Decision **DRAFT DECISION OF ALJ DUDA** (Mailed 3/19/2002)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Verizon California Inc. for Approval Pursuant to Section 851 to Transfer Property Located at One Verizon Way, Thousand Oaks, to Baxter Healthcare Corporation.	Application 01-09-026 (Filed September 20, 2001)

OPINION APPROVING SALE OF ONE VERIZON WAY TO BAXTER HEALTHCARE CORPORATION

I. Summary

This decision grants the request of Verizon California Inc. (Verizon) for authority under Pub. Util. Code § 851 to sell to Baxter Healthcare Corporation (Baxter) its buildings and real estate located at One Verizon Way in Thousand Oaks, California (the Property). Baxter plans to use the Property as the headquarters for Baxter Biosciences, a division of Baxter. The protest by the Commission's Office of Ratepayer Advocates (ORA) requesting deferral of the ratemaking issues for any sale proceeds to another Commission proceeding is denied. Verizon will apportion the net sale proceeds between ratepayers and shareholders based on current New Regulatory Framework (NRF) policies and the ratemaking adopted in Decision (D.) 93-09-038.

II. Background

Verizon is a telecommunications carrier regulated by this Commission and engaged principally in the business of providing local exchange service in

California. Baxter is a subdivision of Baxter International, headquartered in Deerfield Illinois. Baxter Biosciences develops technology and products designed to treat hemophilia, immune deficiencies, and other blood-related disorders.

On September 14, 2001, Verizon and Baxter entered into an Agreement for Purchase and Sale (Sale Agreement) of Verizon's buildings and real estate located at One Verizon Way. The Agreement is targeted to close on July 1, 2002.

The Property that Verizon is selling includes two buildings on 40.49 acres of land located in the City of Thousand Oaks in Ventura County. The Property currently serves as Verizon's regional headquarters for general and administrative purposes. The primary building is a 426,000 square-foot, three-story structure that includes approximately 380,000 square feet of rentable space. The building was built in 1977-78 and is rated as Class A office space suitable for a corporate headquarters facility. The other building on the Property is a one-story, 2,100 square foot building, which houses Verizon's vehicle fleet maintenance services.[1] In addition, the Property includes approximately 1,250 outdoor surface parking spaces and landscaping.

In D.01-11-063, the Commission granted approval of a lease agreement (Lease) involving the use of the Property by Baxter pending Commission approval of the sale. The Lease allowed Baxter to occupy approximately 31,000 square feet of office space on the Property beginning on January 1, 2002. The Lease is set to expire on July 1, 2002, at which point it would be superseded by the Sale Agreement, assuming that closing has occurred. If the sale has not closed,

[1] This vehicle maintenance building will be included in the sale, but will be leased back to Verizon for a five-year period.

Baxter has the option to extend the Lease and to rent approximately 230,000 square feet of additional space.

III. Reasons for the Proposed Sale

Verizon states that the sale of the Property at One Verizon Way is designed to improve efficiency by consolidating Verizon's operations to available office space in other buildings owned or leased by Verizon. According to Verizon, the Property is expensive to operate and is not fully utilized. The sale will enable Verizon to minimize office space expenses by relocating employees at One Verizon Way to other less costly buildings in the Thousand Oaks area that currently have available capacity. Verizon plans to redeploy its work force by selling the Property to Baxter and consolidating employees located at the Property to available office space at Verizon's Lakeview Canyon Road facility, which is across the street from One Verizon Way, and to leased facilities on Ventu Park Road, Newbury Park, five miles from One Verizon Way. After the sale, Verizon's facility at Lakeview Canyon Road will serve as the regional headquarters building for Verizon.

Verizon's application states that the sale to Baxter allows it to sell the Property at a favorable price in a strong real estate market and that the purchase price is consistent with the current fair market value of the property. Based upon the Property's estimated fair market value on August 10, 2001, the purchase price is consistent with the current fair market value.[2] Verizon also notes that it has

[2] Verizon requested confidential treatment of the fair market value and purchase price of the Property. The request was granted in D.01-11-063.

negotiated the sale without the services and fees of a real estate broker, thus incurring lower transaction costs from the sale.

Verizon contends that the sale will benefit California by allowing Baxter to expand its presence in California, thus creating jobs and improving the local economy. Further, the sale does not adversely affect the local economy because Verizon will relocate its employees to other local offices and maintain its headquarters presence in Thousand Oaks and Ventura County.

Verizon maintains there will be no disruption in service to its customers because it will implement a staged relocation to allow all departments currently housed at One Verizon Way to continue providing their services on a seamless basis. Prior to closing, Baxter will occupy a portion of the main building under the Lease agreement. Baxter has the option to extend the Lease beyond July 1, 2002, if the Commission has not yet approved the sale. If the parties close the sale on July 1, 2002 as expected, Baxter will take ownership of the Property but Verizon will lease back a portion of the building, as well as the separate vehicle maintenance facility, for a term of four years and eleven months. Verizon may vary the amount of space it leases, but will initially lease at least 75,000 square feet and may be entitled to at least 100,000 square feet.

IV. Proposed Accounting Treatment for Sale Proceeds

Pursuant to Federal Communications Commission (FCC) and Commission regulations, Verizon records the value of its One Verizon Way property in two separate accounts – one for buildings and another for land. The book value of the buildings located at One Verizon Way was $50,519,416 in 1985, when the Property was put into service. This book value was based upon the buildings' original costs and depreciated on a straight-line basis at 4 percent per year, with adjustments for capital improvements. The net book value of the buildings is projected to be $26,161,325 on July 1, 2002, the expected closing date for the sale. The book value of the land located at One Verizon Way is $8,438,673. The land is not subject to depreciation and therefore, its book value equals its original cost.

According to Verizon, it will follow the Commission's rules for treatment of the proceeds from sale of the Property under Verizon's approved settlement under NRF,[3] and in accordance with the FCC's accounting regulations.[4]

First, Verizon will apportion the net proceeds of the sale[5] between the land and the buildings located on the land. Specifically, Verizon will calculate the percentages of the total net book value in the land account and the building account at the time of closing, and will multiply the respective percentages by the net sales proceeds to determine the allocation of the proceeds between the land and the building accounts. Verizon estimates that based on its projections of net book value at the time of closing, the allocation will be 24.4% of the net sales price to land and 75.6% to buildings.

Second, Verizon will record the net proceeds to the appropriate accounts. For the proceeds allocated to the building account, any proceeds above the net book value will be recorded to accumulated depreciation, as required by salvage accounting principles in Part 32, and not to an income account.[6] For the proceeds

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[3] *See* D.93-09-038, 50 CPUC 2d at 684.

[4] *See* FCC's Part 32 Uniform System of Accounts as adopted in relevant part by the Commission in D.87-12-063.

[5] Pursuant to D.93-09-038, the net proceeds of the sale are equal to the gross sale price less costs associated with completion of the sale. 50 CPUC 2d at 708, fn. 8.

[6] *See* 47 C.F.R. Section 32.2000(d)(2)(i).

allocated to land, any proceeds above the net book value of land, i.e. any "gain on sale of land," will be recorded as other operating in income.

Finally, Verizon will calculate the portion of the gain on sale of land allocated to ratepayers based on the mechanism adopted in D.93-09-038. Under this mechanism, the ratepayers are allocated a pro rata portion of such gains based on the number of months the asset was in service prior to January 1, 1990, divided by the total number of months the asset was in service. The gain is then aggregated and compared to a credit of $4 million, which was assumed in developing Verizon's start up annual revenue requirement. Any amount greater than the $4 million credit is returned to ratepayers through an end-user billing adjustment in Verizon's annual price cap filing.[7]

V. Protest by the Office of Ratepayer Advocates

On November 7, 2001, ORA submitted a late-filed protest to the application.[8] ORA does not oppose the lease or sale of the Property, but objects to Verizon's proposed ratemaking treatment of any gain from the sale.

First, ORA protests that the benefits of the gains associated with the *buildings* on the Property cannot flow to ratepayers because there is no mechanism for sharing earnings under the Commission's current NRF policies.

Second, ORA states that although Verizon's proposed allocation of *land* gains from the sale appears consistent with the settlement adopted by the

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[7] *See* 50 CPUC 2d at 691.

[8] ORA received permission from the assigned Administrative Law Judge (ALJ) to file its protest late.

Commission in D.93-09-038, the arrangement should not continue to apply. ORA notes that the Commission's current rulemaking to examine NRF policies, Rulemaking (R.) 01-09-001 ("NRF Review"), has scheduled a review of gain policies in Phase 3. ORA recommends that the Commission allow the sale to proceed, but separately address the gain on sale ratemaking issues in Phase 3 of the NRF review. Alternatively, ORA suggests the Commission handle any ratemaking issues from sale of the Property in Application (A.) 99-10-010, which involves the allocation of shared assets between Verizon and its affiliates.

Verizon responds that ORA has not justified delaying Verizon's proposed treatment for any gain on sale to another proceeding because the rules which currently govern the accounting of gains are clear. Verizon states that its proposed ratemaking for sale proceeds fully complies with, and is mandated by, existing rules set forth in D.93-09-038. According to Verizon, ORA concedes that the proposed ratemaking complies with the all party settlement approved by that decision. ORA also admits that current NRF policies involve no sharing of earnings, so any gain from the sale of the buildings cannot flow to ratepayers. Verizon maintains that the Commission cannot reverse D.93-09-038 and other NRF decisions, as ORA suggests, to retroactively apply a different ratemaking policy.

Specifically, Verizon states that Phase 3 of the NRF Review proceeding will not commence until late 2002 and will not be completed until the beginning of 2003. Verizon argues that the Commission cannot apply any new gain on sale rules it may develop in its future NRF review to this transaction because this would violate Verizon's due process rights and would constitute retroactive ratemaking. Baxter and Verizon executed the purchase and sale in mid-September 2001, and submitted the application for its approval on September 20, 2001. Both Verizon and Baxter reasonably expected the Commission to evaluate the transaction according to the regulatory principles in effect at that time, not new rules that ORA hopes the Commission might establish in 2003. Verizon alleges that changing the applicable rules for treatment of gains after the parties negotiated the transaction undermines the business rationale for the sale and threatens the viability of the deal. Furthermore, Verizon contends that prohibitions on retroactive ratemaking require any changes to be applied prospectively.

Verizon objects to ORA's additional proposal to defer ratemaking issues to A.99-10-010 because that case involves leases and the appropriate allocation of costs between Verizon and its affiliates. According to Verizon, the issues in that case are entirely irrelevant to any discussion of the appropriate allocation of gains from the sale of property between ratepayers and shareholders.

VI. Discussion

A. The Sale of the Property Should be Approved

Pub. Util. Code § 851 requires advance, discretionary approval before sale or lease of utility property "necessary or useful in the performance of its duties to the public." Advance approval is the mechanism by which the Pub. Util. Code ensures that financial and other transactions do not proceed until the Commission has had a chance to review and, if necessary, place conditions on those transactions. (*See, e.g.,* Pub. Util. Code, §§ 851, 852, 854.) The relevant inquiry for the Commission in § 851 proceedings is whether the proposed transaction is "adverse to the public interest."[9]

Verizon does not need the Property at issue for public utility purposes and the proposed sale of One Verizon Way will not disrupt service to Verizon customers. The sale allows Verizon to consolidate its operations to other office space that it currently owns or leases and reduce its office space expenses.

In addition, the sale price is above fair market value and the net book value of the Property. The sale allows Verizon to achieve a gain on disposing of an asset that is not fully utilized at present. Under current accounting mechanisms, a portion of this gain is allocated to ratepayers.

We find that the sale is not adverse to the public interest and we will approve it. The sale does not disrupt service to Verizon's customers, and it allows Verizon to dispose of an underutilized asset at a financial gain. The sale is supported by the City of Thousand Oaks[10] and has the potential to benefit the Thousand Oaks community by attracting new jobs to the area through relocation of Baxter to the Property. ORA does not oppose the sale of the Property.

B. ORA's Protest on Ratemaking Should be Denied

We agree with Verizon that the ratemaking proposed in the application follows current NRF policies and mechanisms. Under current NRF policies, sharing is suspended so any sale proceeds above the book value of the

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[9] *See, e.g., Universal Marine Corporation*, D.84-04-102, 14 CPUC2d 644 ("[W]e have long held that the relevant inquiry in an application for transfer is whether the transfer will be adverse to the public interest"); *see also* D.89-07-016, 32 CPUC2d 233.

[10] See letter from Thousand Oaks City Manager, contained in Exhibit D of the application.

buildings, which is credited to accumulated depreciation, cannot flow to ratepayers. While it is true that the Commission's current NRF review rulemaking intends to reexamine gain issues in Phase 3, this review will not begin until late in 2002. Further, Verizon's proposed ratemaking for sale proceeds complies with the rules for gain on sale set forth in D.93-09-038. Any gain resulting from sale of the land will be allocated to ratepayers according to the mechanism adopted in that order and returned to ratepayers through Verizon's annual price cap filing.

We also agree that to defer the ratemaking to Phase 3 of NRF or to A.99-10-010 brings too great a level of uncertainty to this transaction. It would not be appropriate to defer the ratemaking for this transaction based on a potential policy change in 2003. Further, we find no connection between the issues in A.99-10-010, involving allocation of costs between Verizon and its affiliates, and the issue here of allocation of gains between ratepayers and shareholders.

Given the current economic climate, we think that Verizon should be commended for structuring a transaction that reduces its operating expenses without disrupting service to its customers, achieves a gain on sale of an asset, and provides a new use for the Property that appears to benefit the Thousand Oaks region. We do not wish to jeopardize the transaction by injecting regulatory uncertainty and deferring the gain on sale issue to future proceedings. Therefore, we will deny ORA's protest and approve the ratemaking treatment that Verizon describes with the understanding that it complies with current rules. Any future changes to NRF revenue sharing or gain on sale policies should not affect the ratemaking for the sale of this Property.

ORA suggests that if the Commission does not consolidate ratemaking issues in this proceeding with either the NRF Rulemaking or

A.99-10-010, it still needs to hold a hearing in this proceeding to review and verify the book costs, transaction costs and allocation of those costs. Verizon responds that the current issue in this case is what rules to apply to ratemaking for gains, and not the precise calculation of book value, transaction costs, and gains. We agree with Verizon that these amounts cannot even be known until the transaction closes and the amounts are reported by Verizon in accordance with Commission requirements. To ensure ORA has the opportunity to examine these figures, we will require Verizon to include specific information regarding the final transaction in its next April 1 earnings filing as required by D.93-09-038. Specifically, Verizon's earnings filing should include the calculations supporting the book values, transaction costs, and gains associated with both land and buildings from sale of the Property. ORA may examine the calculations at that time.

VII. Environmental Matters

The California Environmental Quality Act ("CEQA", Public Resources Code Section 21000 et seq.) requires that an agency consider the environmental consequences of its actions before it makes a discretionary decision.[11]

Verizon states that the sale of the Property involves a change in ownership of an already developed property that will continue to be used by the buyer for administrative and general purposes. Because the transaction contemplates no change in the current use of the Property, Verizon states that review under CEQA is not implicated. According to Verizon, the sole environmental effect arising

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[11] See Public Resources Code § 21065 and 14 California Code of Regulations (CCR), CEQA Guidelines, § 15378.

from the sale involves the removal of a small underground fuel tank and associated equipment located at the vehicle maintenance building on the Property. The County of Ventura's Environmental Health Division will oversee this tank removal. Verizon states that the tank removal is categorically exempt from CEQA pursuant to § 15330 of the CEQA Guidelines.[12] Based on these circumstances, Verizon maintains that the sale will have no significant adverse effect on the environment, and falls within an exemption to CEQA.[13]

We do not agree that CEQA is not implicated by the transaction. Although the property will continue to be used consistent with the existing use of the facility, the contemplated fuel tank removal suggests the possibility that the activity may have a significant effect on the environment. Nevertheless, in this case the fuel tank removal is designed to prevent any release of hazardous materials, is expected to cost less than $1 million, and will be overseen by Ventura County officials. Thus, we find the fuel tank removal falls under the CEQA exemption described in § 15330 as long as it is consistent with applicable state and local environmental permitting requirements.[14]

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[12] See 14 CCR § 15330, which exempts minor actions costing up to $1 million that are taken to eliminate the threat of release of a hazardous waste or substance and are consistent with applicable state and local environmental permitting requirements.

[13] See Rule 17.1(d)(1) and 14 CCR § 15061(b)(3).

[14] CEQA Guideline Section 15330 comprises the Class 30 categorical exemptions from CEQA and provides an exemption for minor actions to prevent, minimize, stabilize, mitigate or eliminate the release of hazardous waste or hazardous substances which are small or medium removal actions costing $1 million or less.

VIII. Categorization

In Resolution ALJ 176-3072, dated October 2, 2001, the Commission preliminarily categorized this proceeding as ratesetting, and preliminarily determined that hearings were not necessary. A public hearing is not necessary, and it is not necessary to alter the preliminary determinations made in Resolution ALJ 176-3072.

IX. Comments

The Commission mailed the draft decision of the ALJ in this matter to the parties in accordance with § 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure. Verizon and ORA filed comments and reply comments.

In its comments, ORA reiterates that it does not oppose the sale of the Property, but it asks the Commission to establish a memorandum account to hold any gains from the sale pending the outcome of further proceedings. In the alternative, ORA asks the Commission to allocate a portion of the gain from the Property to ratepayers because they have paid the costs of the building at One Verizon Way since 1985 and will continue to pay those costs in rates after the building is sold.

ORA alleges that the Commission would commit legal error in adopting Verizon's ratemaking proposals because Verizon's rates will be unjust and unreasonable if ratepayers receive no gain and the costs of the buildings on the Property remain in rates. ORA believes it is unlikely that any gain from sale of the land will accrue to ratepayers above the $4 million annual allotment in the NRF settlement. ORA notes that all gains from sale of the building will accrue to shareholders based on Verizon's proposed "salvage accounting" mechanism. ORA contends that salvage accounting is inappropriate for the buildings on the Property because the building is still "used and useful." Rather than adoption of

Verizon's proposal, ORA asks the Commission to allocate a portion of gains directly to ratepayers.

Verizon responds that its proposed accounting mechanisms for the gains from this transaction were previously approved by the Commission and are well-established. Verizon asserts that "salvage accounting" should apply to proceeds from the sale of the building because it is an accounting term that applies to proceeds received upon disposition of depreciable property, regardless of whether the buyer continues the existing use of the property or sells it for scrap. Further, Verizon contends that ORA misunderstands NRF regulation and how it severed the link between the recorded cost of an individual asset (such as the Property) and rates. According to Verizon, rates were set in 1989 when NRF was adopted and have not changed despite the many additions or subtractions to rate base since that time. Verizon continues to make capital investments that do not lead to rate adjustments and Verizon's shareholders are fully at risk for the efficient management of these assets. Likewise, rates do not decrease when a particular asset is sold. Verizon contends that ORA is seeking a midstream change to NRF rules and established accounting mechanisms and the Commission should ignore this plea. Finally, Verizon argues that attempts to review the gains from this transaction at a future date constitute retroactive ratemaking and would force Verizon to reevaluate the sale of the Property.

ORA does not convince us that it is legal error to adopt Verizon's ratemaking for the gains from sale of land or buildings on the Property. Verizon's proposal for any gains associated with the land complies with the NRF settlement between ORA (formerly the Division of Ratepayer Advocates) and Verizon (formerly GTE California) as adopted by the Commission in D.93-09-038. With regard to gains from the sale of the building, Verizon's proposal complies with FCC salvage accounting rules that this Commission adopted in D.87-12-063 and which we find apply to this transaction. It is not legal error to apply these salvage accounting rules. While the Commission has the authority to direct an allocation of gains directly to ratepayers, it is not required and it is not legal error to follow previously approved accounting rules and settlements regarding gains. ORA disputes the policy choice that is made in this decision to follow established rules and mechanisms. The proper venue for considering different policy choices with regard to the sharing of gains is in Phase 3 of the NRF review.

Furthermore, we agree with Verizon's description of how NRF severs the link between the costs of individual assets and rates. Therefore, we do not agree with ORA's assertion that rates would be unjust and unreasonable unless a gain from the sale of the building is returned to ratepayers. We will not modify the draft in response to ORA's comments.

Findings of Fact

1. On September 14, 2001, Verizon and Baxter entered into an agreement for Purchase and Sale of Verizon's buildings and real estate located at the Property, with a projected closing date of July 1, 2002.

2. The office space in the buildings on the Property is no longer required for utility purposes.

3. Verizon will lease back a portion of the office space and the vehicle maintenance building on the Property for five years after closing of the sale.

4. The sale does not disrupt service to Verizon's customers because Verizon will implement a staged relocation of employees to nearby offices and lease-back a portion of the property.

5. ORA does not oppose the sale of the Property, but requests that the Commission defer ratemaking issues from any gains to either A.99-10-010 or the Commission's NRF Review, R.01-09-001.

6. Verizon will calculate the percentages of the total net book value in the land account and the building account at the time of closing and multiply the respective percentages by the net sales proceeds to determine the allocation of the proceeds between the land and the building accounts.

7. Verizon will record any proceeds above the net book value of the buildings to an accumulated depreciation account as required by FCC accounting rules.

8. Verizon will calculate any gain on sale of land allocated to ratepayers based on the mechanism adopted in D.93-09-038 and allocate any resulting gain to ratepayers through its annual price cap filing.

9. The sale price of the Property is above fair market value and net book value.

10. The sale of the Property involves a change in ownership of an already developed property that will continue to be used by the buyer for administrative and general purposes.

11. The fuel tank removal on the Property is for the prevention of the release of hazardous materials, will cost less than $1 million, and will be overseen by Ventura County.

Conclusions of Law

1. A public hearing is not necessary.

2. The proposed sale as set forth in the application is not adverse to the public interest and should be approved.

3. The proposed ratemaking for this sale complies with the rules for gains set forth in D.93-09-038 and current NRF policies, and should be approved.

4. ORA's protest should be denied.

5. Under CEQA, the Commission must consider the environmental consequences of actions subject to its discretionary approval.

6. The sale of the Property contemplates removal of a fuel tank consistent with the CEQA categorical exemption under Guideline Section 15330.

7. This order should be effective today so that the Verizon and Baxter may proceed to close the sale transaction.

ORDER

IT IS ORDERED that:

1. Verizon California Inc. (Verizon) may sell to Baxter Healthcare Corporation, its buildings and real estate located at One Verizon Way in Thousand Oaks, California (the Property) as set forth in Application (A.) 01-09-026, in accordance with the agreement for purchase and sale attached to the application.

2. Within 60 days of the actual transfer, Verizon shall notify the Directors of both the Telecommunications Division and the Office of Ratepayer Advocates in writing of the date on which the transfer was consummated. A true copy of the instrument effecting the sale and transfer shall be attached to the written notification.

3. Upon completion of the sale and transfer authorized by this Commission order, Verizon shall stand relieved of public utility responsibilities for the Property.

4. Verizon shall allocate the net proceeds from the sale of the Property between its land and building accounts as described in its application and shall comply with Decision (D.) 93-09-038 and current New Regulatory Framework policies for any gains resulting from the sale.

5. In its next earnings filing in accordance with D.93-09-038 following closing of the sale of the Property, Verizon shall submit all calculations and supporting workpapers related to the book values, transaction costs, and gains on sale associated with both land and buildings from sale of the Property.

6. The authority granted herein shall expire if not exercised within one year from the date of this order.

7. A.01-09-026 is closed.

This order is effective today.

Dated ___________, at San Francisco, California.