proceeding was categorized as ratesetting by Resolution ALJ-176-2989.

5. TRI will pay Pacific Bell the higher of fully distributed costs plus 10%, or market rate, for leased assets and the higher of net book value or market value for transferred assets.

6. Pacific Bell has supplied the information required by the Commission for review of the transfer and lease agreements.

7. The ORA has reviewed the application and has raised no objection to its approval.

Conclusions of Law

1. Pacific Bell's proposed transfer of research and development assets to an affiliated organization will not impair Pacific Bell's ability to serve the public.

2. Pacific Bell's accounting for the revenue from the leases and other arrangements is in order.

3. There is no evidence of anticompetitive effects or cross-subsidization of non-regulated entities from these arrangements.

4. The application should be approved.

5. Pacific Bell should be authorized to enter into the leases and transfers set forth in the application.

6. Pacific Bell should be required to notify the Telecommunications Division when the leases and transfer documents have been executed, to verify at that time that the documents conform to affiliate transaction rules, and to make these documents available for inspection.

7. This order should be made effective immediately in order that the transactions can be implemented promptly.

O R D E R

IT IS ORDERED that:

1. Pacific Bell is authorized, pursuant to Public Utilities Code § 851, to transfer and lease certain research and development assets, as described more fully in Exhibit A of the application, to Technology Resources, Inc., a subsidiary of SBC Communications, Inc., on the terms and conditions set forth in this application.

2. Pacific Bell shall notify the Director, Telecommunications Division, in writing, when the lease and transfer agreements authorized herein have been executed, and shall verify at that time that the agreements conform to the Commission's affiliate transaction rules. The documents shall be made available for inspection upon request of the Commission or its staff.

3. This proceeding is closed.

This order is effective today.

Dated July 2, 1998, at San Francisco, California.

RICHARD A. BILAS

President

P. GREGORY CONLON

JESSIE J. KNIGHT, JR.

HENRY M. DUQUE

JOSIAH L. NEEPER

Commissioners