

Decision 06-12-039 December 14, 2006

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

In the Matter of the Application of SBC California (U 1001 C) for a Surcharge and a Balancing Account to Recover Undergrounding Costs in the City of San Diego.

Application 05-03-005  
(Filed March 3, 2005)

**OPINION AUTHORIZING MODIFIED SURCHARGE TO RECOVER COSTS OF UNDERGROUNDING AERIAL TELEPHONE LINES**

**I. Summary**

In this decision, we grant the request of Pacific Bell Telephone Company, doing business as SBC California (SBC)<sup>1</sup> for a surcharge to recover the costs of undergrounding its aerial telephone lines in San Diego. We adopt SBC's proposed fixed amount rate design for the surcharge, but limit this authorization in light of our decision eliminating SBC's retail price regulation.

**II. Background**

In January 2001, the City of San Diego (City) adopted its Underground Utilities Procedural Ordinance to provide for the expedited undergrounding of overhead utility wires within the city limits. The City's goal is to underground all currently overhead utility lines in 20 years. To accomplish this goal, the City must quadruple the current rate at which utility lines are undergrounded.

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<sup>1</sup> Now known as AT&T California, Inc.

This Commission has adopted comprehensive, statewide rules that govern when and where a utility may remove overhead lines and replace them with underground service, and whether such costs will be recovered through rates. These rules are set forth in Tariff Rule 32 for SBC and Tariff Rule 20 for San Diego Gas and Electric Company (SDG&E). To accommodate the City's ordinance, SDG&E sought Commission authorization to deviate from Tariff Rule 20. In Resolution E-3788, the Commission granted both SDG&E and SBC permission to deviate from their respective tariffs and comply with the City's ordinance.

To finance SDG&E's portion of the undergrounding project, the City and SDG&E entered into an agreement whereby the franchise fee SDG&E pays to the City would increase from 1.9% of gross revenues to 5.78%. Ninety percent of the increased funds would be used by the City to pay for the undergrounding. The Commission also authorized SDG&E to increase the City's franchise fee surcharge to all City customers to reflect the increased fee, and directed SBC to file an application to seek permission to recover its increased undergrounding costs from City customers.

On March 3, 2005, SBC filed this application to approve a surcharge and balancing account to track and recover its costs for the City undergrounding project. SBC estimated that the total cost of the San Diego undergrounding project would be \$125 million and that the project would extend over 17 years. SBC requested an initial surcharge of \$0.94 per customer line per month, to be adjusted annually via the balancing account.

On April 7, 2005, the Utility Consumers' Action Network (UCAN) protested the application, arguing that undergrounding costs are before the Commission in the undergrounding rulemaking (Rulemaking 00-01-005). UCAN

also found SBC's cost estimates to be "shockingly high" and suggested that the proposed cost recovery might violate the New Regulatory Framework under which the Commission regulates SBC's rates.

On April 18, 2005, the Division of Ratepayer Advocates (DRA) filed a motion requesting permission to late-file its protest to this application, which was granted on May 3, 2005. DRA also challenged the requested relief as violating New Regulatory Framework principles.

Telscape Communications, Inc. (Telscape), XO Communications, Inc., MPower Communications Corp., and the California Association of Competitive Telephone Companies also protested the application.

DRA and a coalition of the competitive carriers filed motions to dismiss the application, contending that it violated both federal law and the New Regulatory Framework under which this Commission regulates SBC. SBC and the City opposed the motions. On May 24, 2005, the assigned Administrative Law Judge (ALJ) convened a prehearing conference and set a procedural schedule to resolve the motions to dismiss. The Commission denied the motions to dismiss in Decision (D.) 05-10-028.

The assigned ALJ convened a second prehearing conference on December 5, 2005, and set a procedural schedule to address the merits of the application. After completing discovery, the parties distributed written direct testimony. Evidentiary hearings were held on May 15 and 16, 2006. The parties filed opening briefs on June 16, 2006, and the proceeding was submitted for Commission consideration with the filing of closing briefs on July 7, 2006.

### **III. Commission Decision Eliminating Regulation of SBC Retail Prices**

On August 30, 2006, the Commission adopted Decision (D.) 06-08-030 which substantially changed rate regulation for California's largest incumbent local exchange carriers, including SBC, by adopting a Uniform Regulatory Framework. With the objective of symmetrically regulating all providers of local exchange service, the decision eliminated all retail price regulations for all business services. Retail price regulation for residential service, with the exception of basic service, was also eliminated. The existing price caps on basic residential service will remain in place until January 1, 2009, after which SBC will have unlimited authority to set prices for basic residential service. Geographically averaged residential basic service rates will no longer be required. The Commission's decision also recognized two on-going proceedings that will address basic residential service provided pursuant to the Commission's low income program, Lifeline, and California High Cost Fund B subsidized service.

The decision also relaxed the procedural requirements for the largest incumbent local exchange carriers when offering new services and filing tariffs. SBC can now provide new services with full pricing flexibility with an advice letter effective one day after filing. The carriers were also authorized to allow all tariffs to go into effect on a one-day filing, but any tariffs that impose price increases or service restrictions require a 30-day advance notice to all affected customers.

#### **IV. Positions of the Parties**

##### **A. SBC**

SBC did not prepare a detailed cost forecast based on its own costs but instead relied on the historical relationship of its undergrounding costs to SDG&E's costs.<sup>2</sup> SBC's costs have historically been about 23% of SDG&E's, so SBC applied the 23% factor to SDG&E's cost forecast for 2007 through 2023 to obtain the annual forecasted cost for SBC.

SBC proposed a flat fee rate design for its surcharge to recover the cost of the San Diego undergrounding project. SBC calculated the fixed amount surcharge per customer line by dividing the total annual forecasted cost by the average number of access lines in service in San Diego, 657,000 lines. (This amount includes all lines served by SBC and other local exchange carriers.) The result is the annual amount which must be recovered from each access line. The monthly surcharge per line is determined by dividing the annual total by 12, which SBC calculated to be \$0.77 for 2007 and \$1.51 for 2008. The remaining years showed a forecasted surcharge of about \$0.90 per month per line.

SBC proposed to apply this surcharge to all customer access lines it serves directly, as well as all lines SBC provides to competitive local exchange carriers for resale to San Diego end users.

SBC did not exempt from the surcharge low-income customers eligible for discounted local exchange service in the Lifeline program. SBC stated it had no information on the number of low-income program participants taking service from the competitive local exchange carriers, and thus no practical way to reflect

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<sup>2</sup> Aerial telephone and electricity lines are often undergrounded simultaneously so SBC and SDG&E have a long history of joint undergrounding projects.

any such customer exemptions in calculating the surcharge. Because it could not exempt competitive local exchange carriers' low-income customers, SBC did not propose to exempt its low-income customers from the surcharge.

The City supported SBC's proposal.

### **B. UCAN**

UCAN contended that SBC's proposal was anti-consumer and anti-competitive. UCAN stated that SBC's fixed monthly fee proposal was regressive because it would disproportionately impact low- and fixed-income customers, who often have few competitive choices. In contrast, the benefits of undergrounding will accrue disproportionately to homeowners, as property values rise due to improved appearance. UCAN further contended that SBC would be able to cross-subsidize its competitive service offerings by recovering the cost of network enhancements through the undergrounding surcharge on regulated services.

### **C. Telscape**

Telscape opposed SBC's proposal to assess the undergrounding surcharge on Lifeline customers. Telscape explained that SBC's surcharge would amount to a 20% increase in Lifeline rates for local residential service, with no offsetting benefits. Telscape recommended that Lifeline customers be exempt from the surcharge and that the City should make up the shortfall in undergrounding costs.

Telscape also asked that the Commission modify SBC's surcharge by excluding costs where SBC is installing additional capacity, apportion costs to the unused capacity, allocate costs based on use of the system, require pro-rating of the surcharge for partial months, and allow for chargeback of any uncollectible surcharge revenues.

**D. XO Communications Services, Inc.**

XO also opposed SBC's application and argued that "the Commission's jurisdiction and authority are being eroded and undermined by the City's attempt to force [SBC] to act as its collection agent to recover the costs of the undergrounding program."

Specifically, XO contended that the Commission has set up a statewide program for undergrounding, balancing the costs and benefits. Granting SBC's requested surcharge would encourage other cities to by-pass the Commission's program, adopt similar ordinances, and expect the Commission to order surcharges to recover the costs. Furthermore, XO continued, Commission-approved Lifeline rates will be increased by approximately 30% due to the undergrounding surcharge, in derogation of the Commission's determination of the appropriate rate for low-income customers. XO concluded that SBC's proposal was also anticompetitive because certain of SBC's customers that take service pursuant to contracts, rather than tariffs, will not be assessed the surcharge.

XO also stated that SBC was already recovering the costs of undergrounding through its existing rates, as approved by this Commission in the New Regulatory Framework, and in the setting of prices for unbundled network elements, which are purchased by competitive local carriers, such as XO. The surcharge represents a double-counting of these costs.

Finally, the detailed auditing necessary to ensure that SBC does not improperly charge unrelated costs to the surcharge balancing account is impractical due to expense and oversight needed.

### **E. Division of Ratepayer Advocates**

DRA opposed the surcharge as being inconsistent with the New Regulatory Framework which set SBC's prices to include the cost of undergrounding. DRA also opposed the notion of a fixed or per line surcharge as being unprecedented at this Commission, and advocated that Lifeline program participants be exempt from the surcharge.

If the Commission were to adopt a surcharge, DRA recommended that it be proportionally assessed to all SBC customers based on total purchases from SBC and all its affiliates. DRA's proposed to allocate costs between Commission-jurisdictional services and other services, e.g., based on total billed amounts in San Diego. The surcharge on jurisdictional services would be set to recover a share of total undergrounding costs calculated by the proportion of jurisdictional sales in San Diego to total sales. SBC would have discretion to recover the remaining costs, i.e., the nonjurisdictional fraction, from its nonjurisdictional customers. DRA pointed to the Commission's Reimbursement Fee, which applies a surcharge of 0.11% to all jurisdictional revenue, as an example of the surcharges on which its proposal was modeled.

Finally, DRA objected to SBC's cost forecasts as being "far higher than publicly available data of actual expenditures." DRA supported a "monitoring and audit program equivalent to that applied to SDG&E."

### **V. Discussion**

The applicant, SBC, bears the burden of proving that its proposed surcharge is "justified." Pursuant to Pub. Util. Code § 454(a), prior to implementing the surcharge, SBC must make a "showing before the Commission," and, based on that showing, the Commission must find that the surcharge is "justified."

As discussed in detail below, we find SBC's showing on the forecasted costs to be scant; we therefore adopt limitations and oversight modeled on those applied to SDG&E.

The most significant change to SBC's proposal, however, occurs due to this Commission's intervening decision to adopt the Uniform Regulatory Framework. As discussed below and pointed out in several parties' comments, SBC's pricing freedom after January 1, 2009, obviates the need for this Commission to authorize the surcharge.

Prior to considering the specifics of SBC's proposal, however, we address the issue of our statewide plan for undergrounding utility lines and future applications similar to SBC's.

#### **A. The Commission's Undergrounding Program**

As discussed above, the Commission has adopted a long-standing program to determine an undergrounding program, in concert with the affected electric and telephone utilities. In Rulemaking 00-01-005, the Commission acted on Legislative directive (AB 1149) by studying ways to amend, revise, and improve rules for the conversion of existing overhead electric and communications lines to underground. The legislation required that the Commission study ways to: 1) eliminate barriers to undergrounding and to prevent uneven patches of overhead facilities; 2) enhance public safety; 3) improve reliability; and 4) provide more flexibility and control to local governments. The Commission issued an interim decision in that proceeding, D.01-12-009, which expanded the use of the existing program, and set several contentious issues for a subsequent Phase 2. That Phase has not yet been completed.

The parties in this proceeding raised policy issues regarding the wisdom of the Commission allowing its general ratemaking authority to be used by the City as a mechanism to collect the costs of undergrounding utility lines.

Undergrounding utility lines is extremely expensive. With the proposed surcharge, San Diego residents will be paying an extra \$4 per month in utility charges (\$3 to SDG&E and \$1 to SBC), on top of any other price increases. The Commission has historically shouldered the burden of balancing the costs of undergrounding with the benefits in adopting uniform statewide policies. With today's decision and Resolution E-3788, this Commission has allowed the City to effectively short-circuit the long-standing plan.

Extraordinary and unique events led to today's decision. Most significantly, the SDG&E franchise fee increase has been in place for some time and actual work on this project has commenced. On balance, the totality of the circumstances supports going forward with this surcharge despite its inconsistency with the statewide plan. We direct our staff to advise any utilities seeking such measures, either as surcharges or increases in franchise fees, that the statewide plan controls utility undergrounding.

### **B. Uniform Regulatory Framework and Pricing Flexibility**

As discussed above, the Commission has now lifted any limitations on the prices SBC charges for its telecommunications services, with the exception of residential basic local service, which is scheduled for pricing freedom on January 1, 2009. Accordingly, after that date, Commission authorization for a surcharge, such as that proposed in SBC's application, will no longer be necessary. At that time, SBC will have the authority to adopt any surcharge it deems necessary. Several parties objected to extending SBC's surcharge

authorization beyond the scheduled January 1, 2009, date for complete pricing flexibility because the authorization would be superfluous in light of D.06-08-030.

We agree. In adopting the Uniform Regulatory Framework, we concluded that customers are best served when market forces, rather than Commission-required cost-of-service studies, set the prices paid by customers. Consistent with that decision, we will decline to retain this cost-based surcharge beyond the date SBC obtains full pricing freedom, currently scheduled for January 1, 2009.

### **C. Cost Forecasts**

SBC provided no forecasts based on its actual costs in support of its proposed surcharge. Instead, SBC witness Kieren derived SBC's cost forecast from SDG&E's forecast of its cost to underground its facilities in the same areas. SDG&E estimated \$28.3 million for 2007, \$51.8 million for 2008, and \$31 million for each year thereafter until 2023. SBC multiplied SDG&E's annual amount by 0.23, which is the historical ratio of SBC's to SDG&E's costs. SBC's annual amount was then divided by 657,000 lines, which is the current average number of access lines in service in San Diego. Finally, the result was divided by 12 to arrive at a forecasted monthly per line surcharge.

SBC proposed to use a balancing account to track actual labor and expense costs associated with undergrounding and to adjust the surcharge up or down as needed. The surcharge would also be adjusted to reflect changes in the number of access lines in San Diego. The collected surcharge funds would be held in an interest bearing account.

In short, SBC's surcharge proposal, which is contemplated to collect over \$125 million, is derived from three numbers obtained from SDG&E – cost estimates for 2007, 2008, and \$31 million for each year thereafter. Other than

elementary mathematical manipulation, SBC added nothing to SDG&E's forecasts.

SBC, however, is not in any way bound to the cost forecasts. SBC proposed to recover its actual costs over the 17-year project by recording those costs in a balancing account and then setting the surcharge to recover that amount. After setting the initial surcharge, which will be subject to true up to actuals, the cost forecasts will be irrelevant.

Accordingly, the key elements of SBC's proposal are the recording of actual costs and the balancing account to ensure full recovery. These two elements work together to allow SBC a direct path from recorded costs to customers' bills.

SBC proposes to send an annual report to the Director of the Commission's Telecommunications Division to "allow the Commission to track and validate the cost associated with the project and the correctness of the surcharge amount."

XO witness Knowles was skeptical that SBC's promised annual reports would be sufficient to allow the type of detailed auditing required for this \$125 million, 17-year project. Knowles testified that SBC could be tempted to load up the undergrounding surcharge account "with all manner of oversight, management, supervision, systems development and general costs." Annual reports with very little detail will not be sufficient to thwart this temptation.

We agree. SBC's proposed virtually no oversight of costs that might be recorded in the balancing account, and the surcharge will enable SBC to recover the recorded amounts directly from customers. Detailed auditing and oversight, however, would require a commitment of significant Commission and SBC resources.

As an alternative, we find that the historic ratio of SBC's and SDG&E's undergrounding costs provides a convenient point of reference for evaluating future costs. To the extent SBC's future costs exceed this historic ratio, we will impose enhanced oversight obligations on SBC.

If, as XO fears, SBC allocates unrelated costs to the San Diego undergrounding project, then SBC's costs would be expected to exceed 23% of SDG&E's. Such an increase would be a signal to the Commission, and the parties, that greater scrutiny of the cost allocations is required. On the other hand, if the historical ratio remains stable in the future, then the Commission would have some evidence that SBC is not allocating unrelated costs to the San Diego undergrounding program.

Therefore, to the extent SBC's costs do not exceed 23% of SDG&E's costs in any calendar year, SBC will be required to submit a semi-annual report to the Telecommunications Division Director showing the status of the project, items recorded in the balancing account, and surcharge calculations. Supporting detail should also be available. SBC's semi-annual reports shall be filed contemporaneously with SDG&E's similar reports to the Energy Division. Each report shall show the ratio between SBC's and SDG&E's costs. The surcharge shall be recalculated annually via advice letter filing, with supporting workpapers.

Heightened review will be required should SBC's undergrounding costs exceed 23% of SDG&E's costs for the areas included in a particular semi-annual report. A semi-annual report with such a showing should be submitted to the Executive Director, who shall investigate the cause. Unless the amount by which the 23% has been exceeded is: 1) immaterial or 2) readily explained by easily verified facts, the Executive Director shall authorize an audit of SBC's balancing

account.<sup>3</sup> The audit will be funded by SBC, with the total costs of the audit not to exceed 1% of total costs proposed to be recorded in the balancing account that year. Until the cost allocation issues have been resolved, no changes will be made in the surcharge.

Pursuant to the Uniform Regulatory Framework decision, SBC is scheduled to obtain full pricing freedom on January 1, 2009. As determined above, our authorization for this surcharge will expire at that time. The balancing account and audit rights will extend only for the authorized duration of the surcharge. No later than 90 days prior to the date SBC obtains full pricing freedom, SBC shall file and serve its final surcharge advice letter adjusting the surcharge to clear the amount in the balancing account by the date pricing freedom occurs.

Finally, in D.05-10-028, we directed the assigned Commissioner and ALJ to manage this proceeding to ensure that a full factual and legal record was created for our consideration on the issue of whether the undergrounding costs were included in SBC's New Regulatory Framework and network element revenue requirements. Allowing the same costs to be used as a basis for the surcharge would result in double-counting.

SBC's witness explained that SBC's undergrounding projects in San Diego which occur pursuant to SBC's tariff Rule 32 program will be segregated from the undergrounding projects required by the City's ordinance. SBC witness McDaniel testified that SBC will underground lines in San Diego simultaneously under both the tariff Rule 32 program and as required by the City's ordinance.

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<sup>3</sup> Such an audit may be performed by Commission auditors or outside vendors as deemed appropriate by the Director of the Telecommunications Division.

Because the tariff Rule 32 program requires detailed cost accounting, SBC will be required to separately record and track the costs associated with each program.

This explanation, coupled with the auditing requirement imposed above, is sufficient to resolve the issue from our earlier decision.

In conclusion, we will authorize SBC to establish a City of San Diego Surcharge for Underground Conversion Costs Balancing Account, and to record costs associated with undergrounding aerial telephone lines pursuant to the City of San Diego's undergrounding ordinance in the account.

#### **D. Applicability of the Surcharge**

SBC proposed to apply the fixed surcharge to each line issued to customers that subscribe to business and residential telephone service.<sup>4</sup> The parties took issue with SBC's proposal to exclude certain contracts from the surcharge unless the contracts allow for such charges. The parties also objected to SBC's proposal to include two types of customers - Lifeline and Wholesale Customers for two-wire voice grade UNE loops. Lifeline customers are participants in the Commission's program that provides basic telephone service at reduced rates to low-income customers. Wholesale customers that purchase two-wire voice grade UNE loops use that wholesale service to support their own local telephone service which they offer to end-user customers.

As analyzed below, our precedent requires that public policy surcharges, such as this, be applied to the widest possible customer base and that SBC has not presented a persuasive justification for excluding certain contracts from the

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<sup>4</sup> 1FR, 1MR, 1MB, Centrex, ISDN Basic, Business Lines and Trunks, California 900, Direct Connection, FEX Lines, FPS Lines, PSP/COPT, ISDN PRI, PBX (Retail and Resale classes), Residence (Flat, Measured, ADL, and Lifeline) and SDS56.

surcharge. Similarly, end users served by wholesale customers also should be subject to the surcharge. Based on our precedent, we do, however, exclude Lifeline service from the surcharge.

XO witness Knowles objected to SBC's plan to impose the proposed surcharge on lines served pursuant to certain<sup>5</sup> contracts "to the extent applicable contracts allow it." Knowles explained that SBC has not identified the number of customers or lines that might be included in this surcharge exemption, nor stated a rationale for treating these customers differently from similarly situated customers. Knowles concluded that excluding certain wholesale customers but not others, such as XO, constituted anticompetitive discrimination.

The Public Utilities Code requires that SBC justify its proposal to exclude customers from the surcharge. SBC's evidence on this point is limited to an assertion that customers will not be included where the "contract does not allow the surcharge to be applied." SBC has not provided for the record copies of any such contractual language, estimates of the numbers of lines to which this exemption would apply, nor any calculation of amount by which the surcharge will be increased to reflect these exemptions.

Our long-standing goal is to apply public policy surcharges to "the widest possible customer base." See, e.g., *Re Alternative Regulatory Frameworks for Local Exchange Carriers*, 56 CPUC 2d 117, 266 (D.94-09-065). SBC has proposed to exclude an unidentified share of the base from such a surcharge with only conclusory statements unsupported by record evidence. SBC has not provided

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<sup>5</sup> SBC's rebuttal testimony suggests that customers taking service pursuant to Local Wholesale Complete, Individual Case Basis, Express, and Government contracts may be exempted from the surcharge if contract "does not allow the surcharge to be applied."

sufficient justification for its decision to exclude any such pre-existing contracts from the surcharge, nor has SBC explained how it will prevent this class of exempted service from expanding. Therefore, we deny this portion of SBC's proposal and order SBC to impose the surcharge on lines served with SBC facilities in San Diego, whether provided pursuant to contract or tariff.

UCAN and DRA oppose SBC's proposal to apply its surcharge to all residential service lines participating in the Lifeline program. UCAN and DRA contend that this proposal is regressive and that SBC's rationale is not persuasive.

SBC concedes that it could easily exempt its own Lifeline customers from the surcharge. However, no means has been proposed or developed to exempt the Lifeline customers of the competitive local carriers from the surcharge. SBC concludes that, therefore, all Lifeline customers must be included in the surcharge.

We disagree. As discussed in more detail below, the Commission has created a number of public purpose programs which are funded by surcharges and Lifeline service<sup>6</sup> is exempt from these surcharges. See *Re Alternative Regulatory Frameworks for Local Exchange Carriers*, 56 CPUC 2d 117, 266 (D.94-09-065). These surcharges illustrate that the carriers have developed and implemented a means to exempt Lifeline service. We are confident that a similar mechanism can be created to exempt Lifeline customers from a set fee surcharge. If necessary, the carriers may seek guidance from our Telecommunications Division on the best means to exempt Lifeline customers from this surcharge. All

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<sup>6</sup> Any additional services purchased by the Lifeline customer are subject to the surcharges.

Lifeline service, whether provided by SBC or a competitive local carrier, will be exempt from the surcharge.

A similar result occurs with regard to Telscape's and XO's continuing objection to applying the surcharge to SBC lines leased to competitive local exchange carriers. These carriers calculate and collect the surcharges listed below from their customers. A similar process should be adopted for this much simpler, fixed amount surcharge.

### **E. Rate Design of Surcharge**

SBC stated that a flat rate surcharge more appropriately reflects the costs and benefits of undergrounding aerial telephone lines. The costs are driven by the number of wire pairs that must be placed underground. Each pair costs the same to underground regardless of the amount of telephone services provided over the line. The benefits of undergrounding, which the City describes as primarily aesthetic, are shared equally by each resident, again regardless of the amount of telephone services provided.

As set out above, UCAN and DRA objected to the fixed amount surcharge as being regressive and unprecedented by this Commission.

SBC did not challenge the "regressive" characterization, but in its reply brief did cite to two Commission-approved fixed amount surcharges. The cited surcharges - one cent per year for number portability surcharge and 25 cents per month for payphones - are both *de minimus* amounts adopted as fixed surcharges primarily for administrative convenience, not after a thorough analysis of the Commission's policy against regressive surcharges. See *Re Competitive for Local Exchange Service*, 83 CPUC 2d 408 (D.98-12-044) (adopting one cent per year number portability surcharge because "the actual computed surcharge is less than one cent per line and fractions of a cent cannot be collected from

customers.”), and *Re Statewide Expansion of Public Policy Pay Telephones*, 83 CPUC 2d 41, 50-52 (D.98-11-029) (noting that pursuant to a settlement agreement, payphone providers pay the surcharge, rather than the Commission adopting a “broad based public service funding method.”)

The surcharge SBC proposes requires just such a broad based public service funding method. The Commission’s typical rate design for this type of surcharge is a percentage of intrastate revenue.

The Commission has adopted surcharges on intrastate revenues for the following public policy programs:

<b>Program</b>	<b>Surcharge</b>	<b>Purpose</b>
Lifeline	1.29%	Provide reduced rate service to low-income customers
California Relay Service and Communications Devices Fund	0.27%	Provide equipment and relay service to deaf and disabled customers
CPUC User Fee	0.11%	Provide funding for Commission operations
High Cost Fund A	0.21%	Provide subsidy for geographically expensive areas (small carriers)
High Cost Fund B	2.00%	Provide subsidy for geographically expensive areas (large carriers)
California Teleconnect Fund	0.13%	Provide discounted telecommunications service to schools, libraries, and medical clinics

Each competitive and incumbent local exchange carrier in California must assess these surcharges on all intrastate revenues, and remit the collected funds to the Commission. See, e.g., *Application of Transcend Multimedia, LLC for a Certificate of Public Convenience and Necessity to Operate as a Provider of Resold*

*Local Exchange Telecommunications Service Within the State of California*, D.06-07-009 (July 20, 2006).

As set forth above, our authorization for this proposed surcharge will no longer be necessary when SBC obtains full pricing flexibility, currently scheduled for January 1, 2009. Thus, the proposed surcharge is scheduled to be in place for about two years. In its comments on the Proposed Decision, SBC specified the administrative burdens created by a surcharge based on intrastate revenue. With the limited duration of the surcharge, we conclude that that these administrative burdens outweigh the need to conform to our precedent.

In conclusion, we will authorize SBC to assess the City of San Diego Surcharge for Underground Conversion Costs as a fixed amount on all local exchange customers served by SBC or with facilities leased from SBC, with the exception of Lifeline service. The surcharge shall be calculated annually, and SBC shall file an advice letter setting forth its calculations with supporting documentation. SBC's final surcharge advice letter shall be filed and served no later than 90 days before SBC obtains full pricing freedom.

## **VI. Comments on Proposed Decision**

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311 and Rule 14.2(a) of the Rules of Practice and Procedure. Comments were filed November 20, 2006, by DRA, SBC, City of San Diego, XO Communications, and Telscape. At the request of SBC, the due date for Reply Comments was reset to December 1, 2006, and SBC, DRA, City of San Diego, XO Communications, and the California Cable and Telecommunications Association filed Reply Comments. In addition, Cox California Telcom, LLC dba Cox Communications, Time Warner Telecom

Company, and Time Warner Cable Information Services filed a motion to intervene<sup>7</sup> and with attached comments.

SBC opposed a surcharge based on a percentage of intrastate revenue, and explained the administrative burdens associated with calculating and collecting such a surcharge on its wholesale customers. A flat-rate surcharge, as proposed by SBC, did not create these burdens. SBC also opposed excluding Lifeline customers from the surcharge and including certain customers that take service pursuant to contracts. Finally, SBC requested that the Commission adopt a mechanism to assess the costs of an audit to the Commission, under certain circumstances.

The City of San Diego requested that SBC be allowed to apportion and recover its customers from eligible customers, and that timelines be adopted for implementing the surcharge.

DRA argued that there was “no basis” for the Commission to authorize SBC’s requested surcharge for the next 17 years because the Commission deregulated the prices SBC charges in D.06-08-030. DRA contended that the proposed surcharge would “effectively place the Commission back in the role of regulating [SBC’s] rates.”

XO sought clarification of the surcharge mechanism for competitive local exchange carriers and provided a detailed set of recommended changes to the Proposed Decision. Xo also pointed out that D.06-08-030 granted SBC the power to “raise its retail rates in San Diego . . . by as much as it wishes.”

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<sup>7</sup> No party opposed the motion and it is granted.

Telscape argued that SBC's request for Commission authorization to impose a surcharge on its San Diego customers, other than basic residential service, was "now unnecessary" due to D.06-08-030. Telscape contended that the Commission has opted to rely on market forces to ensure just and reasonable rates rather than rate regulation as set out in the Proposed Decision. Telscape also requested that SBC's wholesale contracts be exempt from the surcharge to prevent double collection. Finally, Telscape stated that the surcharge on unbundled network elements violated federal law.

In reply comments, SBC contended that D.06-08-030 did not obviate the need for Commission approval of the surcharge because that decision "froze" SBC's residential basic local service rates until January 1, 2009, and did not extend to the lines leased from SBC by its wholesale competitors. The City of San Diego argued that the decision was "not relevant to this proceeding." XO disputed SBC's contentions that the percentage surcharge was unworkable, and DRA urged the Commission to reject SBC's contention that excluding Lifeline customers was impracticable.

The California Cable and Telecommunications Association's reply comments and joint reply comments of Cox California Telcom, LLC, dba Cox Communications, Time Warner Telecom Company, and Time Warner Cable Information Services sought clarification that the surcharge would apply only to SBC customers, retail and wholesale, but not to other competitive local carriers providing service in San Diego using non-SBC facilities. The joint reply comments also supported XO's, Telscape's, and DRA's opening comments contending that "the proposed surcharge is unnecessary" and pointed out that SBC will have "complete pricing flexibility for all of its services for 15 out of the estimated 17 years that the surcharge will be in place." The joint reply comments

concluded that approving the surcharge would give SBC the best of “both worlds” with deregulated prices but a regulated surcharge.

In response to the comments and reply comments, the Proposed Decision was substantially revised to conform to Uniform Regulatory Framework adopted in D.06-08-030. As set forth above, Commission authorization for the surcharge is not necessary after full pricing flexibility is implemented, currently scheduled for January 1, 2009, and we have limited our authorization in today’s decision. As a now short-term Commission-authorized surcharge, we further concluded that SBC’s specified administrative burdens outweigh the need to conform to Commission precedent with a percentage of intrastate revenue surcharge. We will, therefore, authorize SBC to impose a flat fee surcharge on each line served with SBC facilities in San Diego until such time as SBC obtains full pricing flexibility, currently scheduled for January 1, 2009.

## **VII. Assignment of Proceeding**

Michael R. Peevey is the assigned Commissioner and Maribeth A. Bushey is the assigned ALJ in this proceeding.

## **Findings of Fact**

1. SBC did not prepare its own cost forecasts for the San Diego undergrounding project but rather relied on the historical ratio of its and SDG&E’s undergrounding costs, 23%, and SDG&E’s costs forecasts as the basis for its application.
2. The Commission has adopted a long-standing, detailed, and comprehensive program for undergrounding utility lines. Extraordinary and unique events support the deviations from that program set forth in this decision and Resolution E-3788.

3. SBC provided scant cost justification for its proposed surcharge, and key elements of the proposal are the recording of actual costs and balancing account recovery to ensure SBC full recovery of all recorded costs.

4. SBC proposed virtually no oversight on its cost records.

5. The historic undergrounding cost ratio between SBC and SDG&E provides a reasonable standard against which to initially assess the validity of SBC's costs. To the extent SBC's costs exceed 23% of SDG&E's, enhanced oversight is required.

6. SBC provided no analysis of the number of lines or customers that might be exempt from the proposed surcharge pursuant to contractual terms.

7. Long-standing Commission precedent exempts Lifeline service from public policy surcharges.

8. Competitive local carriers calculate and collect numerous public policy surcharges.

9. The Commission's typical rate design for public policy surcharges is a percentage of intrastate revenue; due to the short-term nature of the surcharge adopted in today's decision, the convenience of a fixed fee surcharge outweighs the administrative burdens of the typical surcharge rate design.

10. The Commission's Uniform Regulatory Framework Decision gives SBC pricing freedom for all services, except basic residential service, which is scheduled for January 1, 2009.

### **Conclusions of Law**

1. SBC bears the burden of proving that its proposed surcharge is justified.

2. SBC did not justify its proposal to exclude from the surcharge customers that take service pursuant to Local Wholesale Complete, Individual Case Basis, Express, and Government contracts. The City of San Diego Surcharge for

Underground Conversion Costs (Surcharge) should be modified to apply to all City customers, excluding Lifeline service.

3. So long as SBC's costs do not exceed 23% of SDG&E's costs for particular areas, SBC should be required to submit a semi-annual report to the Telecommunications Division Director showing the status of the project, items recorded in the balancing account, and Surcharge calculations. Supporting detail should also be available as required. SBC's semi-annual reports should be filed contemporaneously with SDG&E's similar reports to the Energy Division. Each report shall show the fractional relationship between SBC's and SDG&E's costs. The Surcharge shall be recalculated annually via advice letter filing, with supporting workpapers. SBC's final Surcharge calculation advice letter shall be filed and served no later than 90 days prior to the date SBC obtains full pricing freedom.

4. If SBC's San Diego undergrounding costs exceed 23% of SDG&E's costs in a particular semi-annual report, the Director of the Telecommunications Division shall investigate the cause. Unless the amount by which the 23% has been exceeded is: 1) immaterial or 2) readily explained by easily verified facts, the Director of the Telecommunications Division shall conduct an audit of SBC's balancing account either using Commission staff or outside vendors. The audit will be funded by SBC, with the total costs of the audit not to exceed 1% of total costs proposed to be recorded in the balancing account that year. Until the cost allocation issues have been resolved, no changes will be made in the Surcharge amount.

5. Due to the limited duration of the Surcharge, SBC has justified its proposed flat fee rate design as a deviation from our typical surcharge rate design.

6. SBC has not justified its proposal to subject Lifeline service to the City of San Diego Surcharge for Underground Conversion Costs. SBC's proposal should be modified to exclude Lifeline service.

7. Competitive local exchange carriers that provide local service in San Diego using SBC's facilities shall pay to SBC the Surcharge amount for each line served, and the competitive local exchange carriers may, in their sole discretion, assess and collect the Surcharge from their end user customers. Lines served pursuant to the Lifeline program shall be excluded from the line count subject to the Surcharge, and the competitive local exchange carriers shall work cooperatively with SBC to implement a reasonable methodology for tabulating the number of lines to be excluded. SBC shall provide the competitive local exchange carriers no less than 30 days' notice of the Surcharge amount.

8. The Uniform Regulatory Framework Decision, D.06-08-030, renders the authorization to impose the Surcharge unnecessary after SBC obtains full pricing freedom, currently scheduled for January 1, 2009.

9. As modified, SBC's proposed City of San Diego Surcharge for Underground Conversion Costs should be adopted. This authorization should expire on the date SBC obtains full pricing freedom.

10. SBC should provide written notice its customers of the termination of the surcharge authorized in today's decision, and should identify and explain any replacement funding mechanism.

11. This decision should be effective immediately.

## ORDER

### IT IS ORDERED that:

1. The application of Pacific Bell Telephone Company, known as SBC California (SBC) when this application was filed but now known as AT&T California, Inc., for a balancing account for costs associated with undergrounding aerial telephone facilities in San Diego pursuant to the City of San Diego Underground Utilities Procedural Ordinance and the San Diego Surcharge for Underground Conversion Costs (Surcharge) for the assessment of those costs to San Diego customers, is granted subject to the limitations set forth herein.

2. All local telephone service provided over SBC lines in San Diego shall be subject to the Surcharge, including SBC customers that take service pursuant to Local Wholesale Complete, Individual Case Basis, Express, and Government contracts. Local telephone customers that receive service from competitive local exchange carriers over SBC lines are also subject to the Surcharge. Lifeline customers of any provider are exempt from the Surcharge.

3. Competitive local exchange carriers that provide local service in San Diego using SBC's facilities shall pay to SBC the Surcharge for each line served, and the competitive local exchange carriers may, in their sole discretion, assess and collect the Surcharge from their end user customers. Lines served by a competitive local exchange carrier pursuant to the Lifeline program shall be excluded from the line count subject to the Surcharge, and the competitive local exchange carriers shall work cooperatively with SBC to implement a reasonable methodology for tabulating the number of lines to be excluded. SBC shall provide the competitive local exchange carriers no less than 30 days' notice of the Surcharge amount.

4. SBC shall submit a semi-annual report to the Director of the Telecommunications Division showing the status of the undergrounding project, items recorded in the balancing account, and Surcharge calculations. Supporting detail must also be provided as required. SBC's semi-annual reports should be filed contemporaneously with San Diego Gas & Electric Company's (SDG&E) similar reports to the Energy Division. Each SBC report shall show the fractional relationship between SBC's and SDG&E's costs for the lines included in the report. SBC's final Surcharge calculation advice letter shall be filed and served no later than 90 days prior to SBC obtaining full pricing freedom, currently scheduled for January 1, 2009.

5. The Surcharge shall be assessed as a fixed amount per line and separately stated on each customer bill. The Surcharge shall be recalculated annually via advice letter filing, with supporting workpapers, and shall be timed to coincide with one of the semi-annual report filings.

6. If SBC's San Diego undergrounding costs exceed 23% of SDG&E's costs in a particular semi-annual report, the Executive Director shall investigate the cause. Unless the amount by which the 23% has been exceeded is: 1) immaterial or 2) readily explained by easily verified facts, the Executive Director shall conduct an audit of SBC's balancing account either using Commission staff or outside vendors. The audit will be funded by SBC, with the total costs of the audit not to exceed 1% of total costs proposed to be recorded in the balancing account that year. Until the undergrounding cost allocation issues have been resolved, no changes will be made in the surcharge.

7. The Surcharge and balancing account authorization granted in today's decision shall expire on the date SBC obtains full pricing freedom, currently scheduled for January 1, 2009.

8. SBC shall provide written notice its customers of the termination of the surcharge authorized in today's decision, and shall identify and explain any replacement funding mechanism.

This order is effective today.

Dated December 14, 2006, at San Francisco, California.

MICHAEL R. PEEVEY  
President  
GEOFFREY F. BROWN  
DIAN M. GRUENEICH  
JOHN A. BOHN  
RACHELLE B. CHONG  
Commissioners