BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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REPLY COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES ON THE PROPOSED DECISION OF COMMISSIONER CHONG

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Pursuant to Rule 77.3 of the Commission's Rules of Practice and Procedure, and the August 9, 2006 ruling from Administrative Law Judge (ALJ) Reed, the Division of Ratepayer Advocates (DRA) submits these reply comments on the Proposed Decision (PD) of Commissioner Chong, mailed July 25, 2006.

I. INTRODUCTION

Parties' opening comments on the PD reflect the PD's almost total adoption of the positions of the four incumbent local exchange carriers (ILECs).[1] The ILECs laud the PD, but cannot refrain from seeking elimination of even the minuscule regulations that the PD would retain. Virtually all other parties find serious flaws in the PD, especially in its competition analysis.

Here, DRA explains why the CPUC should reject the ILECs' plea for yet more deregulation. DRA also responds to the comments of other parties and, where these comments raise issues DRA did not address in its opening comments, identifies DRA's position and any needed changes to the PD.

II. DISCUSSION

A. Response to Verizon Concerning the PD's Competition Findings

Anyone wishing to understand the PD's flaws needs look no further than Verizon's own summary of four "key facts" on which the PD relied.[2] Each of those "key facts" is either based on misrepresentation of the record or is simply irrelevant to the findings that the PD actually makes.

The first "key fact" that Verizon recites – the PD's conclusion that "over-the-top VoIP" "threatens traditional wireline service" because VoIP providers can enter the market with an incremental investment of "less than $300 per customer"[3] – is a prime example of the PD's flaws. Verizon fails to mention that the PD completely misrepresents the testimony of Verizon's own witness, who did not make this claim about "over-the-top VoIP" providers at all.[4] Instead, the data on which the PD mistakenly relies relates to the cost for cable television providers to upgrade their networks.[5]

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[1] Indeed, the PD's findings regarding geographic deaveraging go beyond the record and beyond even the most deregulatory outcomes that the ILECs themselves proposed. Comments of the Division of Ratepayer Advocates on the Proposed Decision of Commissioner Rachelle Chong, August 16, 2006, pp. 18-20. Hereafter, all references to the parties' August 16, 2006 opening comments on the PD will be appear as "[Party Name] PD Comments."

[2] Verizon PD Comments, pp. 1-2.

[3] Verizon PD Comments, p. 1.

[4] Ex. 41, Aron Reply Comments, ¶ 71.

[5] *See also* DRA PD Comments, p. 9.

Also, as Cox notes, Dr. Aron did not even recognize the extensive prior investments necessary for a cable company to reach the point of making this "incremental" investment in VoIP technology.[6]

Verizon summarizes the second "key fact" as being the PD's finding that wireline losses affirm that wireless competition is a significant threat.[7] Verizon's own data demonstrate that this "key fact" is entirely false. Instead, total wireline volumes have continued to grow and the apparent drop in the market segment of "switched" lines, the line count on which the PD actually relies, is *more than* explained by the ILECs' migration of end-user lines to other wireline technologies such as DSL and high-capacity non-switched services.[8] Further, the source for the wireline vs. wireless volume data cited in the PD is Federal Communications Commission (FCC) data. The CPUC can observe that the most recent version of the FCC's *Local Competition Report* reveals substantial *increases* in both ILEC switched access lines and mobile telephony services in California for the most recent reporting period, as compared to data from six months or one year earlier.[9]

Verizon's third "key fact" simply repeats the PD's conclusion that the mere legal "availability of UNE-L" makes it possible for CLECs to contest any market in California.[10] DRA, TimeWarner and TURN all have shown that the PD's conclusion is a fiction. Instead, the failure of UNE-L competition – which, despite its continuous availability for a decade, has never been successfully used for residential mass market entry, and is currently in decline – can only support a conclusion that the ILECs retain substantial market power, not the reverse.[11]

Verizon's final point is that today's "technologically diverse" marketplace for bundled services means that old service definitions, including "Basic Local Exchange Service," are no longer relevant. Debate about competition for bundles is misdirection, at best. The consumer representatives in this proceeding are not arguing that the CPUC should deny the ILECs pricing flexibility for bundles; instead, DRA and others are recommending that the CPUC should retain price caps for certain stand-

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[6] Cox PD Comments, pp. 15-16.

[7] Verizon PD Comments, p. 2.

[8] DRA PD Comments, pp. 7-8; DRA Reply Comments, pp. 48-55 and 75-81; TURN PD Comments, pp. 12-14.

[9] *Local Telephone Competition: Status as of December 31, 2005*, Industry Analysis and Technology Division, Wireline Competition Bureau, Federal Communications Commission (FCC), July 2006 (hereinafter "FCC 7/06 Local Competition Report"), available online at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-266595A1.pdf. *See* Table 10 for ILEC switched access line counts and Table 14 for mobile wireless telephony customers.

[10] Verizon PD Comments, p. 2.

[11] DRA PD Comments, pp. 13-14; Time Warner PD Comments, pp. 4-5; TURN PD Comments, p. 10.

alone basic services. What matters is whether competition exists for customers who do not want or cannot afford bundles, something the record does not demonstrate at all.[12]

B. Response in Support of CSBRT/CSBA, DOD/FEA and TURN Concerning FCC Competition Statistics

As noted above, both Verizon's PD comments and the PD itself emphasize ILEC wireline losses as justification for ending price regulation of the ILECs. But, as the comments of other parties show, the evidence that Verizon and the PD cite reflects the very peak of CLEC competition. The most recent FCC competition data show competition in California is declining rapidly.[13]

CLECs lost a staggering 26% of their access lines in California (over one million lines) *in just six months*, from June 2005 to December 2005.[14] (The next round of FCC statistics may show even greater CLEC line losses because the Verizon/MCI merger was not completed as of December 31, 2005, and therefore MCI lines in Verizon territory still would have been reported as CLEC lines.) Over that same six months, ILECs *gained* more than 635,000 switched access lines.[15]

Parties' comments and FCC data also reveal that the PD errs in relying heavily on data concerning CLEC presence by zip code as evidence of ubiquitous competition. The PD did not even get its facts straight. Instead, the PD incorrectly cited CSBRT/CSBA as pointing to FCC data that allegedly showed only 14 California zip codes had no CLECs and another 32 had only one to three CLECs, as of June 2004. The correct data were 14 *percent* of zip codes with no CLECs and 32 *percent* with one to three CLECs.[16] CSBRT/CSBA attempts to downplay the PD's error by pointing out that the December 2005 FCC statistics show much better coverage: only 7% of California zip codes with no CLECs and 16% with one to three CLECs (cut in half from June 2004).[17] But, this apparent improvement in CLEC zip code coverage *during the same period when CLEC lines declined by 26% (over one million lines)* simply shows that counting the number of zip codes in which at least one CLEC serves at least one customer is not a meaningful way to measure competition.[18]

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[12] *E.g.,* DRA Opening Brief, pp. 5, 17-35 and 42-42; DRA Reply Brief, pp. 6-7, 10-11 and 34.

[13] TURN PD Comments, p. 10; DOD/FEA PD Comments, pp. 7-8. At page 8, DOD/FEA also notes that the extent of competition in California is well below the national average.

[14] FCC 7/06 Local Competition Report, Table 9.

[15] *Id.*, Table 10.

[16] CSBRT/CSBA PD Comments, p. 5, fn. 3. CSBRT/CSBA had filed a correction to its original erroneous filing.

[17] *Ibid.*

[18] *See also* DOD/FEA PD Comments, pp. 8, 10-11.

C. Response to AT&T and Verizon Concerning Elimination of Residential Price Caps

Both AT&T and Verizon argue that the CPUC should not wait for the PD's two-year "date certain" to eliminate price caps on residential basic service if the CPUC concludes its reviews of the LifeLine and California High Cost Fund - B (CHCF-B) programs in a shorter time.[19] Neither ILEC alleges any legal or factual error to justify its position. Instead, their comments largely "reargue positions taken in briefs;" thus, those arguments should "be accorded no weight."[20]

The error in the PD's two-year date certain for lifting residential price caps is not that two years might represent unnecessary delay. The problem instead lies in the PD's presumption that the only reason for continuing residential price caps is the need to work through details concerning existing subsidy programs. That simply is not true. For example, as Disability Rights Advocates explain, the ongoing Public Policy Program (PPP) rulemaking will not address all concerns of the disabled community because those concerns do not relate exclusively to public programs such as the Deaf and Disabled Telecommunications Program (DDTP) or the LifeLine program. Instead, disabled customers have unique issues, such as an inability to rely on intermodal alternatives such as wireless and VoIP, that form the primary basis for the PD's determination that there is sufficient competition for residential customers to justify removal of existing price caps.[21]

More broadly, the error is that the PD adopts *any* date certain at all for the elimination of residential price caps, given the tremendous uncertainty about the future of competition in California and the lack of record evidence in this proceeding to support a finding of ubiquitous competition for residential service. Indeed, the FCC data discussed above show not only a decline of competition overall, but also early signs that the remaining CLECs are less likely to serve residential customers than was true before the SBC/AT&T merger.[22] Not only is traditional CLEC competition declining, but, as TURN also correctly notes, the merger-related requirement for AT&T and Verizon to offer stand-alone DSL will cease to apply at almost the same time that the PD would lift residential price

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[19] AT&T PD Comments, p. 7; Verizon PD Comments, p. 10.

[20] CPUC Rule 77.3 ("Comments shall focus on factual, legal or technical errors in the proposed decision and in citing such errors shall make specific references to the record. Comments which merely reargue positions taken in briefs will be accorded no weight and are not to be filed.").

[21] Disability Rights Advocates PD Comments, pp. 11-14.

[22] FCC 7/06 Local Competition Report, Table 2 and Chart 2. Unfortunately, these data are national and there are no corresponding data for California.

caps.[23] Thus, the PD's reliance on stand-alone DSL to support competition for voice services from non-cable VoIP providers[24] has no validity two years hence. Nor is there any evidence of meaningful competitive alternatives for especially vulnerable customers, such as disabled and low-income customers.[25]

Thus, the CPUC should ignore the ILECs' request to accelerate residential price deregulation and instead find that this record shows a continuing need to cap prices for residential primary lines. Re-examining the need for residential price caps two or three years from now would be prudent. Removing those price caps at a date certain – whether 18 months or two years from now – would be irresponsible and is not supported by the record.

D. Response to AT&T, Frontier, SureWest and Verizon Concerning Bundling Restrictions for Subsidized Services

The ILECs all vigorously object to the PD's conclusion that they should not be allowed pricing flexibility, bundling and the ability to offer promotions for basic residential services that are still receiving a subsidy.[26] Their primary argument is that the CPUC need not restrain the ILECs' ability to market these subsidized services because a basic service rate freeze is sufficient to ensure that they cannot inappropriately benefit from subsidies relative to competitors. This argument sidesteps the facts that (1) the ILECs are currently receiving hundreds of millions of dollars in subsidy to help them maintain low rates and (2) although the ILECs' competitors contribute disproportionately to provide those subsidies, those subsidies are not equally available to those competitors, such as wireless providers.[27] Given that situation, it is indeed unreasonable to allow the ILECs to leverage subsidized services to gain a competitive advantage in bundled offerings and promotions as the PD concludes.

That said, AT&T and Verizon correctly point out that the CPUC has previously mandated that LifeLine customers must be allowed access to service bundles that include basic exchange service.[28] Moreover, DRA agrees that allowing LifeLine customers equal access to service bundles is pro-consumer and appropriate. For LifeLine customers, DRA suggests that Verizon's proposal to maintain

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[23] TURN PD Comments, p. 11. TURN also notes that AT&T's price for stand-alone DSL is prohibitively high. *Ibid.*

[24] PD at 237, Conclusion of Law 28.

[25] Disability Rights Advocates PD Comments, pp. 3-9; Greenlining PD Comments, pp. 1-2.

[26] AT&T PD Comments, pp. 3-6; Frontier PD Comments, pp. 4-8; SureWest PD Comments, pp 3-9; Verizon PD Comments, pp. 3-9.

[27] DRA Opening Brief, p. 6.

[28] AT&T PD Comments, p. 4; Verizon PD Comments, p. 4.

stand-alone service options[29] might suffice as an interim protection as long as the CPUC also adopts a mandate that the ILECs must continue to offer and vigorously market all stand-alone basic exchange services, including LifeLine service, *and* the ILECs are not granted revenue neutrality.

DRA admits that this compromise would maintain an unfair advantage to the ILECs; however, if the CPUC opts to remove most regulatory restrictions that apply to the ILECs before addressing unequal regulatory subsidies that benefit them, some inequality among competitors is inevitable. DRA's suggested compromise reflects its primary concern to ensure that the most vulnerable ratepayers will not bear all of the consequences of the non-uniform framework.

E. Response to AT&T and Verizon Concerning Price Floors

AT&T and Verizon object to the PD's imposition of a *de facto* UNE-L price floor for access line services and bundles that include lines.[30] While DRA does not necessarily endorse the ILECs' reading of antitrust laws, DRA does agree that the PD's decision in effect to require the ILECs to impute the UNE-L price into the price of their retail access line services and associated service bundles is both problematic and inconsistent with the PD's own findings.[31]

The PD's finding that the ILECs' retail prices must exceed the UNE-L rate to avoid a "price squeeze"[32] implies that competitors depend on UNE-L to offer alternatives to the ILECs' access line services. If that is true, then the CPUC cannot also rely on intermodal competition from cable, VoIP and wireless providers to justify price deregulation.[33] But, the CPUC should recognize the extreme unlikelihood of UNE-L based competition for basic services outside urban and dense suburban areas, as Verizon's comments demonstrate. Verizon's monthly rate for business access line services is $19.22.[34] Its UNE-L prices in Zones 2, 3 and 4 are respectively 2.4, 7.0 and 27.4 times this rate.[35]

Verizon, of course, does not present this information to show the impossibility of UNE-L competition (which it does demonstrate), but rather to "justify" its requested statewide-average UNE-L

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[29] Verizon PD Comments, p. 6.

[30] AT&T PD Comments, pp. 13-15; Verizon PD Comments, pp. 10-12.

[31] *Compare* PD at 184 (disavowing imputation) to PD at 178-179 (effectively requiring UNE-L imputation).

[32] PD at 178-179.

[33] The record certainly establishes the insufficiency of intermodal competition, especially for business customers. *See, e.g.,* California Payphone Association PD Comments, pp. 2-3; DOD/FEA PD Comments, pp. 3-6; DRA PD Comments, pp. 6-10; Time Warner PD Comments, pp. 1-3; and TURN PD Comments, pp. 8-16.

[34] Verizon California Inc.SCHEDULE Cal. P.U.C. No. A-1, 37th Revised Sheet 2.

[35] Verizon PD Comments, p. 10, fn. 40.

price floor. If the ILECs are permitted to geographically deaverage their retail prices, however, then logic requires that the UNE-L price floor be applied on a deaveraged basis. The better solution is to require the ILECs to continue offering basic access line services at geographically averaged prices.

F. Response to Cox, Frontier, SureWest and TimeWarner Concerning Competitively Neutral Removal of Restrictions on CLECs

Cox, Frontier, SureWest, and TimeWarner all note that some of the regulations that the PD would establish for ILECs are actually more liberal than the CPUC's current rules for CLECs. These parties argue that the CPUC should extend the new ILEC rules to non-dominant carriers as well.[36]

DRA agrees with these parties that it would be unfair and unreasonable to give the ILECs (which retain the bulk of the market for most services they offer) more regulatory freedom than is available to CLECs (which, individually, generally have *de minimis* market shares and even collectively serve only a minority of customers).[37] Nonetheless, Phase 1 of this rulemaking focused on changes to the regulation of the *ILECs*, and parties did not develop a record about changes to *CLEC* regulations.

The best way to resolve this matter is to amend the PD to eliminate each instance in which the proposed change to ILEC regulations would place fewer restrictions on ILECs than currently apply to CLECs. If the CPUC wishes to consider further liberalization of the rules that apply to *all* carriers, it should indicate that this issue will be taken up in Phase 2 of this rulemaking.

G. Response to Sprint Nextel Concerning Treatment of Special Access and Interconnection Rates in Phase 2

As Sprint Nextel explains, the PD relies extensively on competition from wireless carriers without recognizing that the ILECs control a substantial portion of the facilities that other wireless carriers need to be able to compete.[38] This is significant because the ILECs' control of special access and interconnection facilities and the apparently inflated rates that they charge for those facilities may substantially impede competition.[39]

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[36] Cox PD Comments, p. 14; Frontier PD Comments, p. 10; SureWest PD Comments, p. 10; Time Warner PD Comments, p. 9.

[37] Even AT&T witness Dr. Harris concurs that firms with very small market shares have a disproportionately small effect on the market relative to firms like the ILECs with very large market shares. 2 RT 410.

[38] Sprint Nextel PD Comments, pp. 6 and 11. *See also* DRA Reply Comments, p. 29.

[39] Sprint Nextel PD Comments, pp. 7-10; Time Warner PD Comments, pp. 7-8.

Inflated wireless wholesale service inputs have an unequal effect on affiliated, as opposed to non-affiliated, providers. An ILEC charging inflated prices for wholesale inputs imposes a true cost on its competitors; in contrast, charges to its own affiliates merely rearrange which affiliate will report the resulting profit.[40] Thus, the PD's failure to address the record evidence that the ILECs (or their parent companies) directly own or control some of the ILECs' supposed chief competitors is a significant omission.[41] California should not depend on competition from ILEC affiliates such as Cingular or Verizon Wireless to discipline the ILECs' pricing behavior. Instead, the CPUC should foster emerging competition from unaffiliated competitors, which may require substantial reductions in the ILECs' special access and interconnection rates. Therefore, DRA agrees with Sprint Nextel that the PD should be modified to affirm that the CPUC will address this important issue in Phase 2.

The possibility of significant reductions in special access charges in Phase 2 makes it even more important to eliminate the PD's unjustified policy of revenue neutrality, which appears to predetermine that the entire burden of offsetting rate increases would fall on residential basic exchange service customers.[42] The ILECs have ample opportunity to do any needed rebalancing elsewhere, including through their wireless and broadband affiliates, which currently enjoy what are in some cases free inputs from the ILECs' massive, ratepayer-funded wireline networks.[43] Thus, if the CPUC adopts Sprint Nextel's proposal for an interim reduction in special access rates, it should also make clear that the ILECs will not be permitted to raise price-capped rates to offset special access revenue losses.[44]

H. Response to AT&T, Frontier, SureWest and Verizon Concerning Elimination of Affiliate Transaction Reporting

Each of the ILECs notes that the PD does not reach any finding regarding affiliate transaction reports and suggests that the PD should be modified to eliminate all such reporting.[45] It makes sense that the PD does not reach such a finding because almost no record was developed regarding those reports. The existing record failed to examine or to analyze how the elimination of affiliate transaction

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[40] Sprint Nextel PD Comments, p. 11, fn. 23.

[41] Cox PD Comments, pp. 5-7; Sprint Nextel PD Comments, pp. 5-8. *See also*, DRA Reply Comments, pp. 9, 25, 29, 45-46, 49, 52, 54, 77-78 and 94.

[42] DRA PD Comments, pp. 22-23.

[43] CCTA PD Comments, pp 3-6; Cox PD Comments, pp. 12-14; DRA PD Comments, pp. 22-23.

[44] Sprint Nextel PD Comments, pp. 12-13. Revenue-neutral rate offsets would be particularly inappropriate because the Sprint Nextel proposal is subject to true-up.

[45] AT&T PD Comments, p. 12; Frontier PD Comments, p. 11; SureWest PD Comments, p. 11; Verizon PD Comments, p. 12.

reports might affect the CPUC's ability to regulate the ILECs or how those reports might be used to help evaluate the level and effect of actual competition between companies.

Also, as discussed above, there is substantial record evidence that much of the apparent competition on which the PD relies is merely the movement of customers between the ILECs and their own affiliates, or between one service offering and another. Moreover, as Sprint Nextel explains, the ILECs' current prices for essential inputs may disadvantage unaffiliated competitors.[46] The CPUC should not eliminate affiliate reports before addressing this potentially significant competitive inequality. At most, the CPUC might temporarily suspend those reports and review the need for continued affiliate reporting in Phase 2.

I. Response to AT&T Concerning Elimination of All Regulations It Considers "Asymmetrical and Unnecessary"

Although the PD would grants AT&T virtually every regulatory freedom requested in Phase 1 of this rulemaking, AT&T asks for more. Specifically, AT&T suggests that the PD should be modified to direct CPUC staff to eliminate all "asymmetric and unnecessary" regulations, which it describes as "myriad tariff, regulatory filing, financial reporting and marketing/customer disclosure rules and regulations that have built up over the years" but that are not currently addressed by the PD.[47]

AT&T over-reaches. The PD does not discuss the unspecified other regulations AT&T seeks to eliminate because those regulations were not addressed in this rulemaking. Parties have not been given the requisite notice and opportunity to be heard on the question of whether to eliminate these regulations,[48] and the CPUC has no basis on which to render the necessary Findings of Fact and Conclusions of Law to justify their elimination.[49] It would be legal error to grant AT&T's request.[50]

In addition to the lack of notice, the CPUC faces another statutory hurdle to granting AT&T's request to detariff services. Specifically, P.U. Code § 489 mandates that the CPUC "shall . . . require every public utility" to file and maintain tariffs showing all "rates, tolls, …charges". While § 495.7 allows the CPUC to exempt "certain telecommunications *services*" from tariff requirements, it does not

[46] Sprint Nextel PD Comments, pp. 6 and 11.

[47] AT&T PD Comments, pp. 10-11.

[48] *See* P.U. Code § 1708.

[49] *See* Rule 1.2.

[50] *See* DRA PD Comments, p. 22.

allow wholesale exemption of carriers from those requirements.[51] And, § 495.7 requires that the CPUC make specific findings prior to granting such an exemption.[52]

J. Response to Inclusion in Record of New York Public Service Commission (NYPSC) Decision

By a ruling on August 18, 2006, the ALJ granted DRA's request for judicial notice of an Oregon PUC decision. In the same ruling, the parties were informed that Commissioner Chong wished for the CPUC to take judicial notice of a NYPSC order issued this past spring.[53] Given that this is the only opportunity DRA has to address the New York decision, we note that the NYPSC required geographic *averaging,* set no date certain for eliminating basic service price caps, and directed its staff to collect data about how competition is faring before reconsidering further deregulation in two years.

III. CONCLUSION

For all of the reasons discussed above and in DRA's August 15, 2006 opening comments, DRA respectfully requests that the CPUC revise the PD to reflect the changes identified in DRA's opening comments.

August 22, 2006

Respectfully submitted,

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[51] DRA notes that § 495.7(a) allows the CPUC to "establish procedures" whereby telephone corporations may "apply" for exemption from tariffing requirements for some services. The CPUC has not established such procedures, nor does AT&T's offhand request in its comments reasonably constitute an "application" for detariffing.

[52] DRA notes that the FCC authorized permissive detariffing of services of some long-distance carriers in the early 1990's. The effort resulted in a U.S. Supreme Court decision which reversed the FCC's action on the basis that the FCC lacked statutory authorization to order the detariffing. *See MCI v.AT&T*, 512 U.S. 218. Ultimately, the FCC received statutory authority through passage of the 1996 Federal Telecommunications Act.

[53] NYPSC, Case 05-C-0616.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of **"REPLY COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES ON THE PROPOSED DECISION OF COMMISSIONER CHONG"** in **R.05-04-005** by using the following service:

[**X**] **E-Mail Service:** sending the entire document as an attachment to an e-mail message to all known parties of record to this proceeding who provided electronic mail addresses.

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Executed on the **22nd** day of **August, 2006** at San Francisco, California.

/s/ HALINA MARCINKOWSKI

Halina Marcinkowski

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address and/or e-mail address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

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