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Decision 99-02-061 February 18, 1999

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS AND ELECTRIC COMPANY for an Order Under Section 851 of the California Public Utilities Code to Sell Certain Assets and to Lease Office Space and Related Assets to PG&E Corporation. (U 39 M)	ORIGINAL Application 98-09-006 (Filed September 2, 1998)

OPINION

Summary

Pursuant to Public Utilities (Pub. Util.) Code § 851, Pacific Gas and Electric Company (PG&E) seeks approval of two proposed transactions: (1) to sell certain items of executive furniture and office equipment to PG&E Corporation for use by the holding company's officers and employees; and (2) to lease office space at 77 Beale Street and 245 Market Street, as well as associated office furniture and equipment, to PG&E Corporation for holding company employees unable to relocate to One Market Plaza. The application is granted.

Procedural Summary

On September 2, 1998, PG&E filed its application.

On September 4, 1998, notice of this filing appeared in the Commission's Daily Calendar.

On October 5, 1998, the Office of Ratepayer Advocates (ORA) filed a protest to the application.

On October 15, 1998, PG&E filed a reply to the protest of ORA.

In January 1999, Commissioner Henry M. Duque issued an Assigned Commissioner's Ruling Pursuant to Rule 2.5 of the Rules of Practice and Procedure which determined that no evidentiary hearing was required. This was consistent with the Commission's preliminary determination that no hearing was required. (Resolution ALJ 176-3000.)

The Application

PG&E Corporation was organized as a holding company on January 1, 1997. Since then, some employees and departments have been transferred from the utility to the holding company. In March 1998, PG&E Corporation moved its headquarters from 77 Beale Street to One Market Plaza.

According to PG&E, since the reorganization of its parent company, several steps have been taken to separate PG&E, the regulated utility, from PG&E Corporation. Several functions have moved to the holding company and it currently employs approximately 240 people. While many of the holding company employees have relocated to these offices, due to the lack of available space at One Market Plaza some of the holding company's employees will continue to lease space at PG&E's offices at 77 Beale Street and 245 Market Street, some on a temporary basis and others on a longer-term basis. Moreover, it is possible that additional utility employees may be transferred to the holding company in the future, and some of these employees will also have to lease space at 77 Beale Street or 245 Market Street until adequate space is made available at One Market Plaza.

Regarding the executive furniture and office equipment, PG&E Corporation prefers to purchase these used assets from the utility for both cost and convenience reasons, and PG&E wishes to sell these assets because they are no longer needed by the utility for its operations. The utility's officers, who will take over the space at 77 Beale Street formerly occupied by the holding company's officers, will continue to use their current furniture; therefore, the utility will not require the holding company officers' executive furniture. In addition, PG&E claims that the excess furniture that it proposes to sell is inappropriate in size, style, and functionality for other types of offices within PG&E. Similarly, the office equipment that PG&E proposes to sell (for example, facsimile machines, paper shredders) is no longer needed by the utility, as the employees who used the equipment have now been transferred to the holding company.

PG&E estimates the total original cost of the assets to be sold is $132,292, and the net book value for the property is $74,153. The estimated replacement cost new less depreciation for this property, which is often used as a proxy for market value, is $55,473. Since the net book value of the property is less than $250,000, according to PG&E's Affiliated Company Transaction Procedures the property can be transferred at net book value. Therefore, PG&E proposes to sell the property to PG&E Corporation for $74,153. Upon close of the sale, PG&E will retire the assets and credit the after-tax proceeds of the sale to the depreciation reserve, reducing rate base and giving the benefit of the gain on sale to ratepayers.

Regarding the lease of surplus office space, PG&E claims that the lease is in the public interest since the space is no longer needed and ratepayers will benefit because the revenues will be credited to PG&E's ratepayers.

According to PG&E, the lease rate is based on the fair market value of the office space and related assets, consistent with PG&E's Affiliated Company Transactions Procedures. The annual rent for this lease is projected to be approximately $2.8 million. The lease rate was based on the market-average rate for Class A office space in San Francisco's Central Business District, to which is added a prorated fee for use of PG&E's furniture, equipment, and other services (for example, mail service, general postage, telephone operators). PG&E states that if additional space is needed by the holding company, PG&E will use reasonable efforts to find and assign the needed space. PG&E cites previous

Commission decisions that approved similar arrangements for Pacific Bell[1] as are being proposed by PG&E in this application. In addition, PG&E requests a waiver from the Commission regarding future space use arrangements.

PG&E requests that the Commission process its application on an ex parte basis.

Protest of ORA

ORA does not oppose the sale of the executive furniture and office equipment by PG&E to its parent company. ORA agrees with PG&E that the additional revenues from these transactions will benefit ratepayers by decreasing rate base. ORA points out that PG&E has failed to specify how the revenues are being accounted for in the ongoing 1999 general rate case (GRC). As a condition of approval of the sale of the furniture and office equipment, ORA recommends that PG&E should be required to demonstrate how the revenues will be credited to the ratepayers in the 1999 GRC.

ORA disputes PG&E's claim that its proposed base rent of $36 per square foot is the market average[2] of Class A space in San Francisco Central Business District during the first quarter of 1998. ORA argues that according to the Grubb & Ellis' *Office Market Report*, Class A rents have now exceeded the $40 per

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[1] See D.97-12-087 and D.97-10-047 approving Pacific Bell's space lease application on an ex parte basis. Also, see D.98-02-005 and D.96-11-019 approving Pacific Bell's asset sales and lease applications on an ex parte basis.

[2] For the record, it should be noted that PG&E does not claim that the proposed base rent "is the market average of Class A space in San Francisco," but rather, that the proposed base rent "is based on the market average for Class A office space" in San Francisco.

square foot rate: the first quarter 1998 Class A rate of $38.39 is an average for all classes of Class A space.[3]

ORA states that it interviewed several realtors to inquire about the lease rates for Class A space in the San Francisco Central Business District. According to these sources, rent for Class A space in the San Francisco Central District is between $40 and $50 per square foot. In addition, ORA believes that rent in downtown San Francisco is expected to continue to increase due to lack of current and new supply and continued demand for three consecutive years. Accordingly, ORA recommends a base rent of $40 per square foot as more reflective of the fair market value.

Further, ORA states that although PG&E indicates in its application that the revenues from the proposed transactions will be credited to ratepayers in the 1999 GRC, PG&E does not specify how this will take place. For example, PG&E projects an annual rent for the lease to be approximately $2.8 million, but ORA could not ascertain whether or where projected revenues are reflected in the 1999 GRC.

Regarding the sale of assets to the parent company, ORA notes that PG&E proposes to retire the assets and credit the after-tax proceeds of the sale to the depreciation reserve, thereby reducing rate base by $55,473. According to ORA, while PG&E has not fully demonstrated that the revenues have been credited as described above, ORA agrees with PG&E's proposal to credit the ratepayers with the benefits from these transactions in the 1999 GRC.

Also, ORA is concerned about possible impairment of PG&E's ability to render utility service to the public by its parent company due to lack of available

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[3] Grubb & Ellis, *Office Market Report*, First Quarter 1998, p. 3.

office space in downtown San Francisco. Furthermore, to ensure that PG&E charges market rate for additional office space, ORA recommends that PG&E file an advice letter if the parent company requests additional office space greater than 10% of the current leased office space. The advice letter should also demonstrate that all additional space is being leased at then current market rates. ORA believes the advice letter process would help safeguard against cross-subsidies, and better ensure that the parent company does not impair the utility's ability to serve the public.

Response of PG&E

PG&E does not oppose either of the two conditions requested by ORA that: (1) in the 1999 GRC, PG&E be required to demonstrate how revenues from the proposed transactions will be credited to ratepayers; and (2) PG&E be required to file an advice letter if the area leased to its parent company increases by more than 10% of current levels. According to PG&E, it has already complied with the first condition by providing information in the 1999 GRC showing that the lease revenues are reflected in PG&E's 1999 estimates. And, PG&E agrees to comply with the second condition.

However, PG&E opposes as unreasonable ORA's recommended increase in the base rent from $36 to $40 per square foot. According to PG&E, the lease rate proposed in PG&E's application is fully consistent with the reported market averages for comparable office space.

PG&E states that in determining the base rent for the office space, it reviewed the San Francisco rental market reports for the first quarter of 1998 from several brokerage firms. According to PG&E, the general consensus among the reports was that market rents were between $34 and $40 per square foot for Class A space in the Central Business District. Given the age and condition of PG&E's offices compared to the general rental market, PG&E concluded that the office space at 77 Beale Street would fall at the lower end of the range and that the office space at 245 Market Street would fall closer to the middle. PG&E therefore settled on a "blended" rate of $36 per square foot.

Further, PG&E states that it tried to err on the side of ratepayers, rather than the parent company, by using the $34 to $40 range for Class A space in the Central District, since the reported rental rates for Financial District South (where PG&E's offices are located) were in the $29 to $36 range. For example:

- According to *Colliers International San Francisco Market Report*, 1998 first quarter rental rates ranged from a low of $22.55 (for the Rincon/South Beach submarket, which is adjacent to PG&E's offices) to a high of $38.99 (for the North Financial District submarket), with an overall average asking rent (fully serviced) of $33.74 per square foot. The average asking rate for the South Financial District submarket was reported to be $28.77.

- Similarly, *Studley Report & Spacedata* reported that, for the first quarter of 1998, the average rental rate offered for Class A buildings in San Francisco (fully serviced) was $33.86. The average asking rate in the Financial District South was reported to be $35.08 for all buildings and $36.15 for Class A buildings.

- The *Grubb & Ellis Office Market Report*, cited by ORA, had a somewhat higher estimate of market rents. Grubb & Ellis estimated that, for the first quarter of 1998, the average rate for all classes of Class A space was $38.39. Grubb & Ellis did not, however, provide any estimates of rates in San Francisco's rental submarkets that PG&E could use for comparison to its office spaces.

Accordingly, PG&E argues that ORA's $40-$50 estimate is inconsistent with the market reports discussed above. PG&E believes that the proposed base rent of $36 per square foot is fully reasonable based on the available market data for office space in San Francisco, taking into consideration the age and condition of the office space in question.

Discussion

Pub. Util. Code § 851 requires Commission authorization before a utility may sell, lease, assign, mortgage, or otherwise dispose of or encumber utility property. The purpose of this section is to enable the Commission to review a proposed transfer and to require, as a condition of transfer, such action as the public interest may require. (*Pacific Bell*, D.97-12-087 (1997).) Another purpose of this section is to enable the Commission to ensure that any revenue from a proposed transfer is accounted for properly, and that the utility's rate base, depreciation, and other accounts correctly reflect the transaction. In addition, when the transactions are with a corporate affiliate, the Commission's review also includes consideration of whether the transactions may have anticompetitive effects or result in cross-subsidy of a nonregulated entity and comply with the Commission's Affiliate Transaction Rules (Rules), as set forth in Decision (D.) 97-12-088, modified by D.98-08-035.

As PG&E states, the executive furniture and office equipment that it proposes to sell to the holding company are no longer needed since some employees and departments have been transferred from the utility to the holding company. And consistent with the Commission's policy on treatment of gain on sale of miscellaneous depreciable assets, PG&E proposes to give ratepayers the benefit of the after-tax proceeds from the sale by crediting the net proceeds to the depreciation reserve, thereby reducing rate base by an equal amount. Accordingly, we will approve PG&E's request to sell the items of executive furniture and office equipment, as listed in PG&E's application.

Regarding the lease of surplus office space, we believe that PG&E's proposed rental rate of $36 per square foot is reasonable since it is within the prevailing range for rents in the area where PG&E's offices are located, in the first quarter of 1998. Accordingly, we will approve PG&E's request subject to the two conditions proposed by ORA that: (1) PG&E be required to demonstrate how revenues from the proposed transactions will be credited to ratepayers in the 1999 GRC, and (2) PG&E be required to file an advice letter if the area leased to its parent company increases by more than 10% of current levels demonstrating that all additional space is being leased at then current rates.

Lastly, regarding any anticompetitive effects of these transactions, we do not believe there are any. It is unlikely that the sale of surplus executive furniture to the parent corporation, or renting of office space and facilities to the parent corporation at prevailing market rates will provide competitive advantages to nonutility affiliates or result in cross-subsidy of PG&E Corporation by the utility (see *Pacific Bell*, D.97-10-047).

The lease and authority to sell surplus assets sought by PG&E are existing non-tariffed services, as described in its Advice Letter 2063-G/1741-E.[4] As such, Rules VII.C.4 and VII.G apply here. Rule VII.C.4 lists five conditions which must be met:

a. The nontariffed product or service utilizes a portion of a utility asset or capacity;

b. such asset or capacity has been acquired for the purpose of and is necessary and useful in providing tariffed utility services;

c. the involved portion of such asset or capacity may be used to offer the product or service on a nontariffed basis without adversely affecting the cost, quality or reliability of tariffed utility products and services;

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[4] We grant authority in this Decision for the lease and authority to sell surplus assets sought by PG&E in its application. We will address Advice Letter 2063-G/1741-E in a subsequent resolution and do not prejudge it here.

d. the products and services can be marketed with minimal or no incremental ratepayer capital, minimal or no new forms of liability or business risk being incurred by utility ratepayers, and no undue diversion of utility management attention; and

e. the utility's offering of such nontariffed product or service does not violate any law, regulation, or Commission policy regarding anticompetitive practices.

The Rules require that the utility inform the Commission by advice letter of the utility's existing or new nontariffed products and services, and how their provision complies with the Rules. However, Rule VII.G requires that, if Commission authority is sought pursuant to Section 851, "the utility need not file a separate advice letter, but shall include in the application those items which would otherwise appear in the advice letter as required in this Rule."

The record indicates that the conditions specified by the Rules have been satisfied for these existing nontariffed services provided by PG&E.

Administrative Law Judge's Draft Decision

The draft decision in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g) and Rule 77.1 of the Rules of Practice and Procedure. Comments were filed by ORA on February 8, 1999, and reply comments were filed by PG&E on February 16, 1999. We have reviewed the comments and reply comments and made changes to the draft decision where appropriate.

Findings of Fact

1. PG&E proposes to: (1) sell certain items of executive furniture and office equipment (assets), and (2) lease surplus office space and associated furniture and equipment to its parent company, PG&E Corporation.

2. Upon close of the sale of the furniture, PG&E proposes to retire these assets and credit the after-tax proceeds of the sale to the depreciation reserve, reducing

rate base. This would give the benefit of the gain on sale to ratepayers through a credit to rate base.

3. The surplus office space and associated furniture and equipment will be leased at the rate which prevailed in the first quarter of 1998 for office space in the area where PG&E's offices are located.

4. Ratepayers will benefit from the proposed lease of surplus office space because revenues of approximately $2.8 million annually will be credited to PG&E's ratepayers.

5. The lease and authority to sell surplus assets sought by PG&E are existing non-tariffed services, as PG&E describes in its Advice Letter 2063-G/1741-E.

6. As such, Rules VII.C.4 and VII.G of the Commission's Affiliate Transaction Rules apply here.

7. The record indicates that the conditions specified by the Affiliate Transaction Rules have been met for these nontariffed services provided by PG&E.

Conclusions of Law

1. Since the reported rental rates for Financial District South (where PG&E's offices are located) were within the $29 to $36 range, PG&E's proposed rent of $36 per square foot is reasonable.

2. There is no evidence of anticompetitive effects or cross-subsidy of nonregulated entities resulting from PG&E's proposals.

3. The application should be granted ex parte since there are no remaining issues of material fact in dispute.

O R D E R

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E) is authorized, pursuant to Public Utilities Code § 851, to: (1) sell certain items of executive furniture and office equipment, and (2) lease portions of office space and associated office furniture and equipment, as set forth in its application.

2. PG&E shall: (1) demonstrate to the Office of Ratepayer Advocates how revenues from the proposed transactions will be credited to ratepayers in the 1999 General Rate Case, and (2) file an advice letter, as described herein, if the area leased to its parent company increases by more than 10% of current levels.

3. Application 98-09-006 is closed.

This order is effective today.

Dated February 18, 1999, at San Francisco, California.

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners