

Decision 87-10-075 October 28, 1987

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of )  
Pacific Bell, a corporation, for )  
authority to increase certain intra- )  
state rates and charges applicable )  
to telephone services furnished )  
within the State of California. )  
\_\_\_\_\_)  
\_\_\_\_\_)

Application 85-01-034  
(Filed January 22, 1985;  
amended June 17, 1985 and  
May 19, 1986)

I.85-03-078  
(Filed March 20, 1985)

And Related Matters. )  
\_\_\_\_\_)  
\_\_\_\_\_)

OII 84  
(Filed December 2, 1980)

C.86-11-028  
(Filed November 17, 1986)

OPINION ON PACIFIC BELL'S  
PETITION FOR MODIFICATION  
OF DECISION 86-12-099

Procedural Background

On September 23, 1987, we issued an Interim Opinion (D.87-09-077) on Pacific Bell's Petition For Modification of D.86-12-099, relieving the utility from any obligation to make a 1988 attrition year filing on October 1, 1987 because of the imminence of our en banc hearing on alternatives to cost of service regulation for local exchange companies. Since the 1988 attrition filing was a topic for discussion at the en banc session, we preferred to defer consideration of the merits of Pacific Bell's. Petition and the opposing arguments of Public Staff Division (PSD) and Toward Utility Rate Normalization (TURN) until after the en banc. We are now prepared to address the merits of the issues of timing and scope presented by the pleadings before us.

Bell believes that separations factors are particularly important due to their use in nearly every formula which comprises the attrition adjustment mechanism. Thus, it argues that failure to use the Phase 2 adopted separations ratios could seriously affect the accuracy of the figures derived from application of the attrition formulae. Pacific Bell also argues that use of a 5% labor productivity factor for 1988 would not be supported by the evidence in this proceeding, since the basis of the Commission's 5% imputation in 1987 was the finding that such level was "sustainable in the near term." In short, the essence of Pacific Bell's first argument is that the pending Phase 2 decision would have a significant impact on the calculation of the 1988 attrition adjustment, and that any adjustment should be made only after the Phase 2 decision issues are resolved.

Pacific Bell also believes other Commission proceedings should be resolved before the 1988 attrition year filing is required. First, it notes that in OII 87-02-023, the Commission is considering issues relative to the USOAR. Depending on the resolution of those issues and the recovery method authorized, the utility estimates that its 1988 revenue requirement could increase by \$144.6 million. In OII 86-11-019, where the Commission is considering the impacts of the Tax Reform Act of 1986, Pacific Bell estimates that its 1988 revenue requirement could decrease by approximately \$270 million. Pacific Bell also cites the outstanding (as yet unquantified) revenue requirements issues being considered in OII 84, in connection with the detariffing of inside wire maintenance.

In support of its argument that the Commission should resolve these outstanding issues before requiring a 1988 attrition filing, Pacific Bell cites D.86-12-099, which provided that the attrition year revenue requirement calculation may include the effects of major governmental and/or regulatory commission actions if certain criteria are met. To be considered in the attrition

**CORRECTION**

**THIS DOCUMENT HAS**

**BEN REPHOTOGRAPHED**

**TO ASSURE**

**LEGIBILITY**

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The arguments of the parties, set forth below, are framed in the context of the now inapplicable October 1 filing date, but nevertheless provide a sufficient basis for resolving the questions presented.

Pacific Bell's Petition

While acknowledging that the December decision contained specific references to a 1988 attrition year filing, Pacific Bell argues that the Commission did not expressly order it to make such filing. Therefore, while admitting that the references in D.86-12-099 provide a basis for argument that such a filing may be required on or before October 1, 1987, Pacific Bell requests relief from any such requirement.

Pacific Bell makes three points. First, it notes that many issues remain outstanding until the Commission has issued its Phase 2 Results of Operations decision in this Docket. These issues include utilization, the San Ramon Valley Project, Pacific Telesis affiliated company transactions, marketing sales practices, separations/settlements, interest synchronization, the revenue requirement impact of ZUM expansion, advice letters and the high cost fund for independent telephone companies. In addition, there is the issue of modernization, initially considered in Phase 2, and the subject of additional hearings yet to be scheduled. According to Joint Comparison Exhibit 754 presented at the conclusion of Phase 2, the annual revenue requirement impact of the Commission's decision on these issues (excluding modernization) ranges from Pacific Bell's estimated increase of \$20.8 million to the PSD's estimated decrease of \$181.9 million. In addition, Pacific Bell believes that in issuing D.86-12-099, the Commission contemplated that the Phase 2 decision would be issued by the time a 1988 attrition filing was due, based on the Commission's discussion of use of adopted separations factors in a 1988 attrition filing and reference to disposition of the overall labor productivity factor to be applied for 1988 premised on the outcome of Phase 2. Pacific

Bell believes that separations factors are particularly important due to their use in nearly every formula which comprises the attrition adjustment mechanism. Thus, it argues that failure to use the Phase 2 adopted separations ratios could seriously affect the accuracy of the figures derived from application of the attrition formulae. Pacific Bell also argues that use of a 5% labor productivity factor for 1988 would not be supported by the evidence in this proceeding, since the basis of the Commission's 5% imputation in 1987 was the finding that such level was "sustainable in the near term." In short, the essence of Pacific Bell's first argument is that the pending Phase 2 decision would have a significant impact on the calculation of the 1988 attrition adjustment, and that any adjustment should be made only after the Phase 2 decision issues are resolved.

Pacific Bell also believes other Commission proceedings should be resolved before the 1988 attrition year filing is required. First, it notes that in OII 87-02-023, the Commission is considering issues relative to the USOAR. Depending on the resolution of those issues and the recovery method authorized, the utility estimates that its 1988 revenue requirement could increase by \$144.6 million. In OII 86-11-019, where the Commission is considering the impacts of the Tax Reform Act of 1986, Pacific Bell estimates that its 1988 revenue requirement could decrease by approximately \$270 million. Pacific Bell also cites the outstanding (as yet unquantified) revenue requirements issues being considered in OII 84, in connection with the detariffing of inside wire maintenance.

In support of its argument that the Commission should resolve these outstanding issues before requiring a 1988 attrition filing, Pacific Bell cites D.86-12-099, which provided that the attrition year revenue requirement calculation may include the effects of major governmental and/or regulatory commission actions if certain criteria are met. To be considered in the attrition

year filing, the governmental or regulatory action must have a definitely quantifiable effect on the attrition year revenue requirement, and must be of sufficient magnitude relative to the utility's operations to merit its inclusion in the attrition year revenue requirement; further, its existence must be certain, its attrition year impact noncontroversial, and its effects readily and easily quantifiable. In addition, recognition of such effects in the attrition year must not conflict with the overall policy goal of avoiding controversies that make the Commission's attrition review unduly complex or protracted. (D.86-12-099, mimeo. p. 25; see also Finding of Fact 22.) Once the outstanding issues in each of the above-referenced OIIs are resolved, Pacific Bell believes the criteria for inclusion will be met. However, until those impacts are known, Pacific Bell believes its 1988 attrition year filing is premature.

Pacific Bell's third argument relates to the Commission's grant of a limited rehearing of Resolution No. T-12007, which was the procedural vehicle used to reduce Pacific Bell's 1987 revenue requirement. In D.87-06-022 the Commission granted limited rehearing for the purpose of receiving evidence and argument concerning what should have been included in the "technical update of booked depreciation rates" for attrition year purposes, and also to allow Pacific Bell to present argument if it chose to do so, concerning the nonlabor escalation factor used in the resolution. D.87-06-022 did not treat the remaining issues in the application for rehearing. Accordingly, Pacific Bell argues that there is a great deal of uncertainty at this time concerning the appropriate attrition methodology. It asserts that such fundamental issues should be resolved before any 1988 attrition filing is required.

TURN's Motion for An Expedited  
Order to Review 1988 Financial  
and Operational Attrition

In TURN's view, the December decision established the Commission's attrition policies that apply to 1988. The issues before the Commission in considering 1988 attrition are repeats of the same issues faced a year ago. Indeed, TURN reminds us that our December decision ordering Pacific Bell to file for 1987 operational attrition and limited financial attrition responded to a series of TURN petitions. In its detailed discussion of telephone utility operational attrition, the December decision addressed a number of proposed modifications and made two explicit references to 1988 operational attrition on issues where the Commission expected subsequent information to change the numerical basis for the 1988 calculation.

In mandating a 1987 attrition filing, the Commission addressed and rejected a series of Pacific Bell arguments very similar to those made in the Petition. For example, Pacific Bell argued that attrition had never been mandated before (the Commission responded by noting that reversal of economic and market factors had turned the tables on what was originally a utility protection measure). The utility also asserted that the operational attrition mechanism contained serious flaws (much of the December decision was dedicated to addressing the mechanism and either affirming or amending particular elements). Pacific Bell noted it was preparing a "price predictability proposal" that would obviate attrition (the Commission rejected this argument noting that there was no basis for anticipating the actual date or terms of the utility filing, or its linkage to attrition). Pacific Bell also argued that important results of operations issues in Phase 2 remained unresolved (the Commission acknowledged the pendency of these issues, but determined that it was required to act promptly under the circumstances).



In TURN's view, Pacific Bell seeks to avoid an 1988 attrition filing, despite recognition of the possibility that the December decision contemplates such a filing and despite the Commission's recent rejection of identical arguments. For example, Pacific Bell argues that it is unclear that there is an existing mandate to file. TURN believes: "Pacific Bell can only hope that the Commission forgets its earlier recognition of the responsibility to protect ratepayers in times of falling costs and rising revenues." (TURN Motion, page 6.)

In response to the argument that elements of the existing operational attrition methodology are "inappropriate" (including the present labor productivity element, the depreciation-related issues now subject to limited rehearing, and other elements still pending for decision) TURN asserts that Pacific Bell ignores the fact that all of these questions should be resolved by the end of 1987; similarly, Pacific Bell fails to acknowledge that the 1987 attrition decision itself was issued despite the fact that several related issues were pending in Phase 2, in order to insure reasonable rates.

TURN also points out that Pacific Bell has refrained from mentioning formally the continued imminence of its regulatory reform proposal, although this was featured in informal attrition workshop discussions. TURN believes that Pacific Bell has apparently waived this argument.

Finally, TURN argues that while important RO issues are pending in Phase 2 and other proceedings, this was true a year ago as well, and prompt action is necessary to protect ratepayers. TURN believes: "It seems likely that important issues will always be pending, which could be used to excuse basic regulatory actions." (TURN Motion, page 7.)

TURN believes that Pacific Bell's cost of capital should again be reviewed in the 1988 attrition review, since, throughout 1987, bond and interest rates have remained low, continuing the

opportunity to refund earlier high-cost issues and to issue new debt at low rates of interest. Pacific Bell has fully recognized these opportunities in other proceedings. For example, in A.86-12-050, Pacific Bell sought authority to issue \$2 billion in new debt securities by December 31, 1988, in addition to \$350 million in remaining authority from an earlier Commission decision. Pacific Bell justified these financings in order to meet new capital needs, and to finance mandatory and optional redemption of nearly \$2 billion of outstanding high-coupon debt securities. (TURN Motion, pages 7 to 8.) In D.87-03-070, dated March 25, 1987, the Commission granted Pacific Bell's request in full. However, that decision did not require a reporting schedule, and TURN therefore does not know how much of the \$2.3 billion has been raised, or whether the Commission would have been informed of any refinancings in the regular course of business. Accordingly, TURN asks that Pacific Bell be ordered immediately to prepare a "financial attrition" application that identifies all financings and refinancings since January 1, 1987, and sets forth any such dealings planned through year-end 1987.

TURN also argues that operational attrition should be considered. Once the uncertainties that Pacific Bell cites in its petition are resolved by issuance of the Phase 2 decision and resolution of the limited rehearing ordered in D.87-06-022, it should be a relatively simple task to update a preliminary "pro forma" filing.

In sum, TURN believes it has demonstrated that circumstances warrant the prompt issuance of a Commission order requiring Pacific Bell to file a 1988 attrition request. The two broad elements of these circumstances are: economic and market factors that indicate strongly that rate reductions are in order; and Pacific Bell's unwillingness to make a timely filing without Commission order.

Public Staff Division's Opposition

The essence of PSD's opposition is that Pacific Bell's attempts to avoid a 1988 attrition filing repeat virtually all of the arguments the utility asserted in opposing a 1987 attrition filing. These same arguments were considered and rejected by the Commission in D.86-12-099, and Pacific Bell has not asserted any new compelling reasons for the Commission to modify its stated intention to conduct a review of attrition issues, both operational and financial during 1987 and 1988 (D.86-12-099, mimeo. pages 5 and 13, Finding of Fact No. 10). Similarly, in Resolution ALJ-156, adopted on October 17, 1985, the Commission directed Pacific Bell to have two attrition years after test-year 1986 (see also D.86-01-026, mimeo. page 5).

PSD acknowledges the uncertainties created by pendency of the Phase 2 decision, which means in its view, that separations ratios and labor productivity factors utilized in the 1987 attrition year filing should be used again as the most recent available adopted factors. Moreover, other actions pending may foreseeably have an effect on 1988 operations. These matters include pending actions at the Federal Communications Commission (FCC) and at this Commission, such as adoption of the USOAR, revenue requirements effects of the Tax Reform Act of 1986, the FCC triennial prescription proceedings for Pacific Bell, and the possibility of a final order in Phase 2. In view of the potential impacts of these various proceedings upon 1988 operations, PSD believes rates should be collected subject to refund after January 1, 1988 to account for any adjustments associated with the 1988 attrition year review.

Discussion

The Petition clearly indicates Pacific Bell's recognition of the fact that the Commission contemplated a 1988 attrition filing would be made. Pacific Bell points out that the Commission contemplated that at least two basic issues (separations factors

and labor productivity issues) would be resolved by the time the 1988 filing was made. It argues based on the fact that these issues are not resolved, and due to the pendency of other proceedings which may impact revenue requirement, that the attrition filing for 1988 should be postponed.

At the September 25th en banc session, Pacific Bell's representative clarified that the utility does not wish to avoid a 1988 attrition adjustment, but that it does have serious concerns about the fairness of the so-called attrition "cookbook" formula, especially in the areas of labor productivity and depreciation. Before addressing these fairness concerns, we have some observations about Pacific Bell's argument for delay.

We conclude that the pendency of the Phase 2 decision weighs in favor of allowing sufficient delay, to enable those preparing Pacific Bell's attrition year advice letter, and the staff members reviewing it, to use newly adopted separations factors and labor productivity findings. Otherwise the process of calculating the attrition adjustment will be unduly complicated by the need to update to recognize Phase 2 effects. Given the imminent issuance of the Phase 2 decision, we believe that granting a reasonable delay strikes the appropriate balance between Pacific Bell's concerns and the ratepayer interest. This remedy is also certainly preferable to dispensing with the 1988 attrition adjustment altogether on grounds of excessive complexity. Given current conditions in the telecommunications industry, Pacific Bell's present rates will become unreasonable during 1988 unless they are examined and adjusted for operational and financial attrition if necessary.

In requiring such filing, we will establish a timetable designed to address some of Pacific Bell's concerns about other pending proceedings. First, a few observations are in order.

The information we heard at the September 24th en banc session made clear the competitive and technological forces now operating upon Pacific Bell and other local exchanges. This is a

transitional time for the local exchange telephone business as well as a time of potential transition for its regulation. Nonetheless, we have a regulatory framework in place that includes attrition filings and rate adjustments, and we will adhere to that framework until it may be changed. Thus, we reaffirm that Pacific Bell will make a 1988 attrition filing.

As a preliminary matter, we believe many of the uncertainties Pacific Bell describes are nearly resolved. We expect our Phase 2 results of operations decision will be issued by the end of 1987. Further, the outstanding 1987 attrition issues which are subject to limited rehearing will also be resolved by year-end 1987, according to the schedule established in the prehearing conference in that proceeding.

As to the other proceedings that Pacific Bell cites in support of its plea for delay, (USOAR, the Tax Reform Act OII, and the inside wire maintenance OII), one simple point should suffice: The existing attrition formula (as Pacific Bell notes) provides for recognition in the attrition year of governmental actions which have a known or quantifiable effect on the attrition year revenue requirement. As we stated in the December decision:

"We will not close the door to a review in the attrition year of the impacts of governmental or regulatory actions which have a definitely quantifiable effect on the attrition year revenue requirement. Such effects must be of sufficient magnitude on the utility's operations to merit their inclusion in the attrition year revenue requirement. Furthermore, their existence must be certain, their attrition year impact noncontroversial, and their effects readily and easily quantifiable. In addition, recognition of such effects in the attrition year must not conflict (as is the case with the weighted uncollectible/net-to-gross multiplier issue) with the overall policy goal of avoiding controversies that will make our attrition review unduly complex or protracted."  
(D.86-12-099, mimeo. page 25.)

In at least two of these proceedings (USOAR and Tax Reform Act OII) we expect to reach decisions by year-end 1987. These decisions may include the sort of definitive information which meets the test we established in the December decision for inclusion in the attrition revenue requirement. At this point we are not certain this will be the case in the inside wiring maintenance matter due to the status of that proceeding. However, we do not agree with the argument that the outstanding nature of these matters justifies their use as a shield to excuse or significantly delay the attrition filing; rather, it should be clear that we intended in the December decision to modify the attrition mechanism to recognize only those rate impacts which met the straightforward test for inclusion--not to delay filings to allow more events to meet the inclusion test. Therefore, we will allow Pacific Bell to present material with its attrition filing that arguably meets that test, with the caveat that we will ultimately decide the issue based on careful scrutiny of the facts before us. Further, since many of these issues will not be resolved until the end of the year we will allow Pacific Bell to make its 1988 attrition filing, on or before January 30, 1988. This will enable it to reflect any actions taken in our Phase 2 decision, our decision on the limited rehearing of attrition issues, and any decisions issued by December 31, 1987 in the USOA and Tax Reform Act OIIs, as well as any other adjustments which may meet the "quantifiable regulatory actions" standard for inclusion. We reiterate our intention to review the filing to ensure that only those modifications which meet the D.86-12-099 inclusion standard are ultimately reflected in the 1988 attrition year revenue requirement.

We reject the opposing arguments that a pro forma filing, with subsequent update, is preferable to allowing a slight delay. One filing, made after the major uncertainties have been resolved, will simplify the Evaluation and Compliance (E&C) Division staff's

efforts to prepare a Resolution for our consideration, by obviating the necessity of performing the multiple calculations associated with such updates.

We believe that TURN's suggestion regarding financial attrition merits adoption. Accordingly, we will require that Pacific Bell's January 30, 1988 advice letter filing identify all financings and refinancings from January 1, 1987, through December 31, 1987, setting forth in clear detail all such financings or refinancings planned, as well as executed, through the end of the year 1987. Consistent with the approach taken in Resolution No. T-12007, our review of financial attrition will take place within the context of the capital structure adopted in D.86-01-026, the Interim Opinion on Pacific Bell's 1986 test year revenue requirement; no change in the authorized return on equity is contemplated.

Consistent with our treatment of this issue last year, we will designate Pacific Bell's rates be collected subject to refund with interest beginning January 1, 1988 to account for any adjustments associated with the 1988 attrition year review.

We recognize that Pacific Bell is concerned about the fairness of the attrition formula, especially in the areas of labor productivity and depreciation. Indeed Pacific Bell has exercised its legal right to appeal our 1987 attrition decision's handling of these same issues. Those appeals are still pending, although, as previously noted, we have granted a limited rehearing of the technical update issue, and expect a decision to be issued by the end of the year. We are also reviewing labor productivity issues, including an incentive mechanism supported by PSD and Pacific Bell, in our Phase 2 deliberations. These are the forums where Pacific Bell's proposals and arguments on labor productivity and technical update issues will be assessed, along with the proposals and arguments of other affected parties. Given the opportunity for a full airing of these issues in these forums, we believe Pacific

Bell's fairness concerns will be considered appropriately. Standing alone, however, these concerns are not an adequate justification for dispensing with the 1988 attrition filing.

This filing will be made at the end of the current rate case cycle, as originally envisioned. As this cycle draws to a close, we have indicated our interest in exploring alternatives to cost of service regulation for local exchange carriers. We expect to be considering Pacific Bell's proposal for a new regulatory framework in the near future, given the discussions at the September 24-25 en banc hearing.

Prior to that hearing, we had asked our E&C staff to conduct workshops "at which interested parties may address the need for further changes to the attrition methodology for telephone companies adopted in D.86-12-099 and the desirability of making attrition year adjustments to the revenue requirements of telephone companies." (D.87-04-078, mimeo. p. 11). This workshop, held on August 11, 1987 was attended by representatives of local exchange companies, AT&T-Communications, PSD, E&C, and TURN. The positions of these participants, summarized in E&C's September 14, 1987 report to the Commission, are detailed in Appendix A. According to E&C, the workshop participants agreed that there were too many issues before the Commission to arrive at any meaningful consensus resolution about attrition. Given that situation, the workshop participants were unwilling and unable to compromise their originally held positions. Both TURN and Pacific Bell stated that formal hearings were the appropriate way to deal with any modifications to attrition. Therefore, in its report to the Commission, E&C recommended that no further attrition workshops be scheduled, but that changes to the Commission's attrition policy and mechanism for telephone companies be effected through formal proceedings.

Given these workshop results and our expectation that Pacific Bell's new regulatory framework proposal will provide a



future forum for addressing the mechanics of multi-year rate changes, we prefer to separate the question of 1988 attrition from the issue of the ultimate fate of the present attrition mechanism. Furthermore, it is absolutely necessary to have the benefit of a 1988 attrition filing in order to obtain the most recent financial information available from Pacific Bell, as we assess our future regulatory policy options. Accordingly we will order Pacific Bell to file for 1988 attrition using the adopted methodology (D.85-03-042, as modified by D.86-12-099), as implemented in Resolution T-12007, and allow only the few specific changes to that methodology which may be adopted in other related decisions to be issued before the end of 1987.

Assuming that we do proceed with a full reexamination of our regulatory process, we will reconsider whether or how to have an attrition mechanism. For now, we are carrying out the existing regulatory rules as we have established them.

Findings of Fact

1. Pacific Bell has filed a Petition for Modification of D.86-12-099 requesting that the December decision be modified to whatever extent may be necessary to remove any requirement that may exist for the utility to make a 1988 attrition filing on or before October 1, 1987.

2. The basis for Pacific Bell's Petition is the pendency of certain major issues, which may not be resolved entirely before October 1, 1987.

3. TURN has filed a motion for an expedited order to review 1988 financial and operational attrition, urging that Pacific Bell's rates be made subject to refund beginning January 1, 1988 to ensure that ratepayers receive the full benefit of any attrition adjustment even if the amount of the attrition adjustment is not fully resolved by that date. TURN also urges rejection of Pacific Bell's Petition for Modification of the December decision, on the basis that the utility misconstrues or ignores the guidance in that

decision in order to manufacture uncertainty and seek relief from its responsibility to file for 1988 attrition.

4. PSD opposes Pacific Bell's Petition for Modification on the basis that it repeats all of the arguments asserted in opposing a 1987 attrition filing, and that these arguments were considered and disposed of by the Commission in the December decision. In the absence of assertion of any new compelling reasons for the Commission to modify its stated intention to conduct a review of attrition issues in 1988, PSD believes that financial attrition and operational attrition should be reviewed in 1988.

5. In D.87-09-077 we relieved Pacific Bell from any obligation to make a 1988 attrition year filing on October 1, 1987, based on the imminence of our en banc hearing on alternatives to cost of service regulation for local exchange companies, and our desire to defer consideration of the merits of the utility's Petition until after the en banc.

6. Most of Pacific Bell's concerns about the fairness of the current attrition methodology, as expressed at the en banc hearing, relate to the past application of labor productivity and depreciation. These issues are currently being considered in Phase 2 of the rate case and in A.87-04-049, where decisions are expected shortly, and thus Pacific Bell has a forum to address its fairness concerns.

7. Given (i) the conclusion of our E&C staff, as a result of August 1987 workshops on the attrition mechanism, that modifications to the status quo should be effected through formal proceedings, and (ii) our expectation that consideration of Pacific Bell's anticipated new regulatory framework proposal will provide a forum for addressing the mechanics of multi-year rate changes, we will separate the question of 1988 attrition from the issue of the ultimate fate of the present attrition mechanism.

8. A 1988 attrition filing will provide the most recent financial and operational data available, for use as a baseline as we assess our future regulatory policy options.

9. Pacific Bell's Petition does not raise any new issue not considered in connection with our December decision ordering a 1987 attrition filing; indeed, several of the uncertainties that Pacific Bell cites in attempting to shield itself from the 1988 attrition filing, will be resolved by the end of this year, thus making the uncertainties less significant than they were at the time we issued D.86-12-099.

10. Pacific Bell's Petition does not contain facts sufficient to justify relief from the requirement that a 1988 attrition year filing be made, since most of the uncertainties it cites will be resolved by year-end 1987; however it appears more feasible to allow a slight delay in the filing in order to avoid undue complexity in calculating updates to arrive at a 1988 attrition year revenue requirement.

11. If the uncertainties Pacific Bell cites in connection with our review of the Tax Reform Act and the USOAR are resolved by year-end 1987, Pacific Bell may make the argument that such decisions have a definitely quantifiable effect on the attrition year revenue requirement within the parameters of D.86-12-099, mimeo. p. 25.

12. The 1988 attrition year filing will use the separations factors emanating from the Phase 2 decision.

13. The 1988 attrition year filing will use the labor productivity factor and/or mechanism adopted in the Phase 2 decision.

14. The 1988 attrition year filing will resolve technical update/depreciation issues in a manner consistent with our resolution of the issues in A.87-04-049, where a decision is expected by year end 1987.

15. Pacific Bell's present rates will become unreasonable in 1988 unless they are examined and adjusted to account for operational and financial attrition if necessary.

16. It is appropriate to require Pacific Bell to make a 1988 attrition filing on or before January 30, 1988, using the methodology for operational attrition adopted in D.86-12-099, with the exceptions noted in the previous three findings.

17. A January 30, 1988 advice letter filing will allow consideration of the results of our Phase 2 decision, including the separations factors and labor productivity items adopted in that decision; depreciation-related issues resolved in A.87-04-049; and any other known or quantifiable effects of regulatory actions taken by December 31, 1987.

18. It is appropriate to require Pacific Bell to make a filing reflecting financial attrition for 1988 on or before January 30, 1988, and to require that the information Pacific Bell employs in this filing identify all financings and refinancings from January 1, 1987, through December 31, 1987, including all such dealings planned or executed through year-end 1987.

19. Consistent with the decisions issued in connection with Pacific Bell's 1987 attrition year, as well as Resolution No. T-12007, issued March 25, 1987, our review of financial attrition will take place within the context of the capital structure found reasonable in the interim opinion in D.86-01-026. No change in the authorized return on equity is contemplated.

#### Conclusions of Law

1. Pacific Bell's Petition for Modification of D.86-12-099 should be denied, to the extent it seeks relief from the requirement of making a 1988 attrition adjustment.

2. Pacific Bell should be ordered to file an advice letter addressing financial and operational attrition for 1988, in accordance with our preceding discussion.

ORDER

IT IS ORDERED that:

1. On or before January 30, 1988, Pacific Bell shall file a 1988 attrition year advice letter, with service on all parties of record, addressing both operational and financial attrition, within the parameters of the discussion contained in the preceding text. The operational attrition request shall follow the attrition formula adopted in D.85-03-042 as modified by D.86-12-099, with the exceptions noted in Ordering Paragraph 2. The financial attrition request shall identify all financings and refinancings from January 1, 1987, through December 31, 1987, including all financings or refinancings planned or executed through the end of the year 1987.

2. In making the January 30, 1988 advice letter filing, Pacific Bell shall use the results of operations adopted in Phase 2, including the separations factors and labor productivity outcome adopted in the Phase 2 decision. Such filing shall also reflect the technical update/depreciation outcome of our proceedings in A.87-04-049.

3. TURN's motion for an expedited order to review 1988 financial and operational attrition is hereby granted, to the extent consistent with this order.

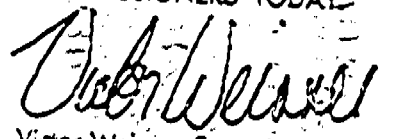
4. Pacific Bell's intrastate rates and charges shall be collected subject to refund with interest at the current three-month commercial paper rate beginning January 1, 1988, to account for any adjustments associated with the 1988 attrition year review ordered herein.

This order is effective today.

Dated October 28, 1987, at San Francisco, California.

STANLEY W. HULETT  
President  
DONALD VIAL  
FREDERICK R. DUDA  
G. MITCHELL WILK  
JOHN B. OHANIAN  
Commissioners

I CERTIFY THAT THIS DECISION  
WAS APPROVED BY THE ABOVE  
COMMISSIONERS TODAY

  
Victor Weisser, Executive Director  
JB

APPENDIX A

Briefly, the comments at the workshop can be categorized into four groups as follows:

**Group 1 — Small Independent Telephone Companies**

This group is concerned with the preservation of their toll revenues. If they are authorized to offset any lost toll revenues in major rate applications and generic investigative proceedings, their concerns would be met. In addition, should the Commission adopt a high cost fund in Pacific Bell's current A.85-01-034, the question of attrition is moot.

**Group 2 — Mid-Size Telephone Companies**

This group consists of Continental, Roseville and Citizens telephone companies. There is no formal attrition mechanism in place for this group of companies. Ad hoc formulas are developed to fit the specific needs of each rate proceeding. Due to the many uncertainties such as the possibility of Pacific filing a new regulatory framework application, tax reform, USOA (Universal System of Accounts), Pacific's Phase II decision, etc., these companies favor the option to request an attrition allowance when they file their next rate application. By that time they feel many of the above issues will be resolved. Continental questions the need of this workshop since the Commission has two pending proceedings on attrition (1) the limited rehearing of Pacific's 1987 attrition resolution T-12007 and (2) General Telephone's (General) current A.87-01-002. Also Continental favors the elimination of attrition, since it is not appropriate in today's changing industry.

**Group 3 -- Large Telephone Companies**

Pacific Bell and General Telephone are in this group. General favors keeping attrition the way they believe it is, that is, at the discretion of the utility. The Commission has broad authority to institute "show cause" proceedings. Pacific as well as Continental favors eliminating attrition since it is "inappropriate" in today's changing industry. However, if attrition is not eliminated Pacific prefers formal hearings to revise the attrition process.

**Group 4 -- TURN and Public Staff Division**

Both agree that attrition should be bi-directional; between rate applications attrition protects the utilities during inflationary periods and it should benefit ratepayers during deflationary periods. TURN is awaiting action on its petition, filed February 5, 1987, to modify D.85-08-093 requesting that mid-sized telephone companies be ordered to make attrition filings. TURN, like Pacific, favors formal proceedings with all participants as respondents. TURN also prefers annual operational and financial reviews of all local exchange companies. PSD would limit annual operational and financial attrition to mid and large telephone companies.

(END OF APPENDIX A)

Decision \_\_\_\_\_

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of )  
 Pacific Bell, a corporation, for )  
 authority to increase certain intra- )  
 state rates and charges applicable )  
 to telephone services furnished )  
 within the State of California. )

Application 85-01-034  
 (Filed January 22, 1985;  
 amended June 17, 1985 and  
 May 19, 1986)

I.85-03-078  
 (Filed March 20, 1985)

And Related Matters. )

OII 84  
 (Filed December 2, 1980)

C.86-11-028  
 (Filed November 17, 1986)

OPINION ON PACIFIC BELL'S  
PETITION FOR MODIFICATION  
OF DECISION 86-12-099

Procedural Background

On September 23, 1987, we issued an Interim Opinion (D.87-09-077) on Pacific Bell's Petition For Modification of D.86-12-099, relieving the utility from any obligation to make a 1988 attrition year filing on October 1, 1987 because of the imminence of our en banc hearing on alternatives to cost of service regulation for local exchange companies. Since the 1988 attrition filing was a topic for discussion at the en banc session, we preferred to defer consideration of the merits of Pacific Bell's Petition and the opposing arguments of Public Staff Division (PSD) and Toward Utility Rate Normalization (TURN) until after the en banc. We are now prepared to address the merits of the issues of timing and scope presented by the pleadings before us.



The arguments of the parties, set forth below, are framed in the context of the now inapplicable October 1 filing date, but nevertheless provide a sufficient basis for resolving the questions presented.

Pacific Bell's Petition

While acknowledging that the December decision contained specific references to a 1988 attrition year filing, Pacific Bell argues that the Commission did not expressly order it to make such filing. Therefore, while admitting that the references in D.86-12-099 provide a basis for argument that such a filing may be required on or before October 1, 1987, Pacific Bell requests relief from any such requirement.

Pacific Bell makes three points. First, it notes that many issues remain outstanding until the Commission has issued its Phase 2 Results of Operations decision in this Docket. These issues include utilization, the San Ramon Valley Project, Pacific Telesis affiliated company transactions, marketing sales practices, separations/settlements, interest synchronization, the revenue requirement impact of ZUM expansion, advice letters and the high cost fund for independent telephone companies. In addition, there is the issue of modernization, initially considered in Phase 2, and the subject of additional hearings yet to be scheduled. According to Joint Comparison Exhibit 754 presented at the conclusion of Phase 2, the annual revenue requirement impact of the Commission's decision on these issues (excluding modernization) ranges from Pacific Bell's estimated increase of \$20.8 million to the PSD's estimated decrease of \$181.9 million. In addition, Pacific Bell believes that in issuing D.86-12-099, the Commission contemplated that the Phase 2 decision would be issued by the time a 1988 attrition filing was due, based on the Commission's discussion of use of adopted separations factors in a 1988 attrition filing and reference to disposition of the overall labor productivity factor to be applied for 1988 premised on the outcome of Phase 2. Pacific

Bell believes that separations factors are particularly important due to their use in nearly every formula which comprises the attrition adjustment mechanism. Thus, it argues that failure to use the Phase 2 adopted separations ratios could seriously affect the accuracy of the figures derived from application of the attrition formulae. Pacific Bell also argues that use of a 5% labor productivity factor for 1988 would not be supported by the evidence in this proceeding, since the basis of the Commission's 5% imputation in 1987 was the finding that such level was "sustainable in the near term." In short, the essence of Pacific Bell's first argument is that the pending Phase 2 decision would have a significant impact on the calculation of the 1988 attrition adjustment, and that any adjustment should be made only after the Phase 2 decision issues are resolved.

Pacific Bell also believes other Commission proceedings should be resolved before the 1988 attrition year filing is required. First, it notes that in OII 87-02-023, the Commission is considering issues relative to the USOAR. Depending on the resolution of those issues and the recovery method authorized, the utility estimates that its 1988 revenue requirement could increase by \$144.6 million. In OII 86-11-019, where the Commission is considering the impacts of the Tax Reform Act of 1986, Pacific Bell estimates that its 1988 revenue requirement could decrease by approximately \$270 million. Pacific Bell also cites the outstanding (as yet unquantified) revenue requirements issues being considered in OII 84, in connection with the detariffing of inside wire maintenance.

In support of its argument that the Commission should resolve these outstanding issues before requiring a 1988 attrition filing, Pacific Bell cites D.86-12-099, which provided that the attrition year revenue requirement calculation may include the effects of major governmental and/or regulatory commission actions if certain criteria are met. To be considered in the attrition

year filing, the governmental or regulatory action must have a definitely quantifiable effect on the attrition year revenue requirement, and must be of sufficient magnitude relative to the utility's operations to merit its inclusion in the attrition year revenue requirement; further, its existence must be certain, its attrition year impact noncontroversial, and its effects readily and easily quantifiable. In addition, recognition of such effects in the attrition year must not conflict with the overall policy goal of avoiding controversies that make the Commission's attrition review unduly complex or protracted. (D.86-12-099, mimeo. p. 25; see also Finding of Fact 22.) Once the outstanding issues in each of the above-referenced OIIs are resolved, Pacific Bell believes the criteria for inclusion will be met. However, until those impacts are known, Pacific Bell believes its 1988 attrition year filing is premature.

Pacific Bell's third argument relates to the Commission's grant of a limited rehearing of Resolution No. T-12007, which was the procedural vehicle used to reduce Pacific Bell's 1987 revenue requirement. In D.87-06-022 the Commission granted limited rehearing for the purpose of receiving evidence and argument concerning what should have been included in the "technical update of booked appreciation rates" for attrition year purposes, and also to allow Pacific Bell to present argument if it chose to do so, concerning the nonlabor escalation factor used in the resolution. D.87-06-022 did not treat the remaining issues in the application for rehearing. Accordingly, Pacific Bell argues that there is a great deal of uncertainty at this time concerning the appropriate attrition methodology. It asserts that such fundamental issues should be resolved before any 1988 attrition filing is required.

TURN's Motion for An Expedited  
Order to Review 1988 Financial  
and Operational Attrition

In TURN's view, the December decision established the Commission's attrition policies that apply to 1988. The issues before the Commission in considering 1988 attrition are repeats of the same issues faced a year ago. Indeed, TURN reminds us that our December decision ordering Pacific Bell to file for 1987 operational attrition and limited financial attrition responded to a series of TURN petitions. In its detailed discussion of telephone utility operational attrition, the December decision addressed a number of proposed modifications and made two explicit references to 1988 operational attrition on issues where the Commission expected subsequent information to change the numerical basis for the 1988 calculation.

In mandating a 1987 attrition filing, the Commission addressed and rejected a series of Pacific Bell arguments very similar to those made in the Petition. For example, Pacific Bell argued that attrition had never been mandated before (the Commission responded by noting that reversal of economic and market factors had turned the tables on what was originally a utility protection measure). The utility also asserted that the operational attrition mechanism contained serious flaws (much of the December decision was dedicated to addressing the mechanism and either affirming or amending particular elements). Pacific Bell noted it was preparing a "price predictability proposal" that would obviate attrition (the Commission rejected this argument noting that there was no basis for anticipating the actual date or terms of the utility filing, or its linkage to attrition). Pacific Bell also argued that important results of operations issues in Phase 2 remained unresolved (the Commission acknowledged the pendency of these issues, but determined that it was required to act promptly under the circumstances).

In TURN's view, Pacific Bell seeks to avoid an 1988 attrition filing, despite recognition of the possibility that the December decision contemplates such a filing and despite the Commission's recent rejection of identical arguments. For example, Pacific Bell argues that it is unclear that there is an existing mandate to file. TURN believes: "Pacific Bell can only hope that the Commission forgets its earlier recognition of the responsibility to protect ratepayers in times of falling costs and rising revenues." (TURN Motion, page 6.)

In response to the argument that elements of the existing operational attrition methodology are "inappropriate" (including the present labor productivity element, the depreciation-related issues now subject to limited rehearing, and other elements still pending for decision) TURN asserts that Pacific Bell ignores the fact that all of these questions should be resolved by the end of 1987; similarly, Pacific Bell fails to acknowledge that the 1987 attrition decision itself was issued despite several important loose ends, in order to insure reasonable rates.

TURN also points out that Pacific Bell has refrained from mentioning formally the continued imminence of its regulatory reform proposal, although this was featured in informal attrition workshop discussions. TURN believes that Pacific Bell has apparently waived this argument.

Finally, TURN argues that while important RO issues are pending in Phase 2 and other proceedings, this was true a year ago as well, and prompt action is necessary to protect ratepayers. TURN believes: "It seems likely that important issues will always be pending, which could be used to excuse basic regulatory actions." (TURN Motion, page 7.)

TURN believes that Pacific Bell's cost of capital should again be reviewed in the 1988 attrition review, since, throughout 1987, bond and interest rates have remained low, continuing the

opportunity to refund earlier high-cost issues and to issue new debt at low rates of interest. Pacific Bell has fully recognized these opportunities in other proceedings. For example, in A.86-12-050, Pacific Bell sought authority to issue \$2 billion in new debt securities by December 31, 1988, in addition to \$350 million in remaining authority from an earlier Commission decision. Pacific Bell justified these financings in order to meet new capital needs, and to finance mandatory and optional redemption of nearly \$2 billion of outstanding high-coupon debt securities. (TURN Motion, pages 7 to 8.) In D.87-03-070, dated March 25, 1987, the Commission granted Pacific Bell's request in full. However, that decision did not require a reporting schedule, and TURN therefore does not know how much of the \$2.3 billion has been raised, or whether the Commission would have been informed of any refinancings in the regular course of business. Accordingly, TURN asks that Pacific Bell be ordered immediately to prepare a "financial attrition" application that identifies all financings and refinancings since January 1, 1987, and sets forth any such dealings planned through year-end 1987.

TURN also argues that operational attrition should be considered. Once the uncertainties that Pacific Bell cites in its petition are resolved by issuance of the Phase 2 decision and resolution of the limited rehearing ordered in D.87-06-022, it should be a relatively simple task to update a preliminary "pro forma" filing.

In sum, TURN believes it has demonstrated that circumstances warrant the prompt issuance of a Commission order requiring Pacific Bell to file a 1988 attrition request. The two broad elements of these circumstances are: economic and market factors that indicate strongly that rate reductions are in order; and Pacific Bell's unwillingness to make a timely filing without Commission order.

Public Staff Division's Opposition

The essence of PSD's opposition is that Pacific Bell's attempts to avoid a 1988 attrition filing repeat virtually all of the arguments the utility asserted in opposing a 1987 attrition filing. These same arguments were considered and rejected by the Commission in D.86-12-099, and Pacific Bell has not asserted any new compelling reasons for the Commission to modify its stated intention to conduct a review of attrition issues, both operational and financial during 1987 and 1988 (D.86-12-099, mimeo. pages 5 and 13, Finding of Fact No. 10). Similarly, in Resolution ALJ-156, adopted on October 17, 1985, the Commission directed Pacific Bell to have two attrition years after test-year 1986 (see also D.86-01-026, mimeo. page 5).

PSD acknowledges the uncertainties created by pendency of the Phase 2 decision, which means in its view, that separations ratios and labor productivity factors utilized in the 1987 attrition year filing should be used again as the most recent available adopted factors. Moreover, other actions pending may foreseeably have an effect on 1988 operations. These matters include pending actions at the Federal Communications Commission (FCC) and at this Commission, such as adoption of the USOAR, revenue requirements effects of the Tax Reform Act of 1986, the FCC triennial rescription proceedings for Pacific Bell, and the possibility of a final order in Phase 2. In view of the potential impacts of these various proceedings upon 1988 operations, rates should be collected subject to refund after January 1, 1988 to account for any adjustments associated with the 1988 attrition year review.

Discussion

The Petition clearly indicates Pacific Bell's recognition of the fact that the Commission contemplated a 1988 attrition filing would be made. Pacific Bell points out that the Commission contemplated that at least two basic issues (separations factors

and labor productivity issues) would be resolved by the time the 1988 filing was made. It argues based on the fact that these issues are not resolved, and due to the pendency of other proceedings which may impact revenue requirement, that the attrition filing for 1988 should be postponed.

At the September 25th en banc session, Pacific Bell's representative clarified that the utility does not wish to avoid a 1988 attrition adjustment, but that it does have serious concerns about the fairness of the so-called attrition "cookbook" formula, especially in the areas of labor productivity and depreciation. Before addressing these fairness concerns, we have some observations about Pacific Bell's argument for delay.

We conclude that the pendency of the Phase 2 decision weighs in favor of allowing sufficient delay, to enable those preparing Pacific Bell's attrition year advice letter, and the staff members reviewing it, to use newly adopted separations factors and labor productivity findings. Otherwise the process of calculating the attrition adjustment will be unduly complicated by the need to update to recognize Phase 2 effects. Given the imminent issuance of the Phase 2 decision, we believe that granting a reasonable delay strikes the appropriate balance between Pacific Bell's concerns and the ratepayer interest. This remedy is also certainly preferable to dispensing with the 1988 attrition adjustment altogether on grounds of excessive complexity.

In requiring such filing, we will establish a timetable designed to address some of Pacific Bell's concerns about other pending proceedings. First, a few observations are in order.

As a preliminary matter, we believe many of the uncertainties Pacific Bell describes are nearly resolved. Our Phase 2 decision will be issued by the time any 1988 attrition rate modification would be effective. Further, the outstanding 1987 attrition issues which are subject to limited rehearing will also



be resolved by year-end 1987, according to the schedule established in the prehearing conference in that proceeding.

As to the other proceedings that Pacific Bell cites in support of its plea for delay, (USOAR, the Tax Reform Act OII, and the inside wire maintenance OII), one simple point should suffice: The existing attrition formula (as Pacific Bell notes) provides for recognition in the attrition year of governmental actions which have a known or quantifiable effect on the attrition year revenue requirement. As we stated in the December decision:

"We will not close the door to a review in the attrition year of the impacts of governmental or regulatory actions which have a definitely quantifiable effect on the attrition year revenue requirement. Such effects must be of sufficient magnitude on the utility's operations to merit their inclusion in the attrition year revenue requirement. Furthermore, their existence must be certain, their attrition year impact noncontroversial, and their effects readily and easily quantifiable. In addition, recognition of such effects in the attrition year must not conflict (as is the case with the weighted uncollectible/net-to-gross multiplier issue) with the overall policy goal of avoiding controversies that will make our attrition review unduly complex or protracted."  
(D.86-12-099, mimeo. page 25.)

In at least two of these proceedings (USOAR and Tax Reform Act OII) we expect to reach decisions by year-end 1987. These decisions may include the sort of definitive information which meets the test we established in the December decision for inclusion in the attrition revenue requirement. At this point we are not certain this will be the case in the inside wiring maintenance matter due to the status of that proceeding. However, we do not agree with the argument that the outstanding nature of these matters justifies their use as a shield to excuse or significantly delay the attrition filing; rather, it should be

clear that we intended in the December decision to modify the attrition mechanism to recognize only those rate impacts which met the straightforward test for inclusion--not to delay filings to allow more events to meet the inclusion test. Therefore, we will allow Pacific Bell to present material with its attrition filing that arguably meets that test, with the caveat that we will ultimately decide the issue based on careful scrutiny of the facts before us. Further, since many of these issues will not be resolved before the end of the year we will allow Pacific Bell to make its 1988 attrition filing, on or before January 30, 1988. This will enable it to reflect any actions taken in our Phase 2 decision, our decision on the limited rehearing of attrition issues, and any decisions issued in the USOA and Tax Reform Act OIRs, as well as any other adjustments which may meet the "quantifiable regulatory actions" standard for inclusion. We reiterate our intention to review the filing to ensure that only those modifications which meet the D.86-12-099 inclusion standard are ultimately reflected in the 1988 attrition year revenue requirement.

We reject the opposing arguments that a pro forma filing, with subsequent update, is preferable to allowing a slight delay. One filing, made after the major uncertainties have been resolved, will simplify the Evaluation and Compliance (E&C) Division staff's efforts to prepare a Resolution for our consideration, by obviating the necessity of performing the multiple calculations associated with such updates.

We believe that TURN's suggestion regarding financial attrition merits adoption. Accordingly, we will require that Pacific Bell's January 30, 1988 advice letter filing identify all financings and refinancings since January 1, 1987, and set forth in clear detail any such financings or refinancings planned or executed through the end of the year 1987. Consistent with the approach taken in Resolution No. T-12007, our review of financial

attrition will take place within the context of the capital structure adopted in D.86-01-026, the Interim Opinion on Pacific Bell's 1986 test year revenue requirement; no change in the authorized return on equity is contemplated.

If it appears necessary for us to hold evidentiary hearings in connection with the 1988 attrition filing, we will set those hearings as soon after January 30, 1988 as possible. In the meantime, consistent with our treatment of this issue last year, we will designate Pacific Bell's rates be collected subject to refund with interest after January 1, 1988 to account for any adjustments associated with the 1988 attrition year review.

We recognize that Pacific Bell is concerned about the fairness of the attrition formula, especially in the areas of labor productivity and depreciation. Indeed Pacific Bell has exercised its legal right to appeal our 1987 attrition decision's handling of these same issues. Those appeals are still pending, although, as previously noted, we have granted a limited rehearing of the technical update issue, and expect a decision to be issued by the end of the year. We are also reviewing labor productivity issues, including an incentive mechanism supported by PSD and Pacific Bell, in our Phase 2 deliberations. These are the forums where Pacific Bell's proposals and arguments on labor productivity and technical update issues will be assessed, along with the proposals and arguments of other affected parties. Given the opportunity for a full airing of these issues in these forums, we believe Pacific Bell's fairness concerns will be considered appropriately. Standing alone, however, these concerns are not an adequate justification for dispensing with the 1988 attrition filing.

This filing will be made at the end of the current rate case cycle, as originally envisioned. As this cycle draws to a close, we have indicated our interest in exploring alternatives to cost of service regulation for local exchange carriers. We expect

to be considering Pacific Bell's proposal for a new regulatory framework in the near future, given the discussions at the September 24-25 en banc hearing.

Prior to that hearing, we had asked our E&C staff to conduct workshops "at which interested parties may address the need for further changes to the attrition methodology for telephone companies adopted in D.86-12-099 and the desirability of making attrition year adjustments to the revenue requirements of telephone companies." (D.87-04-078, mimeo. p. 11). This workshop, held on August 11, 1987 was attended by representatives of local exchange companies, AT&T-Communications, PSD, E&C, and TURN. The positions of these participants, summarized in E&C's September 14, 1987 report to the Commission, are detailed in Appendix A. According to E&C, the workshop participants agreed that there were too many issues before the Commission to arrive at any meaningful resolution about attrition. Given that situation, the workshop participants were unwilling and unable to compromise their originally held positions. Both TURN and Pacific Bell stated that formal hearings were the appropriate way to deal with any modifications to attrition. Therefore, in its report to the Commission, E&C recommended that no further attrition workshops be scheduled, but that changes to the Commission's attrition policy and mechanism for telephone companies be effected through formal proceedings.

Given these workshop results and our expectation that Pacific Bell's new regulatory framework proposal will provide a future forum for addressing the mechanics of multi-year rate changes, we prefer to separate the question of 1988 attrition from the issue of the ultimate fate of the present attrition mechanism. Furthermore, it is absolutely necessary to have the benefit of a 1988 attrition filing in order to obtain the most recent financial information available from Pacific Bell, as we assess our future regulatory policy options.

Findings of Fact

1. Pacific Bell has filed a Petition for Modification of D.86-12-099 requesting that the December decision be modified to whatever extent may be necessary to remove any requirement that may exist for the utility to make a 1988 attrition filing on or before October 1, 1987.

2. The basis for Pacific Bell's Petition is the pendency of certain major issues, which may not be resolved entirely before October 1, 1987.

3. TURN has filed a motion for an expedited order to review 1988 financial and operational attrition, urging that Pacific Bell's rates be made subject to refund after January 1, 1988 to ensure that ratepayers receive the full benefit of any attrition adjustment even if the matter is not fully resolved by that date. TURN also urges rejection of Pacific Bell's Petition for Modification of the December decision, on the basis that the utility misconstrues or ignores the guidance in that decision in order to manufacture uncertainty and seek relief from its responsibility to file for 1988 attrition.

4. PSD opposes Pacific Bell's Petition for Modification on the basis that it repeats all of the arguments asserted in opposing a 1987 attrition filing, and that these arguments were considered and disposed of by the Commission in the December decision. In the absence of assertion of any new compelling reasons for the Commission to modify its stated intention to conduct a review of attrition issues in 1988, PSD believes that financial attrition and operational attrition should be reviewed in 1988.

5. In D.87-09-077 we relieved Pacific Bell from any obligation to make a 1988 attrition year filing on October 1, 1987, based on the imminence of our en banc hearing on alternatives to cost of service regulation for local exchange companies, and our desire to defer consideration of the merits of the utility's Petition until after the en banc.

6. Pacific Bell's concerns about the fairness of the current attrition methodology, as expressed at the en banc hearing, relate to the past application of labor productivity and depreciation. These issues are currently being considered on Phase 2 of the rate case and in A.87-04-049, where decisions are expected shortly, and thus Pacific Bell has a forum to address its fairness concerns.

7. Given (i) the conclusion of our E&C staff, as a result of August 1987 workshops on the attrition mechanism, that modifications to the status quo should be effected through formal proceedings, and (ii) our expectation that consideration of Pacific Bell's anticipated new regulatory framework proposal will provide a forum for addressing the mechanics of multi-year rate changes, we will separate the question of 1988 attrition from the issue of the ultimate fate of the present attrition mechanism.

8. A 1988 attrition filing will provide the most recent financial and operational data available, for use as a baseline as we assess our future regulatory policy options.

9. Pacific Bell's Petition does not raise any new issue not considered in connection with our review of 1987 attrition issues; indeed, several of the uncertainties that Pacific Bell cites in attempting to shield itself from the 1988 attrition filing, will be resolved by the end of this year, thus making the uncertainties less severe than they were at the time we issued D.86-12-099.

10. Pacific Bell's Petition does not contain facts sufficient to justify relief from the requirement that a 1988 attrition year filing be made, since most of the uncertainties it cites will be resolved by year-end 1987; however it appears more feasible to allow a slight delay in the filing in order to avoid undue complexity in calculating updates to arrive at a 1988 attrition year revenue requirement.

11. Assuming that the uncertainties Pacific Bell cites in connection with our review of the Tax Reform Act and the USOAR are resolved by year-end 1987, Pacific Bell may make the argument that such decisions have a definitely quantifiable effect on the attrition year revenue requirement within the parameters of D.86-12-099, mimeo. p. 25.

12. The 1988 attrition year filing will use the separations factors emanating from the Phase 2 decision.

13. The 1988 attrition year filing will use the labor productivity factor and/or mechanism adopted in the Phase 2 decision.

14. The 1988 attrition year filing will resolve technical update/depreciation issues in a manner consistent with our resolution of the issues in A.87-04-049, where a decision is expected by year end 1987.

15. It is appropriate to require Pacific Bell to make a 1988 attrition filing on or before January 30, 1988, using the methodology for operational attrition adopted in D.86-12-099, with the exceptions noted in the previous three findings.

16. A January 30, 1988 advice letter filing will allow consideration of the results of our Phase 2 decision, including the separations factors and labor productivity items adopted in that decision; depreciation-related issues resolved in A.87-04-049; and any other known or quantifiable effects of regulatory actions taken before December 31, 1987.

17. It is appropriate to require Pacific Bell to make a filing reflecting financial attrition for 1988 on or before January 30, 1988, and to require that the information Pacific Bell employs in this filing identify all financings and refinancings since January 1, 1987, as well as such dealings planned or executed through year-end 1987.

18. Consistent with the decisions issued in connection with Pacific Bell's 1987 attrition year, as well as Resolution No. T-12007, issued March 25, 1987, our review of financial attrition will take place within the context of the capital structure found reasonable in the interim opinion in D.86-01-026. No change in the authorized return on equity is contemplated.

Conclusions of Law

1. Pacific Bell's Petition for Modification of D.86-12-099 should be denied, to the extent it seeks relief from the requirement of making a 1988 attrition adjustment.

2. Pacific Bell should be ordered to file an advice letter addressing financial and operational attrition for 1988, in accordance with our preceding discussion.

O R D E R

IT IS ORDERED that:

1. On or before January 30, 1988, Pacific Bell shall file a 1988 attrition year advice letter, with service on all parties of record, addressing both operational and financial attrition, within the parameters of the discussion contained in the preceding text. The operational attrition request shall follow the attrition formula adopted in D.85-03-042 as modified by D.86-12-099 and D.87-04-078, with the exceptions noted in Ordering Paragraph 2. The financial attrition request shall identify all financings and refinancings since January 1, 1987, and set forth any such financings or refinancings planned or executed through the end of the year 1987.



2. In making the January 30, 1988 advice letter filing, Pacific Bell shall use the results of operations adopted in Phase 2, including the separations factors and labor productivity outcome ultimately adopted in the Phase 2 decision. Such filing shall also reflect the technical update/depreciation outcome of our proceedings in A.87-04-049.

3. TURN's motion for an expedited order to review 1988 financial and operational attrition is hereby granted, to the extent consistent with this order.

4. Pacific Bell's intrastate rates and charges shall be collected subject to refund with interest at the current three-month commercial paper rate after January 1, 1988, to account for any adjustments associated with the 1988 attrition year review.

This order is effective today.

Dated \_\_\_\_\_, at San Francisco, California.

APPENDIX A

Briefly, the comments at the workshop can be categorized into four groups as follows:

**Group 1 — Small Independent Telephone Companies**

This group is concerned with the preservation of their toll revenues. If they are authorized to offset any lost toll revenues in major rate applications and generic investigative proceedings, their concerns would be met. In addition, should the Commission adopt a high cost fund in Pacific Bell's current A.85-01-034, the question of attrition is moot.

**Group 2 — Mid-Size Telephone Companies**

This group consists of Continental, Roseville and Citizens telephone companies. There is no formal attrition mechanism in place for this group of companies. Ad hoc formulas are developed to fit the specific needs of each rate proceeding. Due to the many uncertainties such as the possibility of Pacific filing a new regulatory framework application, tax reform, USOA (Universal System of Accounts), Pacific's Phase II decision, etc., these companies favor the option to request an attrition allowance when they file their next rate application. By that time they feel many of the above issues will be resolved. Continental questions the need of this workshop since the Commission has two pending proceedings on attrition (1) the limited rehearing of Pacific's 1987 attrition resolution T-12007 and (2) General Telephone's (General) current A.87-01-002. Also Continental favors the elimination of attrition, since it is not appropriate in today's changing industry.

**Group 3 — Large Telephone Companies**

Pacific Bell and General Telephone are in this group. General favors keeping attrition the way they believe it is, that is, at the discretion of the utility. The Commission has broad authority to institute "show cause" proceedings. Pacific as well as Continental favors eliminating attrition since it is "inappropriate" in today's changing industry. However, if attrition is not eliminated Pacific prefers formal hearings to revise the attrition process.

**Group 4 — TURN and Public Staff Division**

Both agree that attrition should be bi-directional; between rate applications attrition protects the utilities during inflationary periods and it should benefit ratepayers during deflationary periods. TURN is awaiting action on its petition, filed February 5, 1987, to modify D.85-08-093 requesting that mid-sized telephone companies be ordered to make attrition filings. TURN, like Pacific, favors formal proceedings with all participants as respondents. TURN also prefers annual operational and financial reviews of all local exchange companies. PSD would limit annual operational and financial attrition to mid and large telephone companies.

THE NEXT 1  
DOCUMENTS  
ARE POOR  
ORIGINALS

MICROFILMING SERVICES  
WILL NOT ASSUME  
RESPONSIBILITY FOR THE  
IMAGE QUALITY

15. Pacific Bell's present rates will become unreasonable in 1988 unless they are adjusted to account for operational and financial attrition *if necessary*. ✓ DV

16. It is appropriate to require Pacific Bell to make a 1988 attrition filing on or before January 30, 1988, using the methodology for operational attrition adopted in D.86-12-099, with the exceptions noted in the previous three findings.

17. A January 30, 1988 advice letter filing will allow consideration of the results of our Phase 2 decision, including the separations factors and labor productivity items adopted in that decision; depreciation-related issues resolved in A.87-04-049; and any other known or quantifiable effects of regulatory actions taken by December 31, 1987.

18. It is appropriate to require Pacific Bell to make a filing reflecting financial attrition for 1988 on or before January 30, 1988, and to require that the information Pacific Bell employs in this filing identify all financings and refinancings from January 1, 1987, through December 31, 1987, including all such dealings planned or executed through year-end 1987.

19. Consistent with the decisions issued in connection with Pacific Bell's 1987 attrition year, as well as Resolution No. T-12007, issued March 25, 1987, our review of financial attrition will take place within the context of the capital structure found reasonable in the interim opinion in D.86-01-026. No change in the authorized return on equity is contemplated.

#### Conclusions of Law

1. Pacific Bell's Petition for Modification of D.86-12-099 should be denied, to the extent it seeks relief from the requirement of making a 1988 attrition adjustment.

2. Pacific Bell should be ordered to file an advice letter addressing financial and operational attrition for 1988, in accordance with our preceding discussion.

and labor productivity issues) would be resolved by the time the 1988 filing was made. It argues based on the fact that these issues are not resolved, and due to the pendency of other proceedings which may impact revenue requirement, that the attrition filing for 1988 should be postponed.

At the September 25th en banc session, Pacific Bell's representative clarified that the utility does not wish to avoid a 1988 attrition adjustment, but that it does have serious concerns about the fairness of the so-called attrition "cookbook" formula, especially in the areas of labor productivity and depreciation. Before addressing these fairness concerns, we have some observations about Pacific Bell's argument for delay.

We conclude that the pendency of the Phase 2 decision weighs in favor of allowing sufficient delay, to enable those preparing Pacific Bell's attrition year advice letter, and the staff members reviewing it, to use newly adopted separations factors and labor productivity findings. Otherwise the process of calculating the attrition adjustment will be unduly complicated by the need to update to recognize Phase 2 effects. Given the imminent issuance of the Phase 2 decision, we believe that granting a reasonable delay strikes the appropriate balance between Pacific Bell's concerns and the ratepayer interest. This remedy is also certainly preferable to dispensing with the 1988 attrition adjustment altogether on grounds of excessive complexity. Given current conditions in the telecommunications industry, Pacific Bell's present rates will become unreasonable during 1988 unless they are <sup>adjusted</sup> ~~adjusted~~ for operational and financial attritioning <sup>necessary</sup> ~~necessary~~. ✓ DV

In requiring such filing, we will establish a timetable designed to address some of Pacific Bell's concerns about other pending proceedings. First, a few observations are in order.

The information we heard at the September 24th en banc session made clear the competitive and technological forces now operating upon Pacific Bell and other local exchanges. This is a