

Decision 10-01-011 January 21, 2010

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Investigation on the
Commission's Own Motion into the Pacific
Telesis Group's "spin-off" Proposal.

Investigation 93-02-028
(Filed February 17, 1993)

DECISION CLOSING PROCEEDING

Summary

After the Pacific Telesis Group's spin-off of its wireless subsidiaries in a separation transaction in 1993, this decision finds the 1994 independent auditors' recommendation to the Commission to have become moot. Moreover, there has not been a strong argument presented as to how or why the Commission should subject this matter to further uncertainty and challenge 15 years after the auditors submitted their report. Investigation 93-02-028 is closed.

Background

In December 1992, the Pacific Telesis Group's (Telesis)¹ Board of Directors voted to divest its wireless companies and to spin-off these subsidiaries into a separate company, referred to as PacTel Corporation or PacTel.² PacTel was to include the wireless operations of PacTel Cellular, Pacific Telesis International, PacTel Paging, PacTel Services, Locations Technologies, and 51% of PacTel

¹ Telesis, one of the original seven regional holding companies, was the parent of two Bell Operating Companies and certain diversified subsidiaries listed herein.

² Initially named PacTel, but subsequently renamed AirTouch.

Teletrac. The remaining corporate entity was to consist primarily of Telesis, the holding company and the wireline regional Bell Operating Companies, Pacific Bell Telephone Company (currently doing business as AT&T California) and Nevada Bell Telephone Company (dba AT&T Nevada).

In February 1993, the Commission initiated this proceeding by issuing an Order Instituting Investigation into the Telesis spin-off proposal.³ Posing a series of questions, the order required Telesis to “provide a comprehensive description of the spin-off and a showing as to its effects.” (51 CPUC2d 728, 734 (1993)) Ultimately, after examining the Telesis proposal in light of Public Utilities (Pub. Util.) Code § 851 and two other key statutes,⁴ the interim decision determined that “no assets used and useful in the conduct of a utility business” were to be transferred away from any of the operating utilities.⁵ The Commission also required Telesis and AirTouch to transfer or allocate “any assets necessary or useful to the California operating utility . . . or the California wireless utilities” to the appropriate entity.

Since the terms of the proposed transaction were not finalized during the pendency of the investigation and there was the possibility that utility property might be transferred after it was consummated, the Commission ordered a compliance report of the separation transaction by an independent auditor. The Commission directed the immediate commencement of the compliance report,

³ In January 1993, the Telesis Board, asserting that the proposal did not require Commission authorization, provided the Commission with a written description of the plan to spin-off its wireless subsidiaries.

⁴ Pub. Util. Code §§ 818 and 854.

⁵ Including AT&T California and the California wireless utilities.

and the auditor was to complete it as soon after the date of final separation as reasonably possible.

Pursuant to Decision (D.) 93-11-011,⁶ Telesis selected the independent auditing firm of Frederick & Warinner with the Commission's approval. The consulting contract was between Frederick & Warinner and the Commission, with Telesis obligated to reimburse the Commission "for all consultant expenses incurred to accomplish the report." (*Id.*) The predecessor to the Communications Division⁷ administered the contract. Frederick & Warinner submitted its report⁸ on November 7, 1994. No further action took place following submission of the report.

The report's overall assessment was that the Separation Agreement, D.93-11-011, and the Commission's affiliate transaction rules had been complied with during the separation transaction in all material respects. However, the report indicated that a discrepancy had been detected in the transaction in the area of payment responsibility for employee benefits plans. While the report quantified the impact of the discrepancy on Telesis and AirTouch, it noted that quantifying the smaller direct impact on AT&T California ratepayers was contingent upon several future variables, and consequently declined to do so.

⁶ The decision provided that the auditing firm should be selected so as to avoid conflicts of interest relating to the firm's other business, if any, with Telesis, AT&T California, or PacTel. (51 CPUC2d at 770.)

⁷ The Commission's Advisory and Compliance Division.

⁸ Confidential and redacted versions of "Results of the Audit of the Separation of the Pacific Telesis Group of Companies Prepared for the California Public Utilities Commission."

Further investigation of the reported employee benefits plans' discrepancy as well as the capacity to quantify and assess substantiated payment responsibility are complicated by the fact that both the transferor (Telesis) and transferee (AirTouch) have since merged with other companies, one over which we have jurisdiction, while the other operates largely outside of our regulatory purview.

On June 3, 2004, the assigned Administrative Law Judge (ALJ) issued a ruling soliciting comments on concluding the instant proceeding. Specifically, the ruling asked parties: 1) whether or not, given the passage of time and jurisdictional issue, the proceeding had become academic or moot; (2) if not, how the Commission should conclude it; and (3) whether, and to what extent, the commenter wished to participate in any concluding phase of the case. AT&T California and the Division of Ratepayer Advocates⁹ (DRA) responded on June 17, 2004. No other party filed comments.

On April 11, 2006, the ALJ asked AT&T California to brief the Commission as to whether there were remaining issues in this docket that had any New Regulatory Framework implications.

Comments on Concluding the Proceeding

In its comments, AT&T California noted that Frederick & Warinner's vintage audit report concerned the allocation and transfer of pension assets. It reiterated that since the auditors found that the Agreement, D.93-11-011, and the Commission's affiliate transaction rules had been deemed complied with in all material respects, the Commission took no further action following submission

⁹ Formerly doing business as SBC California and designated as the Office of Ratepayer Advocates, respectively.

of the report. AT&T California asserted that the auditors found that the transfer of pension assets also complied with the Separation Agreement. It argued, however, that the auditors raised the speculative concern that depending on unknown future ratemaking treatment, the transfer had the potential to affect AT&T California ratepayers negatively. The incumbent local exchange carrier dismissed this concern.

AT&T California stated that under the then-existing regulatory framework,¹⁰ its prices had not been established based on AT&T California's cost of providing service. Consequently, there could be no further "ratemaking" applicable to these costs. As a result, prices have not changed because of changes in pension costs, and customers have not been affected by any changes in pension costs. In addition, AT&T California maintained that its New Regulatory Framework start-up rates contained zero pension costs. It declared that the risk of cost recovery and changes in pension costs are borne by shareholders, and not by customers. AT&T California proclaimed the auditor's concern and recommendation to be moot. (AT&T California Comments at 4.)

Given the passage of time, AT&T California stressed the difficulties of conducting a further investigation of this matter. The PacTel Corporation companies that were the subject of the spin-off (e.g., AirTouch), have since merged with other entities or ceased to exist. Moreover, AT&T California noted that the extent of the Commission's regulation of wireless companies also has changed. *See* 47 U.S.C. § 332. Further, AT&T California pointed out that reopening any portion of the spin-off transaction at this juncture not only would

¹⁰ Referred to as the New Regulatory Framework, which was adopted in D.89-10-031.

present practical difficulties, but also would directly conflict with the regulatory certainty the Commission sought to achieve when it ordered the audit to be undertaken immediately and be completed as soon as reasonably possible.

Finally, AT&T California insisted that further investigation would be inappropriate based on additional public policy considerations. Over time, evidence can be lost, memories fade, and witnesses become unavailable. AT&T California asserted that it would be prejudicial to the parties to the spin-off transaction to subject the matter to capriciousness and challenge so long after the audit report was submitted. For all of these reasons, AT&T California argued that no further proceedings are warranted, and this docket should be closed.

In its comments, DRA declared that the remaining issues in the proceeding were neither academic nor moot, and urged the Commission to conclude the case by following its predecessor's recommendations regarding the decade-old audit report. DRA characterized the issue of whether the Commission continued to have the jurisdictional authority to require the production of further information necessary to resolve the pension question as unclear. DRA advised that it appeared that the Commission retained jurisdiction over the PacTel's successors to enforce the conditions of the spin-off under *PG&E v. Public Utilities Commission*,¹¹ and to investigate whether pension assets were improperly transferred in the spin-off. It urged the Commission to assert jurisdiction.

DRA reiterated in its comments on the audit report that the audit was incomplete and deficient for failing to calculate the identified surplus pension

¹¹ *PG&E Corp., Petitioner v. Public Utilities Commission, Respondent; Office Ratepayer Advocates et al., Real Parties in Interest*, (Cal. Ct. App., 2004) 118 Cal App 4th 1174, 2204 Cal App. Lexis 785.

assets that were improperly allocated to PacTel. It strongly recommended that an independent actuarial consultant be hired to complete the calculation and any pension surplus improperly transferred to PacTel be returned to Telesis' Master Trust.

DRA also recommended the actuarial consultant (1) review the entire pension asset transfer chronology, and (2) perform/supervise a recalculation of the 1993 and 1994 pension asset transfers from the Telesis pension Trust to the AirTouch Trust. DRA also stated that the identified violations of the Separation Agreement should be corrected and any refunds be made with interest.

DRA further urged the Commission to have the Communications Division seek bids for, hire, and manage a new auditing consultant to administer the work needed to resolve the remaining issues in this docket. It has advised that once a new study is completed, DRA would further participate by filing comments on how any surplus should be treated and dispersed.

Discussion

We find several of AT&T California's arguments to be persuasive. The New Regulatory Framework had been in existence for a couple of years by the time the spin-off had occurred. Consequently, whether or not AT&T California's New Regulatory Framework start-up rates contained any pension costs should not be an open question at this point. Further, if the risk of cost recovery and changes in pension costs were borne by shareholders, and not by customers, the auditors' concern and recommendation has grown moot. Today, the public policy considerations have deepened. After more than 15 years, evidence very likely may have become lost or destroyed; memories have continued to fade, and witnesses able to address the 1994 audit report are apt to be unavailable.

We find DRA's assertions that the Commission: (1) retained jurisdiction over PacTel's successors to enforce the conditions of the spin-off; and thus, (2) should require the production of further information necessary to resolve the pension question to be thinly supported by legal authority and impractical. Moreover, DRA's comments focused on and reiterated its 1994 recommendations and comments.

It appears unlikely that a strong case could be made for the funding required for a new consultant to study any further issues in this proceeding. DRA has indicated that even if a new study were undertaken, its active participation would principally be through filing comments. Further, DRA's comments neither addressed nor rebutted the contention that AT&T California's shareholders bore the risk of cost recovery and changes in pension costs. The comments also were silent on the practical and public policy difficulties of pursuing an investigation of this nature so many years after the fact.

It appears well past the time to close this aged proceeding. We find the auditors' concern and recommendation to have grown moot. Moreover, we have not been presented with a strong argument why we should subject this matter to further uncertainty and challenge more than 15 years after the audit report was submitted. Accordingly, Investigation (I.) 93-02-028 is closed.

Comments on Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. No comments were filed.

Assignment of Proceeding

Michael R. Peevey is the assigned Commissioner and Jacqueline A. Reed is the assigned ALJ in this proceeding.

Findings of Fact

1. In D.93-11-011, the Commission ordered a compliance report of the Telesis separation transaction by an independent auditor.
2. Telesis selected the independent auditing firm of Frederick & Warinner with the Commission's approval.
3. The Communications Division administered the contract.
4. Frederick & Warinner submitted its report on November 7, 1994.
5. No further action took place following submission of the report.
6. On June 3, 2004, the assigned ALJ issued a ruling soliciting comments on concluding the instant proceeding.
7. AT&T California and DRA filed comments on June 17, 2004; no other party filed comments.
8. The PacTel Corporation companies that were the subject of the spin-off have since merged with other entities or ceased to exist.
9. The extent of the Commission's regulation of wireless companies has changed since 1994.
10. After more than 15 years, evidence very likely may have become lost or destroyed; memories have continued to fade, and witnesses able to address the 1994 audit report are apt to be unavailable.

Conclusions of Law

1. Reopening any portion of the spin-off transaction at this juncture not only would present practical difficulties, but also would conflict with the regulatory

certainty the Commission sought to achieve when it ordered the audit to be undertaken immediately and be completed as soon as reasonably possible.

2. Whether or not AT&T California's New Regulatory Framework start-up rates contained any pension costs should not be an open question.

3. If the risk of cost recovery and changes in pension costs were borne by shareholders, and not by customers, the auditors' concern and 1994 recommendation has grown moot.

4. There are pragmatic and public policy difficulties in pursuing an investigation of this nature so many years after the fact.

5. I.93-02-028 should be closed.

O R D E R

IT IS ORDERED that Investigation 93-02-028 is closed.

This order is effective today.

Dated January 21, 2010, at San Francisco, California.

MICHAEL R. PEEVEY
President

DIAN M. GRUENEICH

JOHN A. BOHN

TIMOTHY ALAN SIMON
Commissioners