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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Telecommunications Division **RESOLUTION T-16717**
Market Structure Branch **December 17, 2002**

R E S O L U T I O N

RESOLUTION T-16717. PACIFIC BELL TELEPHONE COMPANY (U-1001-C). REQUEST FOR APPROVAL OF PRICE CAP MECHANISM, IN COMPLIANCE WITH DECISION 89-10-031, AND CORRESPONDING ADJUSTMENTS TO SURCHARGES WHICH WILL BE EFFECTIVE ON JANUARY 1, 2002.

BY ADVICE LETTER NO. 23289 FILED ON OCTOBER 1, 2002.

Summary

This Resolution authorizes Pacific Bell (Pacific) to decrease its annual revenue by $762,000 effective January 1, 2003. A summary of the price cap filing calculation of the adopted revenue adjustment is shown in Appendix A. A summary of the adopted surcredit is shown in Appendix B.

Pacific requested an annual revenue decrease of approximately $762,000 due to impacts of one-time adjustment consisting of Gain on Sale of Land, Intervenor Compensation, and Tier II Payments.

Background

New Regulatory Framework

In Decision (D.) 89-10-031 the Commission adopted an incentive-based regulatory framework (called the new regulatory framework or "NRF") for Pacific and GTE California Incorporated (GTEC), which is now know as Verizon California Incorporated. The decision stated that prices and rate caps would be indexed annually according to the Gross National Product Price Index (GNP-PI) inflation index reduced by a productivity adjustment.

The indexing formula allowed rate adjustments for a limited category of exogenous factors, called Z-factors, whose effects are not reflected in the GNP-PI. Only specific types of costs were considered Z-factors: changes in federal and state tax laws to the extent they affect the local exchange carriers disproportionately, mandated jurisdictional separations changes, and changes to intraLATA toll pooling arrangements or accounting procedures adopted by this Commission.

However, the Commission did not authorize Z-factor treatment for all unforeseen or exogenous factors. In D.89-10-031, the Commission stated that normal costs of doing business (including costs of complying with existing regulatory requirements) or general economic conditions would be excluded as Z-factor items.

In D.94-06-011, the Commission ordered Pacific to replace the GNP-PI with the Gross Domestic Product Price Index (GDP-PI), and in D.94-09-065, the Commission authorized Pacific and GTEC to implement the 1995 price cap rate adjustments through the billing surcharge/surcredit mechanism.

In 1995, the Commission issued D.95-12-052 regarding the second triennial New Regulatory Framework review and suspended the application of the GDP-PI minus productivity factor formula used in price cap regulation of Pacific and GTEC.

In October 1998, the Commission issued D.98-10-026 regarding the third triennial review of the NRF. The order continues the suspension of the GDP-PI minus productivity factor formula, suspends for the first time the sharing mechanism, permanently eliminates the depreciation review, replaces Z-factors with limited exogenous (LE) factors, and continues rate caps on residential services by keeping all rate caps and floors.

The order also specifies that, in the future, LE cost recovery is confined to recovery for cost increase or decreases resulting from (1) items mandated by the Commission and (2) changes in total intrastate recovery resulting from changes between federal and state jurisdiction. Recovery of Commission mandated cost changes must be authorized in the underlying Commission Decision.

Pacific's Price Cap Filing

On October 1, 2002, Pacific filed its 2003 price cap advice letter (A.L.23289) filing to comply with D.89-10-031. In this filing, Pacific proposed to include the following adjustments to its revenues (reduction in parenthesis):

- **Gain on Sale of Land** **($39,000)**
  This is a one-time adjustment to reflect the gains on sale of land.

- **Intervenor Compensation** **$125,000**
  This is a one-time adjustment to reflect recovery for participation or intervention in Commission Proceedings governed by the provisions of Division 1, Part I, Chapter 9, Article 5 (beginning with section 1807) of the Public Utilities Code.

- **Tier II Payments** **($848,000)**
  This is a one-time adjustment to reflect payments to general ratepayers, including interest, as adopted by the Commission in D.02-03-023.

- **Total Revenue Adjustment** **($762,000)**

As shown above, the net result of the One-Time Other Adjustments Proposed by Pacific is a decrease of $762,000 in Total Revenues. To recover this revenue, Pacific Requests authority to modify:

1. The current surcredit to be applied to all IntraLATA Exchange and Private Line Service with the exception of Category III Services and the taxes and surcharges currently listed in the tariffs from -1.720 to –1.309%.

2. The surcredit to be applied to all IntraLATA Toll Services currently listed in the tariffs from –1.722% to –1.311%.

3. The surcredit to be applied to all IntraLATA Access Services currently listed in the tariffs from –1.726% to –1.315%.

Notice/Protests

Pacific states that a copy of the Advice Letter, and related tariff sheets were mailed to interested utilities and other parties. Notice of Advice Letter No.23289 was published in the Commission Daily Calendar on October 4, 2002.

A timely limited protest and comments were filed to Pacific's 2003 price cap filing by the Office of Ratepayer Advocates (ORA) on October 23, 2002. ORA recommends that the Commission direct Pacific to do the following: a) remove the LE factor line item associated with the 314.5 audit from the price cap A.L.23289 filing, b) include the GDP-PI inflation factor as part of Pacific's workpapers, and c) revise its price floor update

format to be consistent with the format used by Verizon in subsequent price cap filings. ORA also comments that the revenue changes, such as the Tier II payments filed by Pacific were unaudited numbers.

On October 31, 2002, Pacific responded to ORA's protest. Pacific states that the inclusion of a potential LE-factor adjustment for Section 314.5 audit costs was solely to highlight the possibility that the Advice Letter would be supplemented if recovery is authorized by the Commission prior to issuance of the 2003 price cap resolution. Pacific also notes that it will accommodate ORA's request for additional information in the table reflecting price floor adjustments and will incorporate the additional information suggested by ORA in the price floor adjustment table that will be included in the workpapers for subsequent filings. Finally, Pacific does not object to including the GDP-PI as part of its workpapers.

Discussion

Gain on Sale of Land

Decision 94-06-011 adopted the settlement agreement between Pacific Bell and the Division of Ratepayer Advocates in Application 92-05-004 as it relates to gain on sale of land. The settlement agreement, included as Appendix B to the Decision, states that for sales which occurred in 1997 and beyond, Pacific will return 50% of the gain on sale directly to ratepayers as one-time rate adjustments in the annual Price Cap filings; the remaining 50% will go to shareholders.

Pacific identified a total gain on sale of land in the amount of $96,382, and consistent with the terms of the settlement, proposes to refund to ratepayers $38,553. The Telecommunications Division recommends the adoption of Pacific's request to refund to ratepayers through a one-time adjustment of ($38,553) for the gain on sale of land.

Intervenor Compensation Recovery

Decision 96-04-063 confirmed that Pacific was entitled to recover intervenor compensation, but concluded that Pacific's rates shall remain subject to refund or adjustment pending completion of an OII. In Resolution T-16265, the Commission agreed that data provided by Pacific appeared to demonstrate that there was no recovery of intervenor compensation in the start-up revenue period. Therefore it would be equitable to allow Pacific to recover intervenor compensation, in accordance with Decision 96-04-063, where the amount shall remain subject to refund or adjustment when the OII is terminated.

During the period of September 2001 through August 2002, Pacific had paid $165,000 (including interest) for intervenor compensation awarded by the Commission. After applying the applicable intrastate separations factor of 0.758, Pacific request recovery of

$125,000. The Telecommunications Division recommends the adoption of Pacific's request to recover intervenor compensation through a one-time adjustment of $125,000.

Tier II Payments

Decision 0203-023 established monetary performance incentives for an incumbent local exchange carrier (LEC) to give competitors equitable access to the LEC's Operations Support Systems (OSS) infrastructure. Under the Commission's incentive plan, there are two types of payments for OSS performance levels that fall below Commission approved performance standards: Tier I which are generally paid to individual Competitive Local Exchange Carriers and Tier II payments which are paid to general ratepayers.

Tier II payments are calculated throughout the year and placed monthly into an interest bearing escrow account and remitted to ratepayers in the subsequent year in the form of a billing surcredit. A 2002 Tier II payment in the amount of $848,000 had been developed consistent with the methodology adopted by the Commission in D.02-03-023. The Telecommunications Division recommends the adoption of Pacific's request to remit to ratepayers through the one-time adjustment of ($848,000) for the Tier II payments.

Section 314.5 Audit Cost (Protest Issues)

In Phase 2B of the 2002 NRF review (R.01-09-001/I.01-09-002), Pacific requested recovery of the payments (with interest) that Pacific made to the Commission to finance the employment of outside consultants to conduct a regulatory audit of Pacific's books and records (Section 314.5 Audit Cost). Pacific was authorized the opportunity to seek recovery of these costs in D.96-05-036 and in December 27, 2001 "Assigned Commissioner's Ruling Determining the Category, Scope, Schedule, Need for Hearing, and the Principal Hearing Officer for the Proceeding" in R.01-09-001/I.01-09-002. As of September 12, 2002, Pacific had paid out $2,120,000 plus $68,000 in interest. If recovery is authorized prior to issuance of the Commission's 2003 price cap resolution, Pacific intends to supplement its 2003 price cap advice letter to implement the LE-factor recovery of the cost of $2,188,000 in 2003.

On October 23, 2002, ORA filed a protest recommending the Commission to direct Pacific to remove the LE factor line item associated with the 314.5 audit from the price cap advice letter. Pacific added a LE factor, one-time revenue requirement impact from section 314.5 audit cost but leaving the number blank with a footnote. The footnote states that in R.01-09-001/I.01-09-002, Pacific requested recovery of the 314.5 audit cost at $2,188,000 (including interest) by supplementing its 2003 price cap filing if the Commission authorized recovery prior to the resolution of 2003 price cap filing. ORA indicated that as noted by Pacific, the issue is currently pending before the Commission in I.01-09-002. In the investigation, ORA's position is that due to Pacific's impediment of the audit, the Telecommunications Division was unable to complete the 314.5 audit

as scoped by the Commission. The original cost of the audit was $1.384 million. Therefore, ORA recommends deferral of recovery of the Overland audit costs until the completion of the audit. Furthermore, ORA notes that Pacific's request had not met the Commission's LE nine criteria requirements. For instance, part of the audit cost was caused by delay of Pacific's responses to data request, hence, there is not a completed audit for which the cost can be considered reasonable. Also, this audit cost does not have a major financial impact on the utility's overall costs.

On October 31, 2002, Pacific filed a response to ORA's protest. Pacific states that the line item for Section 314.5 audit costs were included solely to highlight the possibility that the Advice Letter would be supplemented if recovery is authorized by the Commission prior to issuance of the 2003 price cap resolution. Pacific was not attempting to argue the merits of LE-factor recovery for the Section 314.5 audit cost nor was it requesting recovery prior to receiving Commission authorization. In fact, the dollar amount and surcharge increment for this particular line item were intentionally left blank, since Pacific had made a notation stating that a supplement would be filed to its 2003 price cap only if recovery was authorized prior to issuance of the 2003 price cap resolution.

Price Floor Update Format (Protest Issue)

ORA also recommends that the Commission direct Pacific to revise its price floor filing format in the future price cap filings to conform with Verizon. ORA notes that Pacific's price floor filing lacks necessary details and that Verizon's price floor updates are much more transparent for the Commission and its staff to review. Verizon's price floor filing provides several categories of the cost information for each of the services. These categories, as noted by ORA are: a) the cost at old long run incremental cost, b) imputation as necessary, c) the tariff rate, d) last year's floor, e) this year's floor reflecting inflation update, and finally f) the difference between tariff and the updated price floor. This format provides a clear indication of whether the price floors are below tariff rates or not, and whether they are properly updated by inflation factor from the prior ones.

Pacific did not object to the changes ORA requested for this issue and is willing to incorporate the additional information suggested by ORA in the price floor adjustment table that Pacific will include in the workpapers for subsequent filings. However Pacific maintains that the Commission should decline ORA's request for an order that would "direct" Pacific to make the changes. Pacific submits that the price floor adjustments were included in a table in the workpapers for Pacific's annual price cap filing pursuant to a requirement adopted in D.94-09-065. The table submitted with Pacific's workpapers complies with the requirement, since the Commission requirement did not specify a particular format for the table adjusting price floors, and that the table used had been accepted in prior years. Pacific states that ORA's protest was not the appropriate vehicle for ORA to use to ask the Commission to modify its existing

requirement, and that the Commission should decline ORA's request for an order that would "direct" Pacific to change the contents of the table adjusting its price floors.

We are encouraged by Pacific's willingness to include in future price cap advice letters, the information that ORA requests. For subsequent price cap filings, Pacific shall file in the workpapers the following information for each of the services:

- The line number
- The cost basis
- Whether imputation is required
- Current average unit revenue
- Current price floor
- Proposed price floor
- Difference between current average unit revenue and the proposal price floor

TD believes that this information should be supplied for this year and recommends that the Commission order Pacific to file a supplement to A.L. No. 23289 within 30 days after the effective date of this resolution to update the price floor format consistent with ORA's recommendation.

Gross Domestic Product Price Index (Protest Issue)

ORA recommends the Commission direct Pacific to include its inflation factor, the Gross Domestic Product Price Index (GDP-PI), as part of Pacific's workpapers. ORA notes that the GDP-PI is a necessary component to update price floors. ORA also notes that Pacific had provided ORA the GDP-PI per ORA's request.

Pacific responded to ORA's protest stating that Pacific does not object to include the GDP-PI as part of its workpapers. Pacific commits to providing the GDP-PI data as part of its future filings.

311 Mailing Of Draft Resolution

The draft resolution of the Telecommunications Division in this matter was mailed to the parties in accordance with PU Code Section 311 (g)(1). There were no reply comments filed by interested parties.

Findings

1. On October 1, 2002, Pacific filed its price cap filing A.L. No. 23289, and requests the following one-time adjustments in its revenues:

• Gain on Sale of Land	($39,000)
• Intervenor Compensation	$125,000
• Tier II Payments	($848,000)

- **Total Revenue Adjustment** ($762,000)

2. Pacific proposes that its billing base for calculating the 2003 surcharge/surcredit is $5,457,792,000.

3. Pacific requests to adjust the $762,000 decrease in revenue requirements by applying:

   a) –1.309% surcredit to local exchange services with the exceptions of Category III Services, access charges listed in Schedule No. 1, and surcharges currently listed in Pacific's tariffs.
   b) –1.311% surcredit to intraLATA toll (Schedule No. A2)
   c) –1.315% surcredit to access services (Schedule No. A2)

4. We find reasonable and adopt Pacific's request to refund the ratepayers through a one-time adjustment of ($38,553) for the gain on sale of land.

5. We find reasonable and adopt Pacific's request to recover intervenor compensation through a one-time adjustment in the amount of $125,000.

6. We find reasonable and adopt Pacific's request to remit to ratepayers through the one-time adjustment of ($848,000) for the Tier II payments.

7. On October 23, 2002, ORA filed a limited protest and comments concerning an inclusion by Pacific of a LE factor of a 314.5 audit cost request while the issue is currently pending. ORA also recommends that the Commission direct Pacific to include the GDP-PI as part of its workpapers, and revise its price floor update format following that of Verizon's in subsequent price cap filing.

8. On October 31, 2002, Pacific responded to the protest stating that the inclusion of the line item for Section 314.5 audit cost was solely to highlight the possibility that the Advice Letter would be supplemented if recovery is authorized prior to issuance of the Commission's 2003 price cap resolution. Pacific does not have objections to ORA's recommendation for additional information in the table reflecting price floor adjustments and including the GDP-PI as part of its work papers. Pacific agrees to provide this information in subsequent price cap filings.

9. We find reasonable and adopt TD's recommendation for Pacific to file a supplement to A.L. No. 23289 within 30 days after the effective date of this resolution to update the price floor format consistent with ORA's recommendation.

10. The revenue adjustments associated with Gain of Sale of Land, Intervenor Compensation, and Tier II Payments result in a net revenue decrease of $762,000 to be applied to local, toll, and access services are summarized in Appendix A to this resolution.

THEREFORE, IT IS ORDERED that:

1. Pacific shall decrease its annual revenue by the total proposed revenue adjustment of $762,000.

2. Pacific shall implement billing surcredits reflecting the revenue decrease ordered in Ordering Paragraph 1, applied to a total billing base of $5,457,792,000 for intraLATA exchange and private line services, intraLATA toll services, and intraLATA access service, to become effective on January 1, 2003, subject to review and approval by the Commission's Telecommunications Division. Adopted surcredits are shown in Appendix B.

3. The revisions to Pacific's price floors filed in Advice Letter No. 23289 are adopted and shall be implemented on January 1, 2003.

4. Within 30 days of the effective date of this resolution, Pacific shall file with the TD for review and approval, a supplement to A.L. No. 23289 to update the price floor workpapers consistent with the format recommended by ORA for subsequent price cap filings.

This Resolution is effective today.

I hereby certify that the Public Utilities Commission adopted this Resolution at its regular meeting on December 17, 2002. The following Commissioners approved it:

WESLEY M. FRANKLIN
Executive Director

APPENDIX A
Resolution T-16717
Pacific Bell Telephone Company
2003 Price Cap Filing

One-Time Other Adjustments	Pacific Proposed Revenue Impacts	Adopted Impacts
Gain on Sale of Land	$ (39,000)	**$ (39,000)**
Intervenor Compensation	$ 125,000	**$ 125,000**
Tier II Payments	$ (848,000)	**$ (848,000)**
Total	$ (762,000)	**$ (762,000)**

APPENDIX B
Resolution T-16717
Pacific Bell Telephone Company.
2003 Price Cap Filing

	Current Surcredit	Pacific Proposed Surcredit	Adopted Surcredit
Access	(1.726%)	(1.315%)	**(1.315%)**
Local	(1.720%)	(1.309%)	**(1.309%)**
Toll	(1.722%)	(1.311%)	**(1.311%)**