STATE OF CALIFORNIA

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October 30, 2000

Honorable Rick Auerbach
Los Angeles County Assessor
500 West Temple Street
Los Angeles, CA 90012-2770

Attn: Mr. Dale Edgington, Principal Appraiser

Re: <u>Jurisdiction of Property Owned or Used by Regulated Telephone Companies.</u>

Dear Mr. Edgington:

This is in response to your September 12, 2000 request for clarification and explanation of proposed language on page 7 of the "*State Assessment Manual*" (formerly AH 541), discussing assessment jurisdiction issues. Specifically, you request that we address three questions as to how the Board determines its assessment jurisdiction when a locally assessed company (such as a cable TV company) – by means of merger, acquisition or lease - enters into state assessed telephone operations or uses state assessed telephone company property. These questions are restated in the format below:

1. <u>Is the "separate legal entity theory" – of treating each corporation whether a parent and a subsidiary, as a separate entity for purposes of determining state assessment jurisdiction – justifiable in light of Article XIII A?</u>

2. <u>Who exercises jurisdiction over the property if a parent corporation (state assessed) and its subsidiary corporation (locally assessed) use the same property</u>?

3. <u>If the same property is used by a state assessee and a local assessee, must that property be valued as a single appraisal unit</u>?

For the reasons hereinafter explained, the answer to the first question is "yes." The answer to the second question is "generally, the State Board, not the local assessor" (illustrated by the examples); and the answer to the third question is "no."

The proposed language on page 7 of the draft *State Assessment Manual* to which these questions pertain, is as follows:

> Also, some companies formerly operated for other purposes may begin telephone service and thereby become subject to Board jurisdiction. For

> example, if a cable television company decides to offer telephone service, and obtains authorization under state or federal law for this purpose, all of the company's property then would be subject to the Board's assessment jurisdiction-the company would meet the definition of a "regulated" telephone company.
>
> Occasionally, in such a scenario, the telephone and the cable television operations might be conducted by separate corporations or other legal entities. When companies subject to the Board's assessment jurisdiction form new subsidiary companies, wholly owned either directly or indirectly by the parent company, the "separate legal entity" concept controls whether the Board's assessment jurisdiction extends to the newly created entity. For example, if the newly created entity is the subsidiary of a telephone company, but never obtains either a certificate of public convenience and necessity from the CPUC, or becomes subject to regulation by the FCC as a communications common carrier, then it will not come under the Board's assessment jurisdiction. However, if it operates under the parent company's certificate or common carrier status (or if it acquires either one on its own) it is considered a "regulated" telephone company and will become subject to the Board's jurisdiction.

Added to the foregoing language – as a result of the interested parties' meeting held on August 22, 2000, - is the following footnote relevant to the last sentence of the first paragraph, ending with the words, "… of a 'regulated' telephone company."

> An emerging issue in this regard is the classification of high-speed Internet access services. In a Notice of Inquiry involving cable modem service, the FCC noted, "Service providers are deploying a variety of networks that rely on different network architectures and transmission paths, including copper wire, cable, terrestrial wireless ratio spectrum, satellite radio spectrum, or a combination of these and other media, to provide high-speed services." (Gen. Docket No. 00-185, *Inquiry Concerning High-Speed Access to the Internet Over Cable and other Facilities*," par.7) As regulatory issues concerning these services are resolved by the FCC, there may be jurisdictional concerns for the Board to consider, to the extent that the FCC or the CPUC regulate Internet access services as telephone services. For continuing developments on this subject, see www.fcc.gov.

The purpose of these paragraphs and the footnote is to communicate the Board staff's current policy on how assessment jurisdiction is determined when a locally assessed company (in context, a cable TV company) enters into operations (regulated telephone services) subject to state assessment. Pages 1-6 provide the historical background and governing principles that control jurisdiction, and the answers to your question are based on these principles.

1. <u>Is the "separate legal entity theory" – treating each corporation (parent or subsidiary) as a separate entity for purposes of determining state assessment jurisdiction – justifiable in light of Article XIII A</u>?

Yes.

The Board applies three legal principles in determining its jurisdiction over a legal entity and its property in any given case. First, the Board is guided by the provisions of the California Constitution, specifically Article XIII, sections 11, 17, 18 and 19. The Board holds the right to determine the extent and/or limitations of its own jurisdiction in the first instance with regard to any case brought before it.

Second, under paragraph (2) of Section 19, the Board's assessment jurisdiction extends to all property *owned* or *used* by various types of public utility companies, including telephone companies, that are "*regulated*."[1] The Board has interpreted the term "*regulated*" to mean the following: "telephone companies" that are *regulated* by the California Public Utilities Commission (CPUC) as public utilities, or by a comparable federal commission or board—such as, the Common Carrier Bureau of the Federal Communications Commission (FCC).[2] As discussed on page 6 of the *Manual*, most telephone companies, long distance resellers, and alternative operator services are *regulated* by the CPUC in that they must obtain a Certificate of Public Convenience and Necessity in order to provide these services. Some telephone companies, including cellular companies and resellers using satellite transmission, are *regulated* as "common carriers" by the FCC.

Third, the Board's jurisdiction under Section 19 extends to all property *owned or used* by regulated telephone companies. As stated on page 6 of the draft *Manual*, if a regulated telephone company *owns or leases* property in the state, that property is subject to Board assessment, including, for example, telephone resellers that have their own switching systems in California.

The purpose of the discussion on page 7 of the draft *Manual* is to explain that from both a practical and legal standpoint, each "regulated … telephone company" - whether a parent or subsidiary - is treated as a *separate entity*. Each company is separately evaluated by the Board to determine for jurisdictional purposes whether it: 1) is "*regulated*" by the CPUC or the FCC, and 2) *owns or leases* property.[3] This evaluation of each company as a separate entity is necessary –

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[1] In this passage, the adjective "regulated" does not grammatically modify "car companies" or "companies transmitting gas or electricity"; thus the Board's jurisdiction extends to car companies and companies transmitting or selling gas or electricity whether or not such companies are regulated.

[2] Per FCC "*Glossary of Telecommunications Terms*," a common carrier is defined as follows: "In the telecommunications arena, the term used to describe a telephone company."

[3] If for example, an entity is newly created or acquired and is the subsidiary of a telephone company, but never obtains a CPCN, or never becomes subject to regulation by the FCC, then it is not *regulated* and its property is not subject to Board assessment. If, however, if it operates under the parent company's CPCN or FCC common carrier status (or if it acquires such on its own), then it is considered a "regulated" telephone company and is subject to the Board's jurisdiction.

even though one company may be wholly owned by another -- in order to determine whether the jurisdictional criteria in Section 19 have been met.

The "*separate entity theory*" gives effect to the laws of the state that endow corporations, partnerships, LLC's and similar entities with an identity separate from its owners. The shareholders of a corporation and the partners of a partnership have no "possessory" rights over the property owned by the entity. Whether or not one corporation is wholly owned by another (subsidiary - parent relationship), respect for the separate identity of each legal entity is basic to the administration and enforcement of state law, including the determination of assessment jurisdiction.[4]

The "separate entity" issue regarding state assessees was discussed in 29 Ops.Cal. Atty.Gen. 77, 1957, where State Senator Randolph Collier posed a similar question to the Attorney General:

> (2) Should the Board assess all of the property of a company selling natural gas when such company is the wholly owned subsidiary of a gas and electric utility and when all sales are made to the parent?

Mr. Edward P. Hollingshead, Deputy Attorney General, who answered the question in that opinion concluded that:

> (2) A wholly owned subsidiary need not be assessed by the Board unless the subsidiary is itself a public utility.

Mr. Hollingshead's analysis is grounded on the reasoning discussed above. He cites *Story v. Richardson* (1921) 186 Cal. 162, explaining that the long standing practice of the Board – in its administration of intercounty and state assessment - has been to look to each separate entity and assess only the property of "certified public utilities." He points out that given this longstanding policy of treating each entity separately, *Cudahy Packing Co. v. Johnson* (1939) 12 Cal.2d 583, fully supports the rule that contemporaneous construction of a constitutional provision by the state agency charged with the duty of administering that law - is entitled to great respect.[5]

Application of Hollingshead's analysis here means that: (a) the Board's past practice and policy should be continued without change; and, (b) the Board should assess only those telephone companies that are regulated.

For purposes of applying Article XIII A to determine whether a *change in ownership* has occurred, the "separate legal entity" theory has a totally different application -- which contrasts sharply with and is not applicable to the determination of state assessment jurisdiction. The "separate legal entity" theory applied to change in ownership questions was originally adopted by

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[4] Since the Constitution directs that the Board determine its jurisdiction in this context toward a company that is "*regulated*," the Board would be remiss if it merely "looked through" the subsidiary to the parent.

[5] His conclusion also takes into account the effect of Proposition 8 and its passage on November 5, 1974. The ballot argument submitted to the voters carefully pointed out that "none of these transferred provisions, however, are of substantive nature, . . . the essence of the present Article is retained."

the Legislature in the implementing statutes of Article XIII A in order to treat each legal entity as a single "person" for change in ownership purposes. Later, that theory was eroded by statutes like Section 62(a)(2) and Section 64, which require the application of the "ultimate control" theory. Under Section 62(a)(2) and Section 64, the "ultimate control" theory requires the assessor to determine the ownership of the entity by "looking through" the entity. Who owns the shares in the corporation or the partnership interests in a partnership and in what percentages are the questions to be answered. For example, where the assessor finds, in looking through the entities, that one shareholder or partner has acquired control (more than 50% of the interests) of another entity and the ownership interests in the entities do not remain proportional (or the entities are not owned by the same parent), a change in ownership has occurred. Thus, the issue under Proposition 13 is not the determination of assessment jurisdiction, but rather the enumeration of the ownership interests in legal entities for purposes of determining a transfer of beneficial ownership in order to reappraise the property.

2. **Who exercises jurisdiction if a parent corporation (state assessed) and its subsidiary (locally assessed) use the same property?**

The Board, if the property is *owned or used* by a *regulated* telephone company; however, if the property is *owned* by a locally assessed subsidiary that pays the taxes, the Board may delegate its jurisdiction to the local assessor.

As discussed above, if a corporation, whether parent or subsidiary, is *regulated*, the Board's jurisdiction extends to all property *owned or used* by that company. The last sentence of Section 19, Article XIII, however, grants the Board discretion to " . . . delegate to a local assessor the duty to assess a property *used but not owned* by a state assessee on which the taxes are to be paid by a local assessee."[6] (Emphasis added.) The Board's policy has been to exercise that discretion and delegate assessment jurisdiction of property to the local assessor in some, but not all, situations where the requirements of the sentence are met.[7]

To promote administrative efficiency, the Board staff has generally conditioned delegation authorized under Section 19 to circumstances where the property is not easily segregated from the locally assessed appraisal unit. For example, if the property *used/leased* by the state assessed telephone company is *less than* 100% of the improvement (building or structure) owned by a local assessee, then assessment jurisdiction of that portion will be delegated to the county assessor. On the other hand, if the property *used* by the state assessee is 100% of the improvement owned by a local assessee, the Board will not delegate assessment jurisdiction even though the local assessee owns the property and pays the taxes.

[6] To the extent that the Board delegates any assessment to the local assessor, the property is subject to Article XIII A of the Constitution. (See page 68, AH 541.)

Staff is considering recommending that the Board extend the policy, presently applied only to improvements, to fractional interests in leased *land* used by a state assessee.[8] However, the staff recommendation will not include situtations in which the property *used* by the state assessee is a right-of-way even though a locally assessed cable TV company owns it and pays the taxes on it, because the portion of the right-of-way used by the state assessee can be identified and segregated. Each separate entity is assessed for its fractional interests in the whole right-of-way.

The following examples illustrate the Board staff's application of the separate entity principle in circumstances pertaining to the discussion on page 7 of the *Manual*:

Example 1: Separate Entities.
If a regulated telephone company purchases a cable TV company, and each company continues to remain incorporated/organized as a separate entity (the cable TV entity does not dissolve), then the property owned or used by the telephone company will continue to be state assessed. The property owned by the cable TV company will continue to be locally assessed.

Example 2: Separate Entities – telephone company uses cable TV improvement.
A regulated telephone company purchases a cable TV company, and each company continues to remain incorporated/organized as a separate entity. The cable company does not conduct telephone company operations requiring an FCC license or a CPCN. The telephone company *uses* (leases) an improvement owned by the cable TV company.

The improvement would be subject to state assessment if 100% of it is used by the telephone company. If only *a portion* of the improvement is used by the telephone company (less than 100%) and the cable TV company pays the taxes, assessment jurisdiction would be delegated to the county assessor. If the Board delegates to the assessor, the property will remain on the local roll and is assessed in accordance with Article XIII A.

Example 3: Separate Entities – telephone company uses cable TV right-of-way.
A regulated telephone company purchases a cable TV company, and each company continues to remain incorporated/organized as a separate entity. The cable company does not conduct telephone company operations requiring an FCC license or a CPCN. The telephone company *uses* (leases) the right-of-way owned by the cable TV company.

The portion of the right-of-way, as well as any strands, fibers or wires in the right of way, used by the telephone company, are reported and separately assessed to the telephone company by the Board staff. (Some value adjustment may be made to the right-of-way land value so that its total does not exceed fair market value.) The Board does not delegate assessment jurisdiction for rights-of-way or the cables or fibers in the right-of-way used by a regulated telephone company.

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[8] Formerly, if the property *used* by the state assessee is land, assessment jurisdiction will not be delegated even though the local assessee owns it and pays the taxes on it, because even a small portion of land (such as a cell tower site) can be specifically identified and segregated from the whole.

Example 4: Separate Entities – cable TV provides telephone service.
A telephone company purchases a cable TV company, and each continues to remain incorporated/organized as a separate entity. The cable company begins to conduct telephone company operations requiring an FCC license or a CPCN. (e.g, the cable TV company uses its bandwidth and improvements to provide a combined package of Internet and long distance telephone services – which telephone services require an FCC license.)

Whether the cable company itself obtains common carrier status with the FCC or a CPCN from the CPUC to provide the telephone service – or whether it operates under the parent telephone company's CPCN or FCC common carrier status -- it is a "*regulated*" telephone company and is subject to the Board's jurisdiction. If, on the other hand, it can provide both Internet and telephone service without FCC or CPUC authorization, then it is not "*regulated*" and therefore, its property is not subject to Board assessment

Example 5: Separate Entities – form a new subsidiary company to provide internet and telephone services. – A telephone company purchases a cable TV company, and each company continues to remain incorporated/organized as a separate entity The cable company does not conduct telephone company operations requiring an FCC license or a CPCN. However, the two companies form a new subsidiary entity to provide telephone service – using the cable TV company's bandwidth and property.

As stated in example 4, if the new subsidiary entity is licensed by the FCC or obtains a CPCN to provide telephone service, then it is a "*regulated*" telephone company and subject to the Board's jurisdiction. This is true even if it operates under the parent telephone company's CPCN or FCC license. On the other hand, if the new subsidiary can provide telephone service without obtaining a license from the FCC or certification from the CPUC, it is not *regulated* -- and its property is not subject to Board assessment jurisdiction.

Example 6: Merger of locally assessed company with state assessed entity.
A *regulated* telephone company purchases a cable TV company, but a merger occurs in which the corporate entity operating the cable TV company dissolves. The cable TV company operation merges into the state assessed telephone company and the telephone company conducts the cable TV operations under its "corporate umbrella."

Since the telephone company is "*regulated,*" and has common carrier status with the FCC or a CPCN, all of its operations, including cable TV, are subject to the Board's jurisdiction. In exercising jurisdiction however, the cable TV operation would be treated as a non-unitary appraisal pursuant to Section 723.1.

The foregoing examples indicate that for a previously locally assessed company to become subject to state assessment jurisdiction as a telephone company, it must be *regulated* and, therefore, *classified* by the FCC or the CPUC as a company providing common carrier telephone services. As explained in the footnote on page 7 of the *Manual* (quoted on page 2 above), Internet services, i.e. broadband data telecommunications, are not presently classified by the FCC as telephone company "common carrier" services in the telecommunications arena. Nor are such services currently *regulated* by the CPUC - in that no CPCN is required in order to conduct Internet operations.[9] While the FCC or the CPUC could alter their determinations by requiring a license or certificate from companies providing such services, neither has done so to date.[10]

In A*T&T Corporation* v. *City of Portland*, (2000) 216 F.3d 871, the 9th Circuit U.S. Court of Appeals held that Internet services provided by AT&T through its subsidiary (cable TV) company's cable modem access were not "cable services" under the Communications Act; therefore, Portland may not directly regulate them through its franchising authority. However, the court refused to define these Internet services as *regulated* telecommunications or "telephone services" under the Federal Communications Act; but treated them as *unregulated* - as follows:

> "The FCC considers ISP [internet service provider] itself as providing "information services" under the Act, defined as "the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications." 47 U.S.C.S 153(20) (1996). As the definition suggests, ISPs are themselves users of telecommunications when they lease lines to transport data on their own networks and beyond on the Internet backbone. However, in relation to their subscribers, who are the "public" in terms of the statutory definition of telecommunications service, they provide "information services," and therefore are not subject to regulation as telecommunications carriers. See Federal-State Joint Board on Universal Service, 13 F.C.C.R. 11501, PP BM, CB (1998) (report to Congress); cf. Child Online Protection Act, Pub. L. No. 105-277, S 1403(e)(4), 112 Stat. 2681 (1998) (codified at 47 U.S.C. S 231(e)(4)) & Internet Tax Freedom Act, Pub. L. No. 105-277, S 1101(e), 112 Stat. 2681 (1998) (reproduced at note to 47 U.S.C. S 151(e) (1998)) (defining Internet access services as: "a service that enables users to access content, information, electronic mail, or other services offered over the Internet, and may also include access to proprietary content, information, and other services as part of a package of services offered to consumers. Such term does not include telecommunications services."). Indeed, "information services" -- the codified term for what the FCC first called "enhanced services" -- have never been subject to regulation under the Communications Act. See Howard v. America Online, Inc., 208 F.3d 741, 752-753 (9th Cir. 2000); see also 47 C.F.R. S 64.702(a); California v. FCC, 905 F.2d 1217, 1223-25 (9th Cir. 1990) (discussing history of "enhanced services" non-regulation).

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[9] Per FCC "*Glossary of Telecommunications Terms*," a common carrier is defined as follows: "In the telecommunications arena, the term used to describe a telephone company."

[10] As the court held in A*T&T Corporation* v. *City of Portland*, "Thus far, the FCC has not subjected cable broadband to any regulation, including common carrier telecommunications regulation. We note that the FCC has broad authority to forbear from enforcing the telecommunications provisions if it determines that such action is unnecessary to prevent discrimination and protect consumers, and is consistent with the public interest. See 47 U.S.C. S 160(a). Congress has reposed the details of telecommunications policy in the FCC, and we will not impinge on its authority over these matters." (page 875.)

This exercise of regulatory restraint by the FCC was further confirmed by the FCC's *Notice of Inquiry*, dated September 28, 2000, (Gen. Docket No. 00-185, *Inquiry Concerning High-Speed Access to the Internet Over Cable and other Facilities*) cited in the footnote quoted on page 2 of this letter. When the FCC completes its inquiry and decides the regulatory issues concerning Internet services, there may be jurisdictional concerns for the Board, if the FCC (or the CPUC) determines that Internet access services will be regulated as common carrier telephone services. Thus, until the FCC or the CPUC regulates Internet broadband services over a cable modem (and a FCC license or CPCN is required), the company providing such service would be locally assessed – unless of course, that company is already a state assessee (as discussed in the examples above).

3. <u>If the same property is used by a state assessee and a local assessee, must that property be valued as a single appraisal unit</u>?

No.

The basis for the answer has already been discussed above in response to Question 2. As noted, the Board's policy on delegating assessment jurisdiction is founded on the concept of preserving the local appraisal unit and promoting efficient tax administration, while simultaneously observing the unitary principle under Article XIII, section 19. Therefore, where the Board has authority to delegate (the property is owned and the taxes paid by a local assessee), the staff typically conditions delegation on circumstances that would promote preservation of the locally assessed appraisal unit.

There are, however, a variety of situations where delegation cannot legally occur even though it may seem logical to do so. For example, if an electric company acquires a water company and both operate under the same corporate umbrella, the entire water company is subject to the Board's assessment jurisdiction. For example, Southern California Water Company owns a small electric company, that is not a separate corporate entity, and holds a CPCN in order to operate it – therefore, Southern California Water Company is state assessed.

Furthermore, in situations where the state assessee is leasing/using property owned by a local government (possessory interest), the Board may not constitutionally delegate its jurisdiction, since the government entity is exempt and does not pay taxes. In a right-of-way situation, although it may seem "logical" for the Board to delegate, the staff may not legally do so since the interests in the right-of-way (and often in the improvements in the right-of-way) are "owned" by the state assessee. Just as each separate entity is separately evaluated by the Board staff to determine if it is subject to the Board's jurisdiction, so to the property interests of each state assessee are evaluated to determine whether any of the interests can be delegated to the local assessor.

The views expressed in this letter are, of course, advisory only. They represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Very truly yours,

/s/ Kristine Cazadd

Kristine Cazadd
Supervising Tax Counsel

KEC:tr
prop/prec/standiv/00/17kec

Attachments [29 Ops.Cal.Atty.Gen. 77, 1957, pp. 78-81]

cc: Mr. Dick Johnson, MIC:63
Mr. Harold Hale, MIC:61
Mr. David Gau, MIC:64
Mr. Charlie Knudsen, MIC:64
Ms. Jennifer Willis, MIC:70