

Decision 99-06-092 June 24, 1999

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

In the Matter of Application of GTE California  
Incorporated for Approval to Lease Assets  
Pursuant to Section 851 of the Public Utilities  
Code.

Application 98-12-022  
(Filed December 21, 1998)

**O P I N I O N**

**1. Summary**

GTE California Incorporated (GTEC) seeks retroactive approval of existing lease agreements for GTEC property that the company believes is under-utilized or surplus. Two protests have been filed. Our order today reviews and approves the agreements at issue, and it directs GTEC to conduct a further review of lease and license agreements that may not have been approved. This proceeding is closed.

**2. Factual Background**

GTEC seeks after-the-fact approval of 59 license and lease agreements that it executed between 1994 and 1997. Of the agreements, 25 are leases with affiliate companies of GTEC; 21 are leases with third parties; the remaining 13 are revocable license agreements with third parties. The agreements fall into two categories. First are leases of under-utilized space within existing GTEC facilities. Second are leases of portions of land deemed surplus to GTEC's needs. GTEC states that the excess space is the result of consolidation of various functions in central locations and the use of new equipment that requires less space.

An example is what the application identifies as Lease A17. GTEC states that service office consolidations in Santa Barbara left the facility on Canon Perdido Street vacant except for a backup generator for a nearby central office. The unused space has been leased to Sima Corporation.

In Lease A16, GTEC has leased about two-thirds of an acre of space at a parcel of land where the company's Point Mugu Central Office is located. The lessee is Southland Sod Farms, which operates an agricultural business on the vacant land.

Other leases are with non-profit organizations, such as the Catholic Diocese of Fresno, San Fernando Valley Legal Services, and the Conejo Valley School District. GTEC has also leased space to various affiliates, such as GTE Supply, Incorporated, and GTE Mobilnet.

GTEC states that the leases and licenses benefit GTEC customers by producing revenue for the company. GTEC states that none of the leases interferes with the company's operations, nor do they impair GTEC's ability to serve its customers. All of the agreements require that the lessee's use of the property or facilities will not interfere with GTEC's operations.

### **3. Why GTEC Did Not Seek Prior Approval**

Section 851 of the Public Utilities Code requires Commission authorization for the sale or transfer of necessary or useful utility property. Without such approval, any such purported sale is deemed void. (In re Pacific Bell (1995) 59 CPUC2d 237, 238-39.)

GTEC states that it entered into these leases without seeking Commission approval because it believed at the time that approval was not necessary if the leased space was surplus. It relied on that provision of Section 851 that states

that "[n]othing in this section shall prevent the...lease...of property which is not necessary or useful in the performance of its duties to the public...."

GTEC states that, in light of Commission decisions in recent years, it has determined that Commission approval should be obtained pursuant to Section 851 for these leases. (See, e.g., Decision 96-02-054, 65 CPUC2d 4, in which Southern California Edison Company was authorized to sell certain electric facilities to the trustees of California State University.)

Accordingly, GTEC now seeks retroactive approval of these lease agreements, lest they be deemed void. GTEC states that it has revised its corporate "Guidelines for Leasing Real Estate Assets" to include a new Section 851 checklist to ensure that all future leases will be in compliance with Section 851 requirements. GTEC states that it has notified its managers to disseminate the guidelines and 851 checklist, and to review all leases and licenses and include in this filing all such arrangements that are subject to Section 851.

#### **4. Nature of Leases**

GTEC has attached to its application copies of all of the leases and licenses for which it seeks approval. Also attached is the company's confidential fully allocated cost calculations for each property, and a market analysis of fair rental value of each property. GTEC states that each of the leases with third parties was based on market valuations. In leases to affiliates, affiliates pay the higher of market value or GTEC's fully allocated cost plus return on investment. GTEC states that the leases with affiliates have been amended on a retroactive basis where necessary so that the pricing is in accord with the Commission's affiliate transaction rules.

GTEC has divided the agreements into three categories--third party revocable licenses, third party leases, and affiliate leases. A representative sampling of the agreements in each of the three categories follows.

### **Third Party Revocable Licenses**

3910 Conteras Road, Anza. This license permits Los Angeles Cellular Telephone Company to operate equipment on 360 square feet of unoccupied land and to erect a facility hut and a pole that will support up to nine antennas.

30653 George Smith, Squaw Valley. This license grants the Catholic Diocese of Fresno the right to use for parking a portion of the property that is unused by GTEC at this remote switching unit site.

112 Lakeview Canyon, Thousand Oaks. This license grants the Conejo Valley Unified School District the right to use up to 100 parking spaces at this GTEC administrative facility. The spaces are used on an occasional basis after normal business hours.

Inspiration Point, Idyllwild. This license grants radio station KATY 101.3 FM the right to store an emergency generator and equipment in 37 square feet in a GTEC building, and it grants the licensee space on GTEC's microwave relay tower on which to place its antennas.

### **Third Party Leases**

211 West D Street, Ontario. GTEC entered into two leases with AT&T of California, Inc. (AT&T), granting AT&T the right to use a limited amount of space for AT&T's toll point of presence equipment.

2001 Broadway, Santa Monica. The lease grants AT&T the right to use about 2,712 square feet of this toll center to place telecommunications equipment.

Oregon Mountain, Trinity County. This ground lease allows Cal-North Cellular to use 1,200 square feet of land on this 400-acre parcel to construct a tower and equipment building.

560 Bartlett Road, Big Bear Lake. This lease grants Los Angeles SMSA Limited Partnership the right to install a cellular dish antenna on GTEC's tower and to erect a small building on 2,000 square feet of land.

2320 Junipero Street, Signal Hill. The lease grants the City of Long Beach the right to use 7,800 square feet of surplus land at this site to construct and operate a radio transmitter.

### **Affiliate Leases**

Crestview Summit, Crestview. By this lease, Contel Cellular of California, Inc. is granted an easement to place cellular and dish antenna facilities on an existing tower. The lease has been amended and GTEC's accounts adjusted to reflect the requirements of the affiliate transaction rules.

Conway Summit, Mono County. Contel Cellular has an easement to install a four-channel enhancer and an easement to place cellular and dish antenna facilities on an existing tower.

930 University Avenue, Los Gatos. Two leases with GTE Supply Incorporated grant the right to use 2,623 square feet in this GTEC administrative facility for storage and administration.

1845 Camino do Rios, Newbury Park. This sublease grants GTE Data Services Corporation the right to use 14,213 square feet in GTEC's Newbury Park Bill Print Center for general office use and bill processing activities.

2151 W. Main Street, Barstow. This revocable license grants GTE Directories the right to use 1,500 square feet of the parking lot for placement of a portable office trailer and parking of vehicles on an occasional basis.

Our obligation in reviewing transactions like these under Section 851 is clear. As stated in Re Pacific Bell, supra:

"The Commission reviews these transactions to ensure that the transactions will not impair the utility's ability to provide service to the public. The Commission must also ascertain whether the transactions are accounted for properly. This requires ensuring that any revenue from the transactions are accounted for correctly, and that the utility's rate base, depreciation, and other accounts accurately reflect the transactions. The Commission will also consider benefits to the utility's customers and the public from the proposed lease." (D.97-03-003, 1997 Cal. PUC LEXIS 124, at 3 (March 7, 1997).)

GTEC states that these requirements have been met here. The agreements involve unused, excess space that is either within GTEC facilities or on GTEC property. GTEC states that the leases do not impair GTEC's provision of telecommunications service to the public, and revenues from these transactions are properly recorded. GTEC states that the agreements with affiliates are in compliance with the Commission's affiliate transaction rules, and that they involve no cross-subsidization. In addition, GTEC has amended its internal guidelines for leasing real estate assets to include mandated procedures for the proper review of California transactions.

GTEC also submits to us revocable licenses and a sub-license for a determination that they are not subject to Section 851 or, alternatively, that they be approved to the extent that they are subject to Section 851.

## **5. Protests and Responses**

Protests to the application were filed on January 27, 1999, by the Office of Ratepayer Advocates (ORA) and jointly by Accelerated Connections, Inc.; AT&T;

ICG Telecom Group, Inc.; MCI WorldCom Inc.; NEXTLINK California, and Sprint Communications Company L.P. (Joint Protestants).

ORA's protest deals primarily with GTEC's failure to price its leases with affiliate companies at fully allocated cost plus 10%. ORA does not object to GTEC's third-party lease agreements. ORA recommends that the third-party agreements be approved nunc pro tunc, but it urges that the Commission decline approval of the 25 affiliate transactions until GTEC files an amended application.

The Joint Protestants also contest the leases with GTEC affiliates. They claim that 13 transactions involving space at or near GTEC central offices should be disapproved until GTEC shows that the use of this space will not adversely affect collocation requests by competitive local carriers. The Joint Protestants do not object to GTEC's leases with third parties.

GTEC replied to the protests on February 8, 1999. In a ruling by the administrative law judge (ALJ) dated February 17, 1999, ORA and the Joint Protestants were invited to respond to GTEC's reply and to state any material issues of disputed fact that would require hearing. The responses were filed on March 19, 1999.

Neither GTEC nor ORA seeks evidentiary hearings on this application. The Joint Protestants urge a hearing on its position on collocation issues if that is deemed pertinent to this proceeding.

## **6. ORA Protest and Response**

### **(a) Affiliate Transaction Pricing Rule**

ORA argues that GTEC is or should be bound by the Commission's affiliate transaction pricing rule articulated in Decision (D.) 87-12-067, 27 CPUC2d 1, addressing Pacific Bell's revenue requirement. The pricing rule states that non-tariffed services provided by Pacific Bell to its non-regulated affiliates

must be priced at the higher of fully allocated cost plus a return on investment plus a 10% mark-up, or fair market value. (See D.87-12-067, p. 277; 27 CPUC2d at 136; see also D.86-01-026, 20 CPUC2d 237, 254.)

ORA argues that the pricing rule was applied to GTEC in its dealings with an affiliate, GTEL, as part of GTEC's general rate case decided in D.88-08-061, 29 CPUC2d 63. The Commission noted that it had established the pricing rule for Pacific Bell in D.86-01-026 and perceived "no need to depart from this plan for General [GTEC]." (29 CPUC2d at 88.)

In D.91-07-056, 41 CPUC2d 89, the Commission directed GTEC and Pacific Bell to maintain California cost allocation manuals that would reflect the Commission's cost allocation requirement. (41 CPUC2d at 129.) GTEC prepared a California Cost Allocation Manual and, after required revisions, the manual was approved by the Commission in Resolution T-15950 (December 9, 1996). ORA states that an accord between the Commission's advocacy staff (then the Division of Ratepayer Advocates) and GTEC, negotiated in review of the manual, requires the company to adhere to the affiliate pricing rule adopted in D.88-08-061. However, ORA adds that the issue of the 10% mark-up was not raised in staff's protest, nor was it addressed in the resolution.

GTEC responds that its pricing of the affiliate leases is consistent with the Commission-approved California Cost Allocation Manual, which provides that the fully allocated cost plus 10% price methodology does not apply to the leases at issue here. Specifically, GTEC states, the cost allocation manual provides:

"The provision of non-tariffed goods and services provided by GTE California to other domestic GTE Telephone Operating Companies shall be priced at Fully Allocated Cost, including the return on investment, as described in FCC Part 64 (47 CFR sections 64.901 and 64.902). The return on investment



component used by GTE California in the transfer pricing process is the market based 11.50% as set forth in D.89-10-031, Section 6. Exhibit II of the F-Cam states that the transactions for services and supplies provided to nonregulated affiliates by the GTOCS will be at tariff, cost or prevailing price. *In order to comply with the CPUC Alternative Regulatory Order, 89-10-031, non-tariffed goods and services provided by GTE California to other non-regulate affiliates shall be priced at the higher of Fully Allocated Cost, including a return on investment as described in FCC Part 64...or Market Price. (Emphasis added.)*

GTEC acknowledges that the Cost Allocation Manual requires the 10% mark-up for "affiliate transactions regarding referrals and the billing of on demand services," although it argues that this markup applies only to GTEL, and not to other affiliates. (Manual, Section 3, Item K.) The 10% mark-up also is required for services provided by GTEC to GTEL, an affiliate that since has been integrated into GTEC operations. (Manual, Section 4.) GTEC asserts that none of the leases at issue here are with GTEL, nor do they deal with referrals and billing of on demand services.

In the context of this Section 851 application, we agree with GTEC that the affiliate leases examined here are priced in conformance with the California Cost Allocation Manual at the higher of fully allocated cost (including return on investment) or fair market value. ORA makes the case that the cited Commission decisions, by inference, require that all affiliate leases by GTEC should be priced using the 10% methodology. That inference, however, cannot stand in the face of the specific requirements of the Cost Allocation Manual. This Section 851 application is not the proper forum in which to revisit the affiliate pricing rules set forth in the Cost Allocation Manual.

**(b) Market Valuations**

ORA recommends that the Commission require GTEC to conduct new analyses of fully allocated costs and fair market value for 15 of the affiliate leases because the analyses provided in the application were inadequate. GTEC admits that it should have had more complete market analyses for each affiliate lease, but it states that it "simply could not locate the analyses for each property in issue." (GTE Reply, at 11.) In its defense, the company adds:

"It was GTEC's policy at the time these leases were signed to price them at the higher of FAC (including return on investment) or market, and GTEC has no reason to believe these procedures were not followed with respect to each of the leases submitted for approval. GTEC believes reconstructing market analyses for each property would produce little, if any, change in the price of the leases; the marginal benefit of such reconstructed analyses does not justify the burden and expense of preparing them." (GTE Reply, at 11.)

ORA also notes that three of the 25 affiliate leases contain options to renew or extend the lease or sublease for periods of up to five years. None of the three agreements contain provisions that would require GTEC to adjust the rental price consistent with then current fair market value. ORA argues that such a requirement is necessary to offset the lack of arm's-length bargaining between the company and its affiliates.

GTEC argues that renewal options are a common practice in leasing agreements and that they are based on then-existing projections of future market value. GTEC states that in some cases the market may have over-projected value of properties in the future; at other times, the result may be the opposite. In any event, GTEC states that ORA does not cite Commission authority for the proposition that utilities may not enter into option leases with their affiliates or that such leases have to be recalculated prior to the option being exercised.

We agree with ORA that the market evaluations submitted with some of the affiliate lease transactions are less than complete. Some evaluations lack evidentiary support; others appear to compare different types of properties; still others appear to have been conducted two or three years before the lease transaction in question. We are not convinced, however, that a recalculation is appropriate. Most of the leases involve relatively modest rates. Many were entered into several years ago. In the absence of any allegation to the contrary, we take GTEC at its word that it has priced its leases with affiliates at the higher of fully allocated cost or market value. We are not persuaded that recalculation after the fact will yield any significant difference in pricing.

Similarly, we are not persuaded that Commission policy precludes the renewal options in three of the affiliate leases, or that a recalculation of market value should be required before the options can be exercised. ORA presents us with no authority for such requirements, and we are unwilling to adopt such requirements based on the sparse record in this proceeding.

**(c) Subleases Subject to Section 851**

GTEC argues that two sublease agreements with affiliates are not subject to Section 851 requirements because GTEC is not the owner of the property, but is merely a licensee. ORA responds that the issue under Section 851 is not whether the utility owns the property, but whether the property is reflected in the utility's results of operations for intrastate ratemaking. By reflecting the property in its results of operations, ORA argues that the utility implicitly claims that the property is necessary and useful for utility operations. As ORA notes, we addressed this question in a Pacific Bell application, D.96-04-045, 65 CPUC2d 324, commenting:

"When entering into a sublease, Pacific Bell commits to another entity all or a portion of property it has found to be

necessary or useful in the performance of its public utility duties. This commitment necessarily precludes the leased property being available to serve Pacific Bell's customers. For this reason, a sublease is a disposition of or an encumbrance to utility property which requires Section 851 authorization." (65 CPUC2d at 328.)

We deny GTEC's request to exclude from Section 851 consideration its Lease No. B13 (sublease to GTE Data Services) and Lease B25 (sublicense to GTE Mobilnet).

**(d) Other Section 851 Transaction**

GTEC seeks after-the-fact approval of transactions that were entered into between the years 1994 and 1997. The fact that GTEC has entered into transactions without obtaining Section 851 approval prompts ORA to question whether there are other transactions that were formed without Commission approval. ORA recommends that the Commission should require GTEC to identify all transactions (including leases, subleases, licenses and sublicenses of property, plant, or equipment) with its affiliates and third parties.

ORA does not recommend, as it could, that GTEC be fined under Section 2107<sup>1</sup> for its failure to seek approval for the transactions examined here. We agree. We have no reason to believe, and no party suggests, that GTEC's failure to obtain Section 851 approval for these transactions was anything more than a mistake.

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<sup>1</sup> Section 2107 states, in part: "Any public utility which violates or fails to comply with any provision...of this part...or requirement of the commission...is subject to a penalty of not less than five hundred dollars (\$500), nor more than twenty thousand dollars (\$20,000) for each offense."

On the other hand, since the failure to seek approval was based on a mistaken belief that Section 851 did not apply to certain transactions, we believe that it is appropriate to direct GTEC to conduct a search for, and submit applications for approval of, any other past transactions, including subleases and sublicenses, for which pre-approval has not been secured as required by Section 851. We will require that the search cover the period 1990 to the present, and that GTEC report its findings within 90 days. The report may be made in a follow-up application (if additional transactions are uncovered) or (if additional transactions are not found) in a written statement to ORA and the Telecommunications Division detailing the nature and scope of the search conducted. We note that a similar requirement recommended by ORA in a Pacific Gas and Electric Company proceeding led to review and approval of additional Section 851 transactions that the company had not included in its initial filing. (See Application 99-01-001, dated January 5, 1999.)

## **7. Joint Protestant's Protest and Response**

The Joint Protestants limit their protest to 13 affiliate leases in which GTEC has leased space that could in the future be the subject of a request for collocation. The Joint Protestants urge that GTEC be required to show that none of these leases has a significant affect on the availability or quality of space available for collocation.

GTEC responds that Section 851 does not prohibit a utility from encumbering property because it might become useful for collocation in the future. It adds that GTEC has not denied a collocation request at any of the 13 locations at issue. GTEC argues that the Joint Protestants' concerns are raised in the wrong proceeding. If a competitive local carrier subsequently makes a collocation request at one of the central offices at which GTEC has leased space

to an affiliate, and if GTEC refuses to accommodate such a request because of lack of space, the competitive local carrier then may invoke the Procedures for Administering Collocation Requests recently adopted by the Commission in D.98-12-068.

ORA states that, while it shares the concerns of the Joint Protestants, it agrees that the collocation issue is beyond the scope of this proceeding. ORA notes that, in addition to the remedies established in D.98-12-068, the Commission has made accommodations in its Local Competition docket (Rulemaking 95-04-043/Investigation 95-04-044) to address new collocation issues as necessary in future proceedings.

We agree with GTEC and ORA that this Section 851 application is not the forum in which to examine the broad collocation concerns raised by the Joint Protestants. As GTEC notes, the Telecommunications Act of 1996 contains no requirement that an incumbent local exchange carrier hold space open for potential collocation. (47 U.S.C. § 251(c)(6).) If and when a competitive local carrier is refused space at a GTEC location where space has been leased to a GTEC affiliate, a complaint on those facts may be brought to us at that time.

## **8. Conclusion**

Where appropriate, this Commission has granted Section 851 approval to transfers nunc pro tunc, i.e., with the same effect as if done earlier, where the failure to obtain approval has been deemed inadvertent and where our examination of the transfer revealed no prejudice to ratepayers. (See, e.g., Pacific Gas and Electric Company, D.99-02-062 (February 18, 1999); WinStar Communications (1995) 59 CPUC2d 635.) Here, neither ORA nor the Joint Protestants object to approval of GTEC's transactions with third parties. We have examined and dealt with objections to the affiliate leases. We conclude that

after-the-fact approval under Section 851 is appropriate, based on the record before us. Our order today gives Section 851 approval to these transactions on a nunc pro tunc basis.

In Resolution ALJ 176-3007 dated January 7, 1999, the Commission preliminarily categorized this proceeding as ratesetting, and preliminarily determined that hearings would be necessary. Our examination of the record persuades us that a public hearing is not necessary. Accordingly, we confirm the designation of this proceeding as ratemaking, but we amend the designation to eliminate the requirement for hearing.

The application is granted, subject to the terms and conditions set forth below.

#### **9. Comments on Draft Decision**

The draft decision of the administrative law judge 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. GTEC in its comments supports the draft decision. ORA repeats the arguments it had raised earlier. Both parties urge minor changes in the text of the decision, and those changes have been made where appropriate.

#### **Findings of Fact**

1. Between 1994 and 1997, GTEC entered into 59 license and lease agreements in which unused or under-utilized space and facilities were made available to third parties and GTEC affiliates.

2. Of the agreements that are the subject of this application, 25 are lease agreements with GTEC affiliates; 21 are lease agreements with third parties, and 13 are revocable license agreements with third parties.

3. GTEC did not seek approval for these transactions under Pub. Util. Code § 851 under the mistaken belief that lease of surplus space was not covered by Section 851.

4. GTEC states that it has since determined that Commission approval should have been obtained for the transactions in question.

5. GTEC seeks after-the-fact approval of these transactions pursuant to Section 851.

6. ORA does not object to approval of the lease and license agreements with third parties, but it objects to the pricing of all of the affiliate transactions and to the market valuation supporting some of these affiliate transactions.

7. The Joint Protestants object to the affiliate transactions to the extent that they may interfere with collocation requests by competitive local carriers.

### **Conclusions of Law**

1. Pub. Util. Code § 851 requires Commission authorization before a utility may sell or otherwise dispose of or encumber necessary or useful utility property.

2. GTEC's failure to seek Section 851 approval of the transactions at issue was an error.

3. The lease proceeds were properly recorded and affiliate leases were adjusted in accordance with the Commission's affiliate transaction rules.

4. The Commission has granted Section 851 approval to transfer nunc pro tunc where the circumstances warrant and where examination reveals no prejudice to ratepayers.

5. GTEC's request for retroactive approval of the transactions with third parties is unopposed.



6. GTEC has priced its transactions with affiliates pursuant to its Commission-approved Cost Allocation Manual.

7. The record does not support a requirement for recalculation of market evaluations for certain of the affiliate transactions.

8. The record does not support a requirement precluding renewal options in three of the affiliate leases.

9. GTEC's request to exclude from Section 851 consideration a sublease agreement and a sublicense agreement should be denied.

10. GTEC should be directed to conduct a reasonable search of transactions since 1990 to determine whether other lease or license transactions should have been submitted for Section 851 approval but were not.

11. The collocation issued raised by the Joint Protestants is beyond the scope of this proceeding.

12. A hearing is not warranted on the facts of this application.

13. This proceeding is designated as ratesetting.

14. The Commission should give after-the-fact Section 851 approval of the transaction that are the subject of this application.

## **O R D E R**

### **IT IS ORDERED that:**

1. Pursuant to Pub.Util. Code Section 851, the application of GTE California Incorporated (GTEC) for approval of the 59 separate license and lease agreements in this proceeding is granted. The approval is nunc pro tunc to the date when such authorization would have been granted had proper procedures been followed.

2. Within 90 days of the date of this order, GTEC is directed to conduct a reasonable search for, and submit applications for approval of, past lease, license, sublease and sublicense transactions dating from 1990 forward for which pre-approval has not been secured as required by Section 851. If additional transactions are not discovered, GTEC shall within 90 days submit a written statement to the Office of Ratepayer Advocates and the Telecommunications Division detailing the nature, scope and results of GTEC's search.

3. Except to the extent set forth in these ordering paragraphs, the protests to this application are denied.

4. The issues presented in Application (A.) 98-12-022 are resolved.

5. A.98-12-022 is closed.

This order is effective today.

Dated June 24, 1999, at San Francisco, California.

RICHARD A. BILAS

President

HENRY M. DUQUE

JOSIAH L. NEEPER

JOEL Z. HYATT

CARL W. WOOD

Commissioners