

STATE OF CALIFORNIA

Public Utilities Commission
San Francisco

M e m o r a n d u m

Date: April 20, 2004

To: The Commission
(Meeting of April 22, 2004)

From: Alan LoFaso, Director
Office of Governmental Affairs (OGA) — Sacramento

Subject: AB 2505 (Maldonado) Public utilities: stocks and security transactions.
As introduced February 19, 2004

Legislative Subcommittee Recommendation: None.

Summary: This bill would exempt NRF-regulated telephone corporations from prior approval of specified financial transactions.

Digest: Existing law, P.U. Code Article 5 of Part 1 of Division 1 (secs. 816-830), regulates the issuance of securities by public utilities and, among other things, generally requires advance Commission approval of any issuance of stock or long term debt (12 month-term or longer) by a public utility.

Existing law, P.U. Code sec. 829, authorizes the Commission to exempt any public utility or class of public utility from the requirements of Article 5, if the Commission finds that the requirement is not necessary in the public interest.

Existing law, P.U. Code sec. 1708.5, authorizes interested persons to petition the Commission to adopt, amend, or repeal a regulation.

Existing law, P.U. Code sec. 1901(b), requires the Commission to charge specified fees for securities issuances, with specified exceptions.

This bill would exempt New Regulatory Framework (NRF)-regulated telephone corporations from advance Commission approval requirements for utility financing, if the utility does not pledge a plant or assets to secure the financing, except for any telephone corporation that is also an electrical or gas corporation.

This bill would provide that NRF-regulated telephone corporations are still subject to specified, existing Article 5 requirements that:

- Limit the purposes to which a utility can use the proceeds of stock or long-term debt issuance (P.U. Code sec. 817);
- Prohibit a utility from issuing any indebtedness against or as a lien on a contract for consolidation or merger (P.U. Code sec. 820);
- Require the utility to account for the disposition of proceeds as directed by the Commission (P.U. Code sec. 824);
- Impose specified fines (P.U. Code sec. 826):
- Impose specified criminal liability for officers, employees, or agents of the utility that knowingly aid in a violation (P.U. Code sec. 827(a));
- Bar state obligation to pay or guarantee any applicable security or indebtedness (P.U. Code sec. 828); and
- Prohibit public utilities from guaranteeing the long-term debt of any person or entity without Commission approval (P.U. Code sec. 830);

This bill would authorize the Commission to reimpose any Article 5 requirement from which NRF-regulated telephone corporations are exempted, if the Commission finds that the requirement is required by the public interest, after an evidentiary hearing in a proceeding considering the financial condition of the utility.

This bill would state legislative intent that it does not hinder the Commission's existing authority to disallow imprudent expenses or capital expenditures or to impute a capital structure or cost of capital for utilities under Commission jurisdiction.

Analysis: AB 2505 is a reintroduction of this Verizon-sponsored measure, twice vetoed by former Governor Gray Davis. (See "Legislative History" below.) The Commission supported the measure in 2000, seeking amendments that were incorporated into the bill. In 2002, the Commission opposed the bill.

Contemporaneous with the Commission's opposition to the measure in 2002, the Commission considered an Application by Verizon for exemption from the requirements of Article 5. In D.02-04-058, the Commission partially granted Verizon's application in two respects, by permitting Verizon:

- Exemption from the Competitive Bidding Rule for debt issues with principal amounts greater than \$200 million or for variable rate debt securities and negotiated financing transactions; and
- Quarterly, rather than monthly, reporting of information required by G.O. 24-B.

The Commission rejected the remainder of Verizon's Article 5 exemption request, indicating that applications filed pursuant to Article 5 are one tool to achieve monitoring of financial and rate stability under NRF, and that the Commission would consider revisions to the monitoring reports in NRF Phase III. D.02-04-058 further found that the time period to resolve prior Commission approvals of Verizon's applications under

Article 5 ranged from seven weeks to three months.¹ Moreover, the Commission further concluded that “[p]olicies that permit utilities the means to secure broad financing authority in the shortest possible processing times and streamlining our approval process should keep administrative costs low and permit Verizon to take advantage of favorable financing opportunities.”²

Finally, the Commission found that, as a carrier-specific application, Verizon’s request did not meet the Section 829 showing that Article 5 requirements are not necessary in the public interest that have been found in other utility-specific cases. The decision identified two of these considerations: (1) whether the California portion of the utility’s revenues are small in relationship to total utility revenues and (2) the existence of regulation by another state’s commission.³ D.02-04-058 suggested that Verizon consider seeking a broader review for all NRF-regulated incumbent local exchange carriers (ILECs)⁴ via a Section 1708.5 petition.

AB 2505 would provide that broader exemption via statute. A key consideration is whether the Commission is better positioned to determine which, if any, exemptions from Article 5 are appropriate for these telephone carriers or whether this measure is ripe for the expeditious treatment that the legislature can provide on this issue.

ALJ Division states that AB 2505 is unnecessary because the Commission currently possesses the authority to grant the requested relief for NRF-regulated ILECs. Moreover, existing problems at least one NRF-regulated company⁵ and accounting scandals in the telecommunications industry generally⁶ suggest that this is an inappropriate time to exempt the vast majority of the state’s incumbent carriers from monitoring of their securities transactions.

Although the bill allows the Commission to reimpose Article 5 requirements, its provisions only provide for that reimposition after an evidentiary hearing in a proceeding in considering the utility’s financial condition. These procedural requirements are time-consuming and likely would not occur unless a problem had already arisen, such as a utility’s request that the NRF benchmark return be reinstated in light of that utility’s financial difficulties.

LEGISLATIVE HISTORY

Asm. U&C Committee: 12-0 (do pass) (3/22/04)

1 The decision also noted that the two previous approvals took only seven and nine weeks, respectively. D. 02-04-058, at p. 4.

2 *Id.* at p. 8.

3 *Id.* at p. 6.

4 There are currently four NRF-regulated ILECs: SBC; Verizon California, Inc.; Surewest (formerly Roseville); and Citizens Telecommunications Company.

5 See “SureWest auditors cite weak controls”, *TR State News Wire*, March 17, 2004.

6 “3 Banks Had Early Concern About WorldCom Finances”, *New York Times*, March 17, 2004.

Prior measures:

AB 1082 (T. Calderon), 1999-2000 regular session. The Commission voted to support, if amended, AB 1082 on May 18, 2000. Final disposition: Vetoed.

AB 2669 (Maldonado), 2001-2002 regular session. The Commission voted to oppose AB 2669 on May 2, 2002. Final disposition: Vetoed.

SUPPORT/OPPOSITION

Support: Verizon (Sponsor).

Opposition: Office of Ratepayer Advocates.

LEGISLATIVE STAFF CONTACT

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Date: April 20, 2004

BILL LANGUAGE:

BILL NUMBER: AB 2505 INTRODUCED
 BILL TEXT

INTRODUCED BY Assembly Member Maldonado

FEBRUARY 19, 2004

An act to amend Section 829 of the Public Utilities Code, relating to public utilities.

LEGISLATIVE COUNSEL'S DIGEST

AB 2505, as introduced, Maldonado. Public utilities: stocks and security transactions.

Under existing law, the Public Utilities Commission has regulatory authority over public utilities, including telephone corporations, and authorizes the commission to fix just and reasonable rates. Under that authority, the commission has adopted decisions adopting an incentive-based regulatory framework for telephone corporations, called the new regulatory framework.

The Public Utilities Act generally exempts from provisions of that act governing stocks and security transactions any person or corporation that transacts no business subject to regulation under the act, except performing services or delivering commodities for or to public utilities or municipal or other public corporations primarily for resale or use in serving the public. Notwithstanding that general exemption, those provisions of the act governing stocks and security transactions apply to any public utility if the commission finds that the application of those provisions is required by the public interest. The act authorizes the commission to exempt any public utility or class of public utility from those stock and security transaction provisions if it finds that their application is not necessary in the public interest.

This bill, except as specified, would exempt from those stock and security transaction provisions, a telephone corporation that is regulated under a new regulatory framework that utilizes a price-cap index, price adjustment formula, or substantially similar mechanism established by the commission, unless the corporation secures the financing by pledging a plant or assets. The bill would authorize the commission to reimpose the stock and security transaction provisions if the commission finds, after an evidentiary hearing, that imposition is required in the public interest.

Vote: majority. Appropriation: no. Fiscal committee: yes.
State-mandated local program: no.

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. It is the intent of the Legislature that the amendments to Section 829 of the Public Utilities Code made by the act adding this section not hinder the commission's existing authority to disallow imprudent expenses or capital expenditures of the utilities under its jurisdiction, or the commission's authority to impute a capital structure or cost of capital for utilities under its

jurisdiction.

SEC. 2. Section 829 of the Public Utilities Code is amended to read:

829. (a) This article ~~shall~~ does not apply to ~~any~~ a person or corporation ~~which~~ that transacts no business subject to regulation under this part, except performing services or delivering commodities for or to public utilities or municipal or other public corporations primarily for resale or use in serving the public or any portion thereof but shall nevertheless apply to any public utility if the commission finds, in a proceeding to which the public utility is or may become a party, that the application of this article is required by the public interest.

~~The~~

(b) (1) *The requirements in this article for commission approval of utility financing do not apply to a telephone corporation that is regulated under a new regulatory framework that utilizes a price-cap index, price adjustment formula, or substantially similar mechanism established by the commission, if the corporation does not pledge a plant or assets to secure the financing. However, this article shall continue to apply to any telephone corporation that is also an electrical corporation or gas corporation that is a public utility, as defined in Section 216, 218, or 222.*

(2) *Notwithstanding paragraph (1), a telephone corporation as described in this subdivision shall remain subject to Sections 817, 820, 824, 826, 828, 830, and subdivision (a) of Section 827.*

(3) *The commission may reimpose any or all of the requirements of this article for commission approval of utility financing upon a utility exempt under paragraph (1) if the commission finds, after an evidentiary hearing in a proceeding considering the financial condition of the utility, that the application of any or all of the requirements of this article is required by the public interest.*

(c) *The commission may from time to time by order or rule, and subject to ~~such~~ those terms and conditions ~~as~~ that may be prescribed ~~therein~~ in the order or rule, exempt any public utility or class of public utility from ~~the provisions of~~ this article, if it finds that the application ~~thereof to~~ ~~such~~ of this article to the public utility or class of public utility is not necessary in the public interest.*