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Decision 00-12-032 December 7, 2000

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion into Competition for Local Exchange Service.	Rulemaking 95-04-043 (Filed April 26, 1995)
Order Instituting Investigation on the Commission's Own Motion into Competition for Local Exchange Service.	Investigation 95-04-044 (Filed April 26, 1995)

O P I N I O N

Summary

On May 3, 1999, Pacific Bell (Pacific) filed a motion seeking limited exogenous (LE) factor recovery of Commission-mandated educational costs incurred by Pacific to implement overlay area codes in various areas of California. Pacific claims these costs meet the criteria for Z-factor recovery established in Decision (D.) 94-06-011 and adopted for LE factor recovery in D.98-10-026. Pacific thus believes that LE factor recovery of overlay educational costs in each decision adopting an overlay education plan is warranted.

The Commission previously adopted decisions ordering carriers to implement overlay area codes in certain areas within California, including the 310 Numbering Plan Area (NPA), 714 NPA, 909 NPA, 408 NPA, 415 NPA, 510 NPA, and 650 NPA. In each of these decisions, the Commission mandated comprehensive public education programs (PEP) as a prerequisite to implementation of the overlay, based on the Commission's earlier holding that it

would require an appropriate customer education and awareness program prior to any introduction of an overlay.

The Commission directed its staff and an industry group to develop for each overlay area a proposed PEP for Commission review. The Commission contemplated issuing subsequent decisions to adopt an actual PEP and appropriate funding mechanism for each overlay.[1]

Parties' Positions

Pacific seeks authority to recover its costs for PEPs from ratepayers through the LE factor recovery mechanism. The LE factor mechanism was authorized in D.98-10-026 in which the Commission eliminated further Z-factor recovery but allowed Pacific and GTE California, Inc. (GTEC)[2] to continue recovery of certain types of cost changes resulting from matters mandated by the Commission. The Commission called this type of recovery an LE factor adjustment, and stated that the LE factor adjustment should be authorized by the Commission in the decision authorizing the program or event causing the cost change. Pacific and GTEC were authorized to make requests for such treatment by advice letter filed on October 1 each year. The Commission designated this the LE factor mechanism. (D.98-10-026, p. 61.)

In establishing the new LE factor mechanism, the Commission retained the same nine criteria that had been developed and adopted for Z-factor recovery in D.94-06-011. These criteria are: (1) the event creating the cost at issue must be

[1] The Commission subsequently suspended the 310/424 NPA overlay by D.99-09-067, and suspended all remaining previously approved overlay plans by D.99-12-051. PEP implementation was likewise suspended.

[2] Subsequent to the date of filings, GTEC changed its name to Verizon California. For purposes of this decision, the company is identified by its prior name.

exogenous; (2) the event causing the cost must occur after the new regulatory framework (NRF) was adopted in late 1989; (3) the cost is clearly beyond management control; (4) the cost is not a normal cost of doing business, even if it is increased by an exogenous event; (5) the event has a disproportionate impact on local exchange carriers; (6) the cost is caused by the event reflected in the economy-wide inflation factor (GDPPI) used in the annual NRF price cap proceeding; (7) the event has a major impact on the utility's overall cost; (8) actual costs can be used to measure the financial impact of the event, or the costs can be determined with reasonable certainty and minimal controversy; and (9) the proposed costs are reasonable.

Pacific claims its costs for PEPs to be performed meet the criteria for recovery specified in D.94-06-011. Pacific claims the event creating these costs is exogenous since the Commission mandated implementation of the PEPs in D.96-12-086 in every NPA in which an overlay was to be implemented.

Since the Commission orders the specific activities included in the PEP and adopts budget levels for those activities, Pacific claims its management has no control over the costs for these activities. Moreover, Pacific claims these costs are not normal costs of doing business, but are new costs occasioned by the need to implement Commission-mandated area code overlays.

Pacific claims PEP costs impact local exchange carriers disproportionately. In defining the criterion of "disproportionate impact," the Commission stressed that the criterion was meant to preclude "double-counting between Z-factor adjustments and the inflation index."[3] In other words, the event causing the costs should not affect all businesses in the economy in the same manner or

[3] D.94-06-011, 55 CPUC2d at 39.

proportionately. Pacific claims that the PEP costs impact only telecommunications carriers providing service within the area covered by the overlay, and that no other businesses bear these educational costs. Similarly, Pacific believes the requirement that the cost not be reflected in the economy-wide inflation factor is satisfied. As stated above, since telecommunications providers in the area affected by the overlay are the only companies that experience these PEP costs, Pacific argues, these could have no measurable effect on GDPPI.

Pacific requests LE factor recovery for two types of PEP costs. "Group 1" costs are those that, for example, in the 310 overlay, were to be paid for by all code holders in the NPA in proportion to the number of NXX codes they held—costs for items such as public service announcements on broadcast television. "Group 2" costs were costs incurred by Pacific for items such as bill inserts and informational letters to customers, and were not part of the costs to be paid proportionately by all code holders. In its motion, Pacific offers to pay all Group 1 costs incurred for the 408 area code PEP and in other NPAs in the future if it is guaranteed recovery of these costs as an LE factor.

For the 310 overlay, the total for both groups of PEP costs incurred by Pacific equaled approximately $789,000.[4] Pacific argues that similar costs will be

[4] For the 310 overlay, Pacific paid only a portion of the Group 1 PEP costs based on the number of NXX codes it holds in that area. For that overlay, the Commission approved Group 1 costs of $257,715, of which Pacific's portion was about $103,000. In addition, Pacific states it has been required to spend approximately $236,000 more than the amount originally authorized by the Commission (for Commission-mandated newspaper and radio advertising) to ensure that the PEP was implemented as ordered by the Commission. Pacific also seeks LE recovery of this extra $236,000. Other code holders also paid a portion of the costs based on the number of NXX codes they each hold in that area (D.98-12-081, p. 21 (Ordering Paragraph 9).)

incurred for any other overlays ordered by the Commission, resulting in a major impact on Pacific's overall costs.

Pacific proposes to keep records of its actual expenditures to carry out the PEPs according to the Commission's specifications. Each year, Pacific proposes to include with its annual Price Cap filing the amount of actual PEP costs incurred during the year. Pacific asks that the Commission, in its decision on the Price Cap filing, include recovery of those actual PEP costs.

Other Parties' Positions

On May 18, 1999, responses to Pacific's motion were filed by GTEC; Allied Personal Communications Industry Association of California; The Utility Reform Network; AT&T Communications, Inc.; Sprint Communications Company, L.P.; MCI Worldcom; the California Cable Television Association; and the Office of Ratepayer Advocates (ORA). ORA filed a separate motion for an order to deny LE factor recovery for PEP costs. In addition to the parties noted above, the cities of Glendale and Burbank and Roseville Telephone Company (Roseville) responded to ORA's motion.

On June 3, 1999, Pacific filed a reply to the responses to its motion as well as to the separate motion of ORA. ORA filed a reply to the responses of Pacific and Roseville on June 21, 1999.

GTEC supports Pacific's request in its entirety. GTEC also asks the Commission to allow it similar recovery for Group 2 costs incurred by GTEC related to PEP-ordered educational programs. Should the Commission decline to grant Pacific's request to recover all of the Group 1 costs, GTEC would ask the Commission to return to the original order by the Commission (i.e., allocation to carriers based upon their number of NXX codes in the subject NPA) and allow

GTEC to recovery its allocated share of the Group 1 costs as an LE adjustment in its annual Price Cap filing.

Roseville notes that the Commission has already opened a proceeding to review Roseville's NRF, including the criteria for recovery of costs by the Z-factor mechanism. (A.99-03-025, filed March 8, 1999.) On May 19, 1999, Assigned Commissioner Neeper issued a ruling and scoping memo in this proceeding identifying changes to the Z-factor criteria applicable to Roseville as an issue to be considered. Roseville argues that this would be the proper place for ORA to raise its recommendation regarding recovery of overlay education costs by Roseville. To the extent ORA wishes to address Roseville's recovery of overlay public education costs, Roseville proposes that ORA submit its proposal as part of its recommendations in Roseville's NRF review proceeding.

ORA argues that any LE factor treatment transferring costs of overlays from telecommunications carriers to ratepayers would violate the express language of the Telecommunications Act of 1996 which states:

> "The cost of establishing telecommunications numbering administration arrangements . . . shall be borne by all telecommunications carriers on a competitively neutral basis as determined by the Commission [the FCC]." (See, 47 U.S.C. § 251(e)(2) (emphasis added).)

ORA argues that because the cost of implementing overlays is part of establishing telecommunications numbering administration arrangements, the cost of implementing overlays within California must be borne by telecommunications carriers, not ratepayers.

ORA further denies that the PEP costs satisfy the LE factor criteria for recovery.

ORA asserts that, in D.98-10-026 issued October 8, 1998, the Commission established two narrow areas for LE factor recovery: (1) matters mandated by

the Commission, and (2) changes in total intrastate cost recovery resulting from changes between federal and state jurisdictions. (*Id.* at p. 61.) The Commission further limited this allowance to costs for which LE factor treatment is authorized in the underlying Commission decision. (*Id.*) In the instance of educational costs associated with the implementation of overlays in California, the Commission did not provide for LE treatment of those costs in its underlying decision mandating the 310 NPA PEP. (See, D.98-12-081, issued December 17, 1998.) The Commission issued this decision two months after D.98-10-026. ORA thus argues that by the terms of D.98-10-026, the educational costs associated with implementing an overlay in the 310 NPA are not eligible for LE factor treatment.

Parties representing competitive local carriers (CLCs) generally oppose Pacific's LE factor recovery proposal, arguing that it fails to meet all of the criteria prescribed in D.98-10-026. Particularly, parties argue that the costs are not exogenous, do not disproportionately impact Pacific, and are a normal cost of doing business. Parties also point out that the PEP costs were not authorized for LE factor recovery in the underlying decision authorizing the PEP. Parties further argue that granting LE factor recovery would be anticompetitive since it would allow Pacific to recoup its share of "Group 1" costs from ratepayers while CLCs and wireless carriers would likely have to absorb their share of such PEP costs. Various CLC parties believe that if Pacific picked up other carriers' share of PEP "Group 1" costs as well through the LE factor, it would neutralize such potentially anticompetitive impacts.

Discussion

We shall address both Pacific's motion and ORA's motion together since they both deal with the issue of LE factor recovery of PEP costs. We grant ORA’s

motion to deny these requests. We deny Pacific's and GTEC's requests for LE factor recovery of PEP costs. Pacific has failed to show that the PEP expenditures meet the criteria for LE factor recovery. We find the opposing parties' arguments persuasive as to why denial of LE factor recovery is appropriate. As stated in D.98-10-026, the LE factor is to be limited to those costs for which LE factor treatment is explicitly authorized in the underlying decision. In the case of the 310 NPA PEP, the underlying decision authorizing the program was D.98-12-081. Yet, in that decision, we did not authorize LE factor recovery for PEP costs. Thus, a key eligibility criterion for LE factor recovery for the 310 NPA PEP has not been satisfied.

In its comments to the ALJ's Draft Decision, Pacific argues that it should not be held to this "technical requirement" since the LE factor rules had not yet even been adopted when the PEP for the 310 NPA was provisionally adopted in July 1998. Moreover, D.98-10-026 (which adopted the LE factor recovery rules) was mailed only 17 days before the final PEP proposal for the 310 NPA was submitted to the Commission. Pacific thus argues that "it is not surprising" that the final PEP proposal submitted on October 30, 1998 did not address LE factor recovery.

Pacific also notes that this rationale for denying LE factor recovery would not apply to the PEP costs for the 408 NPA since the ILECs did state their intent to request LE factor recovery of PEP costs at the time the 408 PEP proposal was submitted. In D.99-07-009 in which the PEP for the 408 NPA was approved, the Commission stated that it would address the issue in a subsequent decision.

Notwithstanding Pacific's arguments, we still find that it had the opportunity to raise the issue of LE factor recovery for PEP costs in the 310 NPA at the time of the final submittal of the PEP on October 30, 1998. Pacific had been actively participating in the proceeding which established the LE factor

mechanism, and was duly informed of the requirements for LE factor recovery prior to the submission of the final PEP proposal at the end of October 1998. Yet, Pacific failed to meet this requirement.

We agree with Pacific that this rationale for denying LE factor recovery would not apply to the 408 NPA since the issue was timely raised in that instance. Yet, on other grounds, as described in this order, we find that other criteria for LE factor recovery have not been satisfied, thereby justifying denial of LE factor treatment for PEP costs for both the 310 and the 408 NPAs.

Another of the assumptions underlying Pacific's LE factor request was that PEP expenditures would be ongoing with the cumulative financial effect becoming significant over time. Yet, all previously approved overlay plans in addition to the 310 plan, have since been suspended pursuant to D.99-12-051.[5] Because of this, there will be no need for Pacific to incur ongoing PEP expenditures for additional overlay plans, as argued in its filing. With the suspension of the overlay plans, the extent of PEP expenditures are now limited to only funds already spent. There will be no cumulative growth of PEP costs for additional overlay plans the foreseeable future. Based on the limited amounts already spent on all PEPs for overlay plans throughout the state to date, the magnitude of costs absorbed by Pacific and GTEC will be much more limited than they originally anticipated. LE factor recovery is not justified given the limited duration that PEPs for overlay plans were in effect and the resulting limited financial sums involved.

[5] By D.99-12-051, we suspended the implementation of previously approved overlay plans for six NPAs to provide for the development of alternative number conservation measures and for the adoption of backup NPA relief plans based upon consideration of geographic splits.

We find Pacific's claim unpersuasive that the PEP costs meet the criteria established in D.94-06-011. We are not persuaded that the PEP costs are the result of an exogenous event. For the event to be exogenous, we would have to find that Pacific had no control over these costs. While it is true that the Commission mandated the PEP as a condition of an overlay and approved the PEP budget, Pacific had a significant degree of control over the PEP costs. Pacific has been among the strongest proponents of the overlay form of NPA relief. Pacific has strongly argued in favor of overlays while acknowledging that a mandatory PEP would be needed in order to prepare the public for the new dialing procedure. Pacific also had a major role with respect to the development of the proposed PEP budget that was submitted to the Commission both for the 310 and the 408 NPA overlays. Although the final budget was subject to Commission approval, Pacific exercised a significant role in developing the budget that was ultimately proposed for PEP expenditures. The development of the proposed budget called for many discretionary decisions concerning the level of effort that would be involved, and how extensively information concerning the overlay would be disseminated among the public interest groups.

In its comments on the ALJ's Draft Decision, Pacific argues that it lacked control over PEP expenditures because the Commission ultimately was responsible for approving the overlay and, consequently, for requiring a PEP to inform and educate the public concerning the overlay. Pacific's argument seems to be that if the Commission approves a utility program or authorizes a budgeted program cost, then the utility consequently has no management control over the related expenditures. Yet, the mere fact that the Commission issues a decision authorizing a budget for implementing a program does not determine whether an underlying cost is beyond management control.

The Commission-approved PEP budget included a number of program elements that were intended to inform and educate the public about the overlay. It remained within the management discretion of the utility to implement each program measure in the most efficient and cost-effective manner. For example, if money was budgeted for advertising or public service announcements about the overlay, it was within management discretion to do comparison shopping and to negotiate the most favorable terms with media sources consistent with maintaining quality control over the results. Guaranteeing LE-factor recovery of PEP expenditures would defeat the purpose of NRF which was to preserve the utility's incentive to manage costs by holding the utility financially responsible for the outcome of its management actions.

The PEP costs have not had a disproportionate impact on Pacific. In developing the allocation of PEP costs among industry participants for the 310 NPA, we specifically required that the cost obligation be directly proportional to the number of NXX codes each carrier holds within the overlay NPA. Thus, while the aggregate percentage of costs absorbed by Pacific may exceed that of other carriers, Pacific also has a greater share of NXX codes as compared to other carriers. Consequently, there is no disproportionate impact in relation to other carriers in terms of the cost per NXX code.[6] Thus, Pacific fails to satisfy another requirement for LE factor recovery as stated in D.98-10-026:

> "Moreover, in considering whether the costs will be allowed, we will consider whether the cost is unique to Pacific and/or GTE, or

[6] Although Pacific and GTEC provided temporary up-front funding of the "shared-industry" costs of the PEP, D.99-09-021 provided a process whereby the ILECs are to be reimbursed by other carriers.

> is a cost generally borne uniformly by all carriers in the industry."

Without going through each of the remaining prescribed criteria for the Z-factor, we conclude that Pacific's failure to satisfy those criteria discussed above is sufficient to justify a denial of its request for LE factor recovery of PEP costs for each of the NPAs for which such costs have been incurred. For similar reasons, we deny LE factor recovery for GTEC.

Comments on Draft Decision

The draft decision of the Administrative Law Judge in this matter was mailed to the parties in accordance with Public Utilities Code § 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure. Comments were filed by Pacific on November 27, 2000, and reply comments were filed jointly by ORA and The Utility Reform Network on December 4, 2000. We have taken parties' comments into account, as appropriate in finalizing this order.

Findings of Fact

1. By D.98-12-081, the Commission directed telecommunications carriers serving the 310 NPA to undertake a public education plan to prepare the public for the then-pending 310/424 NPA overlay.

2. The Commission did not prescribe LE factor recovery for the costs of the 310/424 NPA PEP.

3. In D.98-10-026, the Commission prescribed the criteria for recovery of costs through the LE factor, confined to Commission-mandated costs for which recovery is authorized in the underlying decision mandating the cost.

4. In view of the suspension of all previously approved overlay plans within California, PEP expenditures are now limited only to the funds already spent, and there will be no cumulative growth of PEP costs for the foreseeable future.

5. Based on the limited amounts spent on PEPs to date, the magnitude of such costs incurred by Pacific and GTEC is not sufficient to require LE factor recovery.

6. While the Commission mandated the PEP as a condition of an overlay and approved the PEP budget, nonetheless, Pacific and GTEC have had a significant degree of control over the discretionary spending decisions giving rise to the PEP costs.

7. While the aggregate percentage of PEP costs absorbed by Pacific or GTEC may exceed that of other carriers, Pacific and GTEC experienced no disproportionate impact in relation to other carriers in terms of the cost per NXX code.

Conclusions of Law

1. The PEP costs incurred by Pacific and GTEC fail to meet the necessary conditions for LE factor cost recovery.

2. Customers of Pacific and GTEC should not be required to bear the burden of the PEP costs through an LE factor since the requisite LE factor criteria have not been met.

3. The motion of Pacific for LE factor treatment of PEP costs should be denied.

O R D E R

IT IS ORDERED that:

1. The motion of Pacific Bell for Limited Exogenous (LE) factor recovery of Public Education Plan (PEP) costs incurred as part of an overlay relief plan is denied.

2. The motion of the Office of Ratepayer Advocates to deny carriers LE factor recovery of PEP costs incurred as part of an overlay relief plan is granted.

This order is effective today.

Dated December 7, 2000, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
JOSIAH L. NEEPER
RICHARD A. BILAS
CARL W. WOOD
Commissioners