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Decision 88 08 024 AUG 10 1988

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Pacific Bell (U 1001 C), a corporation, for authority to increase intrastate 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)
Application of General Telephone Company of California (U 1002 C), a California corporation, for authority to increase and/or restructure certain intrastate rates and charges for telephone services.	Application 87-01-002 (Filed January 5, 1987)
In the Matter of Alternative Regulatory Frameworks for Local Exchange Carriers.	I.87-11-033 (Filed November 25, 1987)
And Related Matters.	I.85-03-078 (Filed March 20, 1985) OII 84 (Filed December 2, 1980) C.86-11-028 (Filed November 17, 1986) I.87-02-025 (Filed February 11, 1987) C.87-07-024 (Filed July 16, 1987)

(For appearances see D.85-08-047, D.86-01-026, D.87-12-067, D.87-08-051, D.87-12-070, and Appendix A for additional appearances.)

INTERIM OPINION

In this decision we provide that a consolidated supplemental rate design proceeding will be conducted for Pacific Bell (Pacific) and GTE California (GTEC, formerly General Telephone Company of California) after Phase II of Investigation (I.) 87-11-033. This decision also establishes issues and testimony requirements for Phase II, but leaves the structure and timing of the supplemental rate design proceeding and Phase III of I.87-11-033 to future determination. We provide that the revenue requirement changes for Pacific and GTEC currently being accumulated in memorandum accounts will be placed in rates through a surcredit or surcharge mechanism. The two rate cases and the investigation are consolidated to facilitate the supplemental rate designs and development of the surcredit/surcharge mechanisms.

The Commissioners assigned to these cases[1] issued a Joint Assigned Commissioners' Ruling (the Joint Ruling) on July 11, 1988 in which they propose restructuring these proceedings in a manner similar to that adopted by today's decision. Parties were invited to file comments on the proposal no later than July 28, 1988. The following parties filed comments:

Pacific
GTEC
Citizens Utilities Company of California (Citizens)

1 Commissioner Donald Vial is the assigned Commissioner in the Pacific general rate case (Application (A.) 85-01-034 consolidated with I.85-03-078, OII 84, and Case (C.) 86-11-028). Commissioner G. Mitchell Wilk is the assigned Commissioner in the GTEC general rate case (A.87-01-002 consolidated with I.87-02-025) and in the Commission's investigation into alternative regulatory frameworks for local exchange carriers (I.87-11-033 consolidated with C.87-07-024).

Smaller Independent Local Exchange Companies
(Smaller Independents):
Calaveras Telephone Company
California-Oregon Telephone Co.
CP National
Ducor Telephone Company
Foresthill Telephone Company
GTE West Coast Incorporated
Happy Valley Telephone Company
Hornitos Telephone Company
Kerman Telephone Co.
Pinnacles Telephone Company
The Ponderosa Telephone Co.
Sierra Telephone Company
The Siskiyou Telephone Company
Tuolumne Telephone Company
The Volcano Telephone Company
Division of Ratepayer Advocates (DRA)
Toward Utility Rate Normalization (TURN)
AT&T Communications of California, Inc. (AT&T)
MCI Telecommunications Corporation (MCI)
US Sprint Communications Company (US Sprint)
Bay Area Teleport (BAT)
API Alarm Systems (API)
Western Burglar & Fire Alarm Association (WBFAA)

Prior to issuance of the Joint Ruling, procedural recommendations had been received via three avenues: a petition for modification of Order Instituting Investigation 87-11-033 (the OII)[2] filed by The Dun & Bradstreet Corporation, The Reuben H. Donnelley Corporation, and Donnelley Information Publishing, Inc. (Dun & Bradstreet); parties' comments regarding the framing of Phase II issues and possible restructuring of the investigation and related proceeding included in their comments on the Phase I settlement; and a DRA motion filed in Pacific's general rate proceeding requesting that Pacific's supplemental rate design be delayed until after Phase III of the investigation and that the

2 The term "OII" refers to the Commission order instituting the investigation; "I.87-11-033" and "the investigation" refer to the investigation itself.

revenue requirement accruing in the memorandum account be refunded to ratepayers by application of a surcredit to Pacific bills. Positions presented by parties in those filings as well as in the comments on the Joint Ruling are discussed throughout this decision.

A. Background

In the OII, the Commission laid out an intended road map for comprehensive reconsideration of the regulatory framework for local exchange carriers. The investigation itself was divided into three phases (Phase I: pricing flexibility for services subject to competition; Phase II: alternative ratemaking for basic rates; and Phase III: pricing flexibility and competition for intraLATA message toll and related services). Procedurally outside the investigation but closely coordinated with it, we contemplated a supplemental rate design phase of the Pacific Bell general rate case, to deal with rate design for major revenue requirement changes not included in Phase 2 of the rate case, e.g., the tax reform investigation, USOA rewrite, inside wire, and 1988 attrition decisions. In the interim, the OII provided for accumulation of these revenue requirement changes in a memorandum account. The OII anticipated that similar rate design issues for GTEC would be handled within its pending general rate proceeding.

The OII contemplated a staggered sequence for the phases of the investigation and for Pacific's supplemental rate design proceeding. Supplemental rate design hearings would be held after Phase I hearings but before a Phase I decision had been rendered. The Phase I decision would include further instructions for Phase II. Phase II hearings would be held following supplemental rate design hearings but before issuance of the supplemental rate design decision. The supplemental rate design decision would include further instructions for Phase III filings. Finally, Phase III hearings and a decision would wrap up the investigation.

The planned structure of hearings and decisions arose from a perceived logical sequence of addressing the interlocking issues. Phase I was to determine which, if any, local exchange carrier services (other than basic services, switched access services, and message toll and related services) are sufficiently competitive to warrant some pricing flexibility and whether the intraLATA competition ban should be lifted for such services. We contemplated development of a pragmatic approach to assessment of competitiveness and adoption of pricing flexibility for services found to be competitive in Phase I. Phase II would then consider alternative approaches to ratemaking and the setting of rates for services not subject to competition.

Message toll and related services were excluded from consideration in Phase I because it appeared that the current rate design for these services, with prices significantly above costs, made consideration of pricing flexibility and competitive entry for these services premature in Phase I. A central goal of the supplemental rate design proceeding for Pacific was to more closely align these rates with costs. Following the supplemental rate design decision, parties could then proceed with Phase III, which would consider pricing flexibility and whether competition for these services should be granted. Ancillary Phase III issues include possible modifications to the intrastate settlement procedures and possible extension of interexchange carrier access charges to the intraLATA realm.

We anticipated at the time the investigation was begun that hearings in Phase I, Pacific's supplemental rate design, and Phase II could be completed within 1988 with at most hearings in Phase III spilling over into 1989. The passage of time has made clear, however, that such a schedule will not come to pass. Two events in particular have transpired which make this schedule unworkable.

One of these is the settlement reached by some of the parties in Phase I of the investigation.[3] The OII saw establishment of criteria for determination of competitive market conditions as a preliminary step needed before proceeding to Phase II. However, the settlement as submitted does not resolve this issue. Instead, the settlement would allow limited flexibility for vertical services, centrex services, and private line high speed digital services, would allow broad competition for intraLATA private line high speed digital services, and would extend interim guidelines for special contracts developed for Pacific to all local exchange carriers. Generic criteria to assess competitive conditions are left unaddressed, and the terms of the settlement, if adopted, would be implemented on an interim basis pending permanent resolution of such issues in later phases of the investigation.

The second unanticipated development is that Decision (D.) 88-07-022 in Phase 2 of Pacific's general rate case did not adopt service costs as assumed by the OII. As a result, it now appears that a supplemental rate design proceeding could involve litigation of service cost issues and thus may take longer than anticipated in the OII.

In summary, we find ourselves unable to proceed at this time either with an expeditious supplemental rate design proceeding or with a Phase II based on adopted criteria for assessing competitive market conditions, as contemplated in the OII. We must choose among procedural changes which will either delay each portion of the planned sequence and/or restructure the proceeding

3 The settlement was filed with the Commission on April 1, 1988. Parties filed comments and reply comments on the settlement, with the deadline for the latter being May 17, 1988. A Commission decision on whether to accept the settlement is to be considered on August 24, 1988.

to allow some portions to remain more or less on schedule at the expense of significant delay in other portions. The remainder of this decision addresses the recommendations in the Joint Ruling.

B. Further Rate Design Proceedings

The assigned Commissioners recommend that no decision on rate design be issued at this time in GTEC's general rate proceeding and, instead, that a single rate design proceeding be undertaken on a consolidated basis for Pacific and GTEC sometime after Phase II of the investigation. They would leave the structure and timing of both the consolidated rate design proceeding and Phase III of the investigation to future determination.

GTEC and DRA argue that postponement of a new rate design in GTEC's rate case beyond the 1988 test year would be unreasonable since, unlike Pacific, GTEC has not had its rate design revised by the Commission since July 1984. In GTEC's view, a delay in its rate design decision would permit the existing record to grow stale and would greatly increase the length of any consolidated hearings.

GTEC asserts that its rate design changes proposed in its rate case are needed now. GTEC has proposed structural changes such as expanding measured rate service, restructuring local and extended area service rates, restructuring private line services, and eliminating touch call rates. GTEC states that these changes and others proposed in the rate case would provide GTEC with an updated foundation from which it can move forward into any alternate regulatory framework that may emerge from the current proceeding. GTEC and DRA have no objection to a followup supplemental rate design proceeding consolidated for Pacific and GTEC after Phase II, as long as an initial rate design decision is issued for GTEC based on the existing record.

Other than this issue regarding rate design for GTEC, DRA supports the deferral of a supplemental rate design proceeding until either during or after Phase III of the investigation. It

states that if the settlement submitted in Phase I is approved by the Commission, certain competitive pressures which would have been addressed in the supplemental rate design proceeding will be significantly reduced. Further, DRA believes that another round of rate design hearings for some or all of the local exchange carriers would be necessary concurrent with or following Phase III of the investigation, to implement any regulatory changes made by the Commission in the investigation. DRA argues that three rate design changes over a two-year period (Phase 2 in the Pacific general rate case, the supplemental rate design proceeding, and rate design changes following Phase III of the investigation) would be needlessly confusing to ratepayers.

The Smaller Independents state that they are not directly affected by most of the issues in the supplemental rate design proceeding but that two impacts of a deferral should be recognized. First, D.88-07-022 provided that Pacific's supplemental rate design proceeding would consider the rate design impact of removal of the present pooled interLATA access surcharge. The Smaller Independents state that this pooled surcharge will terminate on January 1, 1989 and comment that, with deferral of the supplemental rate design proceeding, Pacific can reflect removal of the pooled surcharge in its filing for its 1989 interLATA SPF-to-SLU revision.

A second issue which the Smaller Independents state is inherent in postponing the supplemental rate design proceeding is the resulting delay in reducing intraLATA toll rates to compensate for the effects on intraLATA toll costs of the intraLATA SPF-to-SLU shift adopted in D.87-12-067. The Smaller Independents state that the intraLATA toll rate reduction ordered in D.88-07-022 is less than the amount of nontraffic sensitive costs removed from the intraLATA pool as of January 1, 1988 and that this disparity will further increase if the January 1, 1989 SPF-to-SLU shift goes forward without accompanying toll rate reductions. They note that the only effect upon a pool of SPF-to-SLU cost reassignment when

the shift is not accompanied by an equal toll rate reduction is to cause the rates of individual companies to increase or decrease, with the rate changes summing to zero for the industry as a whole. They recommend that the Commission suspend further intraLATA SPF-to-SLU shifts until corresponding intraLATA toll rate reductions can be implemented.

All the other parties filing comments, with the exception of MCI, support or do not oppose the proposed deferral of the supplemental rate design proceeding. Pacific comments that it should be conducted at the same time as, rather than subsequent to, Phase III of the investigation, to ensure full consideration of the broad range of issues necessary to formulate a meaningful long term rate design. TURN believes that a realistic timetable must be established for this proceeding, and that a supplemental rate design phase at this point would be wasteful, ineffective, and confusing. TURN and API support consolidation of this proceeding for Pacific and GTEC, stating that they have long advocated uniformity of rates between Pacific and GTEC. WBFAA asks that the Commission address the scope and timing of the supplemental rate design as early and with as much specificity as possible, so that parties may allocate time and prepare budgets for these complex proceedings.

MCI, alone of the parties commenting on the Joint Ruling, recommends that the procedural order originally conceived by the Commission in the OII be retained. In its view, failure to identify the local exchange carriers' costs of providing various services prior to granting flexibility would leave the Commission powerless to identify and prevent monopoly or anticompetitive pricing practices and would subject ratepayers to considerable risk.

Implementation of Phase I Settlement Provisions

In its motion, DRA recognizes that a delay in the supplemental rate design proceeding would run contrary to the

expectation in the Phase I settlement that certain portions of the settlement, including unbundling of centrex and high speed digital services tariffs, would be implemented in the supplemental rate design proceeding before the end of 1988. Assuming that the settlement will be approved, DRA recommends that the Commission implement these rate design changes by requiring the local exchange carriers to file separate applications or advice letters. While we have not yet ruled on the acceptability of the settlement, parties were asked in the Joint Ruling to comment on DRA's recommendations.

None of the parties which joined in the settlement take the position in their comments that deferral of the supplemental rate design proceeding, which would prevent the Phase I settlement from being carried out exactly, would require the settlement to be scuttled. To the contrary, each party either supports DRA's proposed implementation of the rate design changes in the settlement or recommends other alternatives which, in its view, would effect the intent of the settlement.

We expect to consider the settlement on August 24, 1988. Parties' comments provide assurance that the proposed deferral of the supplemental rate design proceeding need not prejudge the acceptability of the Phase I settlement. We will discuss the specifics of the parties' comments in our upcoming decision addressing the Phase I settlement.

Discussion

We will adopt the recommendations of the assigned Commissioners regarding the timing of further rate design proceedings. We agree that a supplemental rate design proceeding could require development of a more extensive record and thus could take longer than originally contemplated. Such an undertaking at this time would necessarily entail a significant delay in Phase II.

Further, there will be additional revenue requirement adjustments approved for Pacific and GTEC as the investigation progresses due to, e.g., the audit and modernization phases of

Pacific's general rate case, 1989 SPF-to-SLU changes, and 1989 attrition. In addition, further rate design changes may be needed as a result of regulatory changes approved in this investigation. It appears that multiple rate design changes may not serve ratepayers nor be an efficient use of the resources of this Commission or those of the parties.

We also agree with the Joint Ruling's proposal regarding pending revenue changes for GTEC. The ALJ's proposed decision issued in GTEC's 1988 general rate case recommends a revenue reduction of approximately $328 million, to be implemented at this time through a surcredit mechanism. Unlike Pacific, the net amount accruing in GTEC's memorandum account is a revenue increase rather than a decrease. GTEC also has anticipated 1989 revenue adjustments due to SPF-to-SLU changes and attrition. The magnitude of the net result of all the upcoming changes for GTEC including the general rate case decision, or even whether it will be a net revenue increase or decrease, is not clear at this time.

We hesitate to recommend rate changes for GTEC of the magnitude indicated by the proposed general rate case decision on other than a surcredit basis at this time. We believe the best approach is to implement this and other revenue changes as they occur through a surcredit or surcharge (if appropriate) mechanism and then to consider final implementation in permanent rates once all the changes are known.

The Smaller Independents state that the present pooled interLATA access surcharge will terminate on January 1, 1989. We disagree, and refer parties to D.88-07-022, mimeo. page 216, where we state that:

> "The only surcharge that is affected by adoption of the proposed [High Cost Fund] is the pooled access services surcharge which we will eliminate in the decision we will issue following supplementary rate design hearings after our Phase I rate flexibility hearings in I.87-11-033."

The Smaller Independents also recommend that we suspend further intraLATA SPF-to-SLU shifts until corresponding intraLATA toll rate reductions are implemented. It is not clear whether they are proposing that this step be taken in today's decision; in any event we conclude that consideration of such a change at this time would be inappropriate. Parties may raise this issue in a more appropriate forum if they wish to do so.

Consolidation of further rate design proceedings for Pacific and GTEC with the investigation would enhance the Commission's ability to formulate consistent rate design policies for the two companies and to implement any regulatory changes which may be adopted on a consistent basis. We conclude that these proceedings should be consolidated.

We recognize that deferral of further rate design for Pacific and GTEC, unfortunately, will not meet the Commission goal articulated in the OII of bringing certain rates closer to costs in mid-1988. We are concerned also that this deferral might impede immediate implementation of alternative regulatory mechanisms to be considered in Phase II. As examples, Phase II implementation might require mechanisms to ensure that revenue changes resulting from a later supplemental rate design proceeding are indeed passed through in rates, or some realignment of rates prior to implementation.

These potential problems should not be viewed as prohibiting a move to Phase II at this time. However, they do highlight the need for parties to address in their testimony whether each regulatory proposal made in Phase II allows a verifiable reflection in rates of specific modifications in revenue authorizations and/or revenue allocations (such as the annual SPF-to-SLU shifts) which may be approved in the future. Such a characteristic would both mitigate potential problems due to delay in the supplemental rate design proceeding and allow for future rate changes such as those mentioned above.

MCI contends that a supplemental rate design proceeding is needed to determine costs of service before proceeding to consideration of any pricing flexibility. MCI's concerns would be better taken if the proposals being considered in Phase II encompassed, for example, very broad pricing bands or complete or almost complete deregulation of local exchange carrier services. The extent to which a specific proposal for pricing flexibility appears to allow anticompetitive conduct, given existing uncertainties about costs of service, is a topic which any party may raise in Phase II. Significant concerns in this regard could affect the amount of pricing flexibility which we might otherwise deem appropriate in Phase II.

We conclude that deferral of the supplemental rate design provided for in the OII is desirable. We emphasize that such deferral does not indicate a lessening of our aim to go forward with the indicated restructuring of rates as soon as it is administratively feasible to do so. Growing efficiencies of the network should be captured as soon as possible in more economic pricing of services as reductions in revenue requirements become available.

The adopted delay in the supplemental rate design proceeding will allow us to proceed, more or less on schedule, with Phase II of the investigation. It is our clear intent to reach a Phase II decision within the first quarter of 1989.

We prefer not to set strict procedural requirements regarding Phase III or the supplemental rate design proceeding at this time. Some parties have recommended that all local exchange carriers be included in the supplemental rate design proceeding, or that only specific services be considered in that proceeding. Which of the two proceedings should be undertaken first or indeed whether the two sets of issues should be consolidated is not clear from this vantage point. Just as events subsequent to the issuance of the OII have required the modifications adopted in this

decision, developments in Phase II could foreseeably require changes in whatever steps beyond Phase II we might establish at this point. The OII gave adequate guidance regarding issues which should be addressed. We prefer that further shaping of the supplemental rate design proceeding and the investigation beyond Phase II be deferred to the Phase II decision or, if appropriate, to further rulings by the assigned Commissioners or the assigned ALJ. Recognizing WBFAA's concerns, we will endeavor to inform parties of the anticipated structure of these portions of the proceeding in a timely fashion.

C. Treatment of Memorandum Accounts

In its motion in Pacific's 1986 general rate proceeding, DRA requests that revenue requirements accruing in Pacific's memorandum account be refunded to ratepayers through a surcredit mechanism as quickly as possible. In DRA's view, the Commission would likely not issue an order in the supplemental rate design proceeding before the end of the year, since many special interest groups might participate in hopes of a share of the funds in the memorandum account. On the other hand, DRA believes that a surcredit can be established and implemented quickly.

The assigned Commissioners similarly conclude in the Joint Ruling that the memorandum accounts for Pacific and GTEC should be closed out as quickly as possible, and recommend that a surcredit/surcharge mechanism be implemented which would both amortize the existing memorandum account balances over a short period and implement the authorized revenue changes on an ongoing basis. Additional revenue changes authorized subsequently would also be reflected in rates through adjustments to the surcredit/surcharge mechanism. In the Joint Ruling, parties were asked to comment on what information is needed to implement a surcredit/surcharge mechanism and to provide recommendations regarding the best procedural approach to develop the mechanism. Comments were also solicited regarding an appropriate amortization

period for the existing memorandum account balances and whether additional customer notice is needed prior to reflection in rates of any rate changes being accrued in the memorandum accounts.

All parties concur that the memorandum account balances should be closed out, but parties differ regarding specifics of the process. GTEC discusses in some detail the status of its revenue changes receiving memorandum account treatment.

Regarding revenue requirement adjustments relating to tax reform, GTEC notes that it has made the advice letter filing required by D.88-01-061 in I.86-11-019 to implement a surcharge/ surcredit to reflect 1987 revenue requirement adjustments but that Commission action is still pending. It also notes that closing briefs on certain unresolved tax reform issues are due in August. GTEC recommends that the tax issues be resolved in I.86-11-019 and that the related memorandum account be closed out through that proceeding.[4]

GTEC also mentions that inside wire revenue requirement changes are pending, with hearings held and briefs filed. GTEC concludes that implementation of inside wire revenue requirement impacts should be deferred to a later date.

According to GTEC, its important balancing account item is the revenue requirement impact associated with USOA. Beginning January 1, 1988, GTEC and other utilities record the revenue requirement impacts of adopting the new FCC rules in a balancing account, as provided by D.87-12-063 in I.87-02-023. GTEC urges the Commission to consider disposition of its resulting revenue increase as soon as possible. GTEC recommends that the USOA

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4 We note that D.88-04-065 modifying D.88-01-061 provides that, to the extent the pending 1988 general rate case decision for GTEC does not fully reflect the effects of tax act changes, GTEC shall record the difference in a memorandum account and dispose of such balance as the Commission further orders.

increase be implemented through GTEC's 1988 test year rate case and netted against its imminent rate case reduction, with the USOA amortization period set to recover the USOA amount in as short a period as possible without causing an overall increase in customer bills. GTEC recommends that the pending rate case decision require that the revenue requirement changes adopted therein be accrued in a balancing account and be initiated when a decision finalizing the USOA revenue impacts is issued. GTEC concludes that this approach would be appropriate and cost effective and would reduce customer confusion.

DRA recommends that the 1988 memorandum account balance for Pacific be amortized over a four month period. DRA cautions that a lump sum credit might unfairly advantage or disadvantage customers who experience unusually high or low bills during the month of the refund. AT&T suggests that an amortization period be set so that the balances are depleted by or before the end of 1988. On the other hand, Pacific, TURN, and MCI recommend a one-time bill credit for Pacific. TURN believes that a one-time credit would be a more equitable way to refund money. Since the funds accruing in GTEC's memorandum accounts may result in a rate increase, however, TURN recommends that amortization of GTEC's balance be spread over several months.

Pacific recommends that the ongoing revenue changes authorized at the end of 1988 be reflected in an ongoing surcredit/surcharge beginning January 1, 1989. The surcredit/surcharge would be adjusted subsequently only for major revenue requirement or regulatory policy changes, e.g., 1989 attrition or adoption of a new regulatory framework. In Pacific's view, minor revenue changes should accumulate in the memorandum accounts until a supplemental rate design decision, at which time the net accumulated balance in the memorandum accounts would be returned via a one-time bill adjustment. Pacific states that this approach would avoid unnecessary customer confusion and administrative burdens that

would result from fluctuating the surcredit/surcharge every time minor revenue changes are authorized.

DRA recommends that the Commission require the utilities to track the balance in each memorandum account until the account is closed in order to true-up the changes in revenue requirements adopted in the USOA, inside wire, and tax proceedings against the amounts refunded to customers and the amounts provided through rate reductions. DRA recommends that a final true-up be made in the supplemental rate design proceeding.

AT&T, MCI, and US Sprint recommend that the surcredit/surcharge mechanism be applied to all intraLATA services, including access charges. DRA recommends that services currently excluded from billing surcredits or surcharges continue to be excluded. AT&T states that any deviation from an across-the-board adjustment would constitute adoption of an interim rate design, and would almost certainly be contested by one or more interested parties.

Parties have various recommendations regarding how the surcredit/surcharge mechanism would be implemented. GTEC wants its surcredit/surcharge mechanism implemented in its rate case, and does not believe that separate workshops or hearings are needed. GTEC states that an agreement between GTEC and DRA is imminent regarding an acceptable methodology to be used to calculate the 1988 revenue requirement of USOA; it anticipates filing a motion in the USOA case "within the next few days" requesting adoption of the agreed-upon methodology.

DRA recommends that the Commission order Pacific to file an advice letter by October 1, 1988 proposing refunds to customers by way of a surcredit, based on estimates of January 1, 1989 memorandum account balances, and proposing an ongoing reduction associated with the recurring accruals in the memorandum account. It states that a prehearing conference could then schedule settlement workshops during which parties could propose alternative

treatment of the memorandum account refunds. Other parties state that workshops, hearings, or written comments would suffice.

Parties also differ in their views regarding notice requirements. Pacific believes that no additional customer notice is legally required prior to reflecting the net balance of its memorandum accounts in rates, noting that its balance is negative. GTEC states that implementation of its USOA changes through its ongoing rate case would comply with due process notice requirements which, it contends, would have been met through prior customer notification of pending changes to rates in the rate case.

DRA believes that the utilities should be required to formally notify customers of any rate increases which may occur as a result of memorandum account issues. However, since Pacific will likely require refunds and rate reductions; DRA recommends that Pacific only be required to provide customer notice in the form of bill inserts in the first month's bills in which the refunds and rate reductions are applied.

Discussion

We agree with the assigned Commissioners that delay in reflecting any revenue changes in rates until a supplemental rate design proceeding could result in unacceptably large accruals in the memorandum accounts. The resulting one-time refunds or amortized surcharges or surcredits could have potentially undesirable short term rate distortions. Such accruals could also exacerbate any problems in ensuring that future rate changes indeed reach ratepayers under any modified regulatory framework. We want to make sure that any regulatory changes are implemented with a "clean slate" in which all prior authorized revenue reductions have been realized by ratepayers. We conclude that all authorized revenue changes being accrued in memorandum accounts should be reflected in rates and existing balances closed out.

We note that final determination of revenue requirement changes due to tax reform and USOA changes is still pending. We do

not believe that GTEC's revenue changes to be approved in its rate case should be delayed until these other changes are finalized; our decision in the rate case will implement the rate case revenue changes on a surcredit basis.

Some specifics of placing current balances and amounts accruing in the memorandum accounts into rates are best decided in the context of a detailed proposal in which the complete impacts on rates can be determined. However, certain basic attributes can be established at this time. We will require that Pacific and GTEC make advice letter filings no later than October 1, 1988 and that the Commission's Advisory and Compliance Division (CACD) hold workshops shortly thereafter, to develop bill-and-keep surcharge/surcredit mechanisms to be effective January 1, 1989 which coordinate with 1989 attrition and interLATA and intraLATA SPF-to-SLU changes, and which use an estimated 1989 billing base. The surcharge/surcredit mechanism should implement on an ongoing basis all revenue changes authorized as of October 1, 1988 which are receiving memorandum account treatment as of that date. Existing balances should also be closed out. Whether the account balances should be amortized or refunded will depend on the magnitude of the balance and on the effort involved in calculating a one-time refund. We will decide this issue in the context of the advice letter filings. We agree with parties that the surcharge/surcredit mechanism should apply to all local exchange carrier services (access, intraLATA toll, toll private line, and exchange services), with the exception of those services currently excluded.

To prevent over- or undercollections for AT&T as a result of the surcredits or surcharges emanating from Pacific's and GTEC's advice letter filings, we also require that AT&T file an advice letter by October 15, 1988 to pass on to its customers the resulting changes in access charges it pays to the local exchange carriers, including attrition and interLATA and intraLATA SPF-to-SLU changes, with the effective date to also be January 1, 1989.

Pacific differentiates on some unspecified basis between "major" and "minor" revenue changes and recommends that minor revenue changes accumulate in the memorandum accounts until a supplemental rate design decision. The Joint Ruling explicitly contemplated pass-through of USOA, tax reform, attrition, and inside wire revenue changes; we do not know whether Pacific considers any of these minor. We anticipate that any additional revenue changes for these items authorized subsequent to implementation of the surcredit/surcharge will be reflected immediately in rates through adjustments to the surcredit/surcharge mechanism as needed, to prevent further accruals and reduce the size of future amortizations. Any decision authorizing such revenue changes will discuss how the change will be reflected in rates.

Parties may protest the advice letter filings and request hearings if they believe that hearings are required. However, based on the comments of the parties, we see no need to plan prehearing conferences or evidentiary herings at this time.

Notice requirements for the advice letter filings depend on whether the underlying requested rate changes are increases or decreases. Public Utilities (PU) Code Section (§) 454 requires that customer notice be given of any proposed rate increase; we conclude that this notice requirement applies to GTEC's USOA changes. GTEC should provide notice of its advice letter filing through a customer bill insert pursuant to § 454. For a proposed decrease, as is anticipated for Pacific, customer notice through a bill insert in the first bill reflecting the decrease, as DRA suggests, will suffice.

D. Scope of Phase II

The assigned Commissioners recommend that parties be allowed to file in Phase II their regulatory proposals in toto, including regulatory strategies for those services originally slated for consideration in Phase I and Phase III. Parties would

be required to address as part of their Phase II testimony whether monopoly and competitive services should be treated differently and, if so, what competitiveness criteria should be used. Phase II and Phase III would not be consolidated; however, discussion would not be prohibited in Phase II of any Phase III topics which play an integral role in a party's Phase II proposals. The Joint Ruling contains a list of 17 topics for inclusion in Phase II testimony.

This recommendation is based on GTEC's comments on the Phase I settlement, in which GTEC recommends that Phase II be broadened to include ratemaking treatment of all intraLATA services, not just those not subject to competition as contemplated by the OII. GTEC notes that its own alternative ratemaking proposal covers all of its services and does not require a determination that any particular services are competitive. Pacific agrees that the "not subject to competition" qualifier in Phase II should be eliminated as an unnecessary limitation that, in its view, could preclude full consideration of proposals that would otherwise be appropriate for consideration in Phase II.

Pacific, GTEC, and the Smaller Independents indicate in their comments that they support the assigned Commissioners' recommendations concerning the scope of Phase II.

Citizens recommends that small company issues be added to Phase II, in particular protection for small company subscribers and the adequacy of current pooling arrangements and the High Cost Fund. Pacific notes that these issues are planned for Phase III and offers its opinion that Phase III is the appropriate place for them.

DRA recommends that separation between Phase II issues and Phase III issues be made more clear. While it states that issues related to intraLATA competition cannot be ignored in Phase II, DRA does not want Phase II to get bogged down in details related to intraLATA competition. It urges the Commission to direct the ALJ to defer to Phase III those issues related to the

implementation of intraLATA competition, intraLATA access charges, and intrastate separations. DRA also does not wish to see the major policy considerations in Phase II hearings overshadowed by the details of implementation, and proposes that the following implementation issues be reserved for implementation hearings or review following the resolution of policy issues in Phase II:

- Any rate design changes,
- Any cost allocation changes,
- Any new cost studies,
- Tariff filings, and
- Major changes to tariff, application, or advice letter filing procedures.

DRA states that implementation hearings could be incorporated into a revenue requirements adjustment proceeding in lieu of a test year 1990 general rate case. DRA proposes that the Commission require each party to address which features of its proposal would be directly implementable following Phase II hearings and which would require further hearings under these guidelines.

TURN complains that the expanded scope of Phase II proposed in the Joint Ruling "muddles" all three phases and provides little direction to parties which must prepare responses to voluminous utility filings. TURN is concerned that consumer advocates and others will be ill-prepared to adequately address additional issues if they come up. It contends that the Commission should rule on the propriety of all local exchange carrier testimony at least one week prior to the due date for reply testimony and should give respondents additional opportunities, if warranted, to respond to any Phase III testimony included in Phase II filings.

AT&T is concerned that the Phase II issues as set forth in the Joint Ruling are framed in such a manner as to provide the moving parties the option to avoid development of criteria to be

used to determine the competitiveness of services for which flexibility might be sought. AT&T strongly believes that the development of such competitiveness criteria is necessary for a complete consideration of alternative regulatory proposals that provide for rate flexibility. AT&T concludes that the Commission should ensure that all parties provide comments on what criteria should be used to determine the competitiveness of a service, and that they apply these criteria to each local exchange service that is affected by a recommended change in regulation.

AT&T contends that it is premature to rule that consolidation of Phase II and Phase III is unwarranted, stating that this depends directly on the requested relief sought by the local exchange carriers. AT&T suggests that parties be allowed to seek the joining of Phase II and Phase III issues once the proposals have been submitted in Phase II.

WBFAA, in a position similar to AT&T's, recommends that the basic Phase I questions asked in the OII be addressed in Phase II. In its view, answers to these questions are relevant whether or not the settlement is adopted in whole or in part. WBFAA points out that, even if adopted in toto, the settlement is a short run measure addressing only specific services without resolving the fundamental questions posed in the OII. In WBFAA's view, it would be inappropriate to set rules for cost determinations and ratemaking without first giving consideration to whether a particular service is subject to competition. It states that if a particular monopoly service is construed as competitive with no need for regulatory protection, its users may be subjected to unregulated price and service modifications that are unwarranted.

MCI recommends that Phase II and Phase III be inverted and that the Commission conclude its review of competitive issues prior to beginning a review of alternative regulatory frameworks for monopoly services. As an alternative, MCI suggests that Phase II and Phase III issues be merged. It states that the

assigned Commissioners' suggestion that parties be permitted to address issues such as intraLATA entry in their Phase II testimony is a step in the right direction but that it does not go far enough. MCI's position continues to be that there should be no consideration of pricing flexibility for a local exchange carrier service until the Commission has determined that the service faces effective competition. It states that the very purpose of utility regulation is to serve as a proxy for competition that does not exist. MCI asserts also that no pricing flexibility should be granted for local exchange carrier services while there is a prohibition against competition with those services.

US Sprint states that the Joint Ruling takes a major step by indicating that parties can file total regulatory proposals in Phase II which include services from other phases. In its view, parties should be allowed to explain fully how all the issues interrelate in order for the Commission to make informed decisions in the important policy matters in this proceeding. US Sprint would support other parties' suggestions that Phase II and Phase III be consolidated or that Phase III precede Phase II and states that, at a minimum, the Commission should encourage full discussion in Phase II of whether alternative rate structures should be permitted if competitive entry is not allowed. It contends further that any actual rate restructuring should await consideration of Phase III issues and that Phase II should not be used to preempt discussion of supplemental rate design or Phase III issues or to prejudge any specific result.

BAT submits that the portion of the Joint Ruling pertaining to the scope of Phase II should be clarified to delineate the scope of Phase II and its interplay with Phase III. In its view, if the Joint Ruling were all that the parties had to guide them on the scope of Phase II, the result would be confusion and potential chaos in the Phase II hearings as the parties argue over which issues were or were not included in the hearings.

Dun & Bradstreet Petition for Modification

On February 24, 1988, Dun & Bradstreet filed a petition for modification of the OII requesting that Phase II include examination of the local exchange carriers' policies and practices regarding use and availability of the telephone companies' subscriber data for directories, business lists, and other competitive or potentially competitive information services.

Dun & Bradstreet asserts that this issue involves the basic question of use by the telephone companies and others of assets and byproducts of the local monopoly franchise to participate in competitive or potentially competitive businesses. In its view, the appropriate scope and degree of regulation of subscriber lists depends upon proper identification of the relationship between monopoly activities and competitive activities.

Dun & Bradstreet alleges that Pacific provides to Pacific Bell Directory and other Pacific affiliates, on an exclusive basis, subscriber information not presently required for Yellow Pages directories or provided for by tariff. Dun & Bradstreet further alleges that GTEC engages in similar transfers of information to its directory publishing operations. In Dun & Bradstreet's view, the Commission must determine how such information is to be made available to telephone company affiliates and third parties so as to maximize consumer and ratepayer welfare. It argues that these questions are too important to ignore or defer and are conceptually inseparable from the matters the Commission has undertaken to resolve in this investigation.

In response to the Dun & Bradstreet petition, GTEC and Pacific submit that the issues raised by Dun & Bradstreet are so different from Phase II issues identified in the OII that it would be inappropriate to include them in this proceeding. GTEC and Pacific recommend that, if the Commission is to entertain claims of

the type Dun & Bradstreet describes, this be done in a separate proceeding.

Discussion

We establish the scope of Phase II to a large extent as recommended in the Joint Ruling. The OII provided that a Phase I decision would include further instructions for Phase II testimony. We conclude, however, that Phase II issues and testimony requirements should be set at this time in order to allow Phase II to proceed more expeditiously. We allow for changes by subsequent rulings by the assigned Commissioner or ALJ, as appropriate.

MCI believes that the first step toward regulatory changes is a determination that effective competition exists for the service. MCI's procedural recommendations are similar to the Prediction Approach discussed for AT&T in D.87-07-017 in I.85-11-013. As in that interLATA proceeding, it is not clear to us that development of competitiveness criteria and a finding of effective competition are necessary precursors to adoption of alternative regulatory proposals for local exchange services. We had anticipated in the intraLATA OII that the level of accuracy of cost information could affect the degree of pricing flexibility which we would be willing to adopt for a local exchange carrier. We noted that, even in the face of imprecise cost information, a limited flexibility may be acceptable, along the lines of the Observation Approach developed in D.87-07-017. A similar rationale can be applied to the question of whether effective competition must be established before any pricing flexibility is granted.

While not prejudging the issue, we conclude that some amount of limited pricing flexibility may be appropriate even absent clear evidence of sustainable competition. We recognize that certain other states have adopted types of regulatory flexibility which do not distinguish between competitive and noncompetitive services. GTEC asserts that its alternative ratemaking proposal covers all services and does not require a

determination that any particular services are competitive. We note also that the price cap regulation recently proposed by the Federal Communications Commission (FCC)[5] divides interstate services into two "baskets" of related services, with linked prices within each basket, but with no explicit determination that any individual service is competitive.

We conclude that parties should be allowed to file in Phase II their entire regulatory proposals, including regulatory strategies for those services originally slated for consideration in Phase I and Phase III.[6] However, the absence of clear competitiveness criteria, which we had anticipated emerging from Phase I, will necessarily limit the extent of regulatory flexibility which can be found in the public interest at this time.

The testimony requirements proposed in the Joint Ruling would require parties to address issues regarding competitiveness criteria from Phase I only if their specific proposals involve a finding of competitiveness, as AT&T and WBFAA point out. These parties request that all parties be instructed to provide testimony on competitiveness criteria and apply those criteria to each service for which regulatory changes are requested.

After serious consideration of AT&T's and WBFAA's requests, we will reject their suggestions at this time. Looking toward the future, we remain convinced that any substantial retreat from close regulatory oversight would require clear evidence of the

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5 Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Further Notice of Proposed Rulemaking, released May 23, 1988.

6 We note that the regulatory changes in the Phase I settlement are meant by the parties to be interim in nature, until the generic issues could be considered in later phases of the investigation. Therefore, it is appropriate that parties present their recommendations for ongoing regulatory treatment of these services as part of their expanded Phase II testimony.

existence of strong market forces and competitive conditions. However, development of guidelines for establishing that such conditions exist may not be necessary at this time. We will retain the requirement in the Joint Ruling that parties address as part of their Phase II testimony whether monopoly and competitive services should be treated differently and, if so, what competitiveness criteria should be used. We will, however, add the Phase I question on page 10 of the OII regarding consumer safeguards.

We do not wish to simply consolidate Phase II and Phase III. Issues regarding intraLATA competition, intraLATA access charges, and intrastate separations are not included in the topics for Phase II set forth below. However, we do not wish to prohibit entirely the discussion of such topics in Phase II, if they play an integral role in any party's Phase II proposals. At the same time, we will remain wary of any unnecessary expansion of the issues which might make Phase II unduly cumbersome.

Parties have asked that issues to be addressed in Phase II and issues to be deferred to Phase III be delineated more clearly than in the Joint Ruling. We do not believe this advisable at this time. We recognize that the proceeding will require close oversight by the assigned Commissioner and ALJ to prevent the "bogging down" feared by DRA and others. However, submittal of the complete regulatory proposals, including issues specified in this decision, is needed before the proceeding can be shaped with more specificity. We reiterate that any party which raises Phase III issues should recognize that they may be deferred, either by rulings prior to hearings or by the Phase II decision.

The Dun & Bradstreet petition should be denied. The intent of the investigation is to look at alternatives or refinements to the current cost-of-service approach to setting revenue requirements and establishing rates. We agree with GTEC that addressing at-best tangential issues such as those raised by Dun & Bradstreet would not serve the objectives of the

investigation. Further, we note that Dun & Bradstreet filed a complaint (C.88-06-031) against Pacific on June 21, 1988 raising substantially the same issues. Such a complaint is a more appropriate forum for the issues it raises.

We do not foresee that parties' Phase II testimony will depend on the contents of a Phase I decision. At this point, we anticipate that the Phase I decision will establish whether interim measures should be implemented while more permanent changes are considered in Phase II. However if, in reaching our decision on the Phase I settlement, we conclude that a linkage exists we may establish supplemental Phase II testimony requirements in the Phase I decision.

It is our hope that any regulatory changes adopted in Phase II can be implemented directly as a result of Phase II. We require that parties specifically address whether their regulatory proposals can be implemented following Phase II or whether a followup proceeding, as envisioned by DRA, would be needed.

Independent of parties' positions, there is no certainty in this regard until the record is developed. It is conceivable that we would conclude at the end of Phase II that an overall framework should be adopted but that implementation of some or all of it should be delayed pending further proceedings. It could be that full implementation would require, for example, development of a supplemental rate design or of criteria for determination of the extent of competitiveness of certain services and the lifting of entry barriers for competitive services. Alternatively, further evidence regarding the effects of specific proposals on, for example, settlements may be needed before a statewide policy can be adopted. These uncertainties buttress our conclusion that procedural steps beyond Phase II are best developed once Phase II is well underway or completed.

The list of Phase II issues set forth below is built from the list in the Joint Ruling, with several modifications and

clarifications requested by certain parties in their comments. We urge parties to provide full information on all aspects of their proposals, and to assist in the development of a full record to support implementation of their proposals with a Phase II decision.

Parties' Phase II testimony is required to address at least the following:

1. What should be the basis for ratemaking? Should cost-of-service regulation continue to be used, or would some alternate form of regulation, e.g., social contract, be more effective in meeting the Commission's goals discussed in the Notice of En Banc Hearing?

2. If the Commission continues using cost-of-service regulation, are there any modifications that should be made to make the ratemaking process more effective?

   a. Should regulation separate basic or monopoly services from competitive services and treat them differently? If so, what criteria should be used to draw the distinction, and what services are monopoly or competitive based on those criteria?

   b. What steps should the Commission take to ensure that basic or monopoly services do not cross subsidize competitive services? How could cross subsidizations be detected?

   c. What, if any, additional incentive mechanisms for productive efficiency should the Commission institute?

3. If some form of social contract or other "macro" regulatory approach is proposed, what would the basic terms be?

   a. If price caps or indices are involved, what would be the basis for them? Would updates to reflect, e.g., cost escalation, productivity improvements, or external events be required? If so, what types of updates would be

appropriate and how would they be calculated and implemented?

b. To what extent do alternative proposals depend on some form of "regulatory lag" (delay between Commission reviews of rates and costs) as a stimulus to efficiency?

c. Would there be any sharing of additional profits with ratepayers?

d. What would be the length of any contract? What would happen after the expiration of the contract?

e. If the recommended ratemaking approach would be in effect only for a limited time, how would the proposal promote long term benefits to ratepayers?

f. Are there any circumstances under which external events or utility performance would terminate the contract?

4. Should there continue to be regularly scheduled reviews of rates, revenue requirements, or earnings, or should the timing of reviews be based on utility or Commission request or performance criteria established in advance?

5. What effect would the recommended ratemaking approaches have on basic rates? If appropriate, use historical data to estimate how the recommended ratemaking approaches would have affected basic rates in recent years.

6. How would, first, the current form of regulation and, second, the recommended ratemaking approaches perform under the following conditions for the next five years:

a. Projected inflation and interest rates?

b. High inflation and interest rates?

c. Low inflation and interest rates?

d. Removal of the ban on intraLATA competition?

e. Severe bypass?

f. A substantial decline or end to the cost-cutting impacts of technological change?

Specifically, what would be the impact on basic exchange, toll, private line, and other rates? What would be the financial impacts?

7. What would be the impact of the recommended ratemaking approaches on specific customer groups, e.g., urban residential, rural residential, urban business, rural business, etc.?

8. What are the risks and benefits of the recommended ratemaking approaches for local exchange carriers? For ratepayers? How can the risks be measured?

9. What impact would the recommended ratemaking approaches have upon various service quality indicators?

10. What type of updating or attrition process would be appropriate for the recommended ratemaking approaches?

11. Should there be some special ratemaking treatment for new services (including ONA)?

a. What type of capital investment review is appropriate?

b. How can substantial uncertainty of demand be best taken into account in deciding whether to approve new services and how to regulate them?

c. To what extent is economic pricing of Basic Service Elements an essential precondition to the projection of demand for new services?

d. In planning for new services, is some form of regulatory reform more or less urgent than progress in achieving more economic pricing?

e. Who should bear the risk for uncertain ventures? How?

f. Should trials and market tests be treated differently than proposals for permanent new services? If so, how?

12. What distinctions should be made among local exchange carriers in designing ratemaking approaches?

13. How well does each party's proposal allow explicit and verifiable flow through of changes in revenues or revenue allocations approved in the future?

14. How well does each party's proposal allow measurement of profits?

15. How would the ratemaking recommendations of each party be implemented? Could implementation be immediate or would a followup proceeding be needed?

16. Would each party's proposal require (now or later) determination of costs or competitiveness of specific services? If so, how and when should this be done?

17. What monitoring procedures should be implemented to allow assessment of utility compliance with the regulatory proposals, if adopted, and the effects of the regulatory proposals on ratepayers and the marketplace? How would the short term and long term benefits to ratepayers be assessed? What administrative requirements would be imposed on the local exchange carrier and on the Commission?

18. What would be the impact of each party's proposal on the costs of regulation?

19. If a party's ratemaking recommendations were adopted, what issues would need to be

addressed in followup phases or proceedings to complete the scope of the investigation and supplemental rate design described in the OII?

20. Compare each party's proposal with existing procedures and with the FCC price cap proposal. Discuss the relative merits of any differences between each proposal and both existing procedures and the FCC proposal.

21. Address the legal basis and enforceability of any proposal to foreclose a local exchange carrier from filing for rate relief for a specified period of time.

22. What, if any, additional safeguards are needed to ensure just and reasonable rates for ratepayers and fair competition for competitors of local exchange carriers if pricing flexibility is granted?

23. What, if any, specific provisions should be made to afford adequate protection for small independent telephone company subscribers under the proposed regulatory approaches?

Each party which proposes a comprehensive regulatory alternative must answer each of the above questions for its own proposal. Parties are encouraged, but not required, to address other parties' proposals as well. To further assist our evaluation of the parties' proposals in Phase II, each party which files comments, reply comments, or any other filings with the FCC in response to its Further Notice of Proposed Rulemaking should submit such documents as part of its testimony in Phase II.[7]

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7 Comments on the FCC proposal were due not later than July 26, 1988 and reply comments are due not later than August 26, 1988.

E. Phase II Schedule

The assigned Commissioners propose that Pacific and GTEC submit their prepared testimony on Phase II issues no later than August 22, 1988 and that other parties submit prepared testimony no later than September 19, 1988. Reply testimony would be submitted by all parties by October 17, 1988. Hearings could then be scheduled commencing about November 1, 1988. Parties were asked to comment on the workability of this proposed schedule in light of the issues delineated by the Joint Ruling.

Pacific recommends that the submittal dates of all testimony other than Pacific's and GTEC's initial testimony be moved forward to allow additional time to prepare for hearings. Under its proposal, all parties submitting testimony proposing a comprehensive alternative regulatory framework would file concurrently by August 22, 1988, other parties would submit their testimony by September 12, and reply testimony would be submitted by October 10.

GTEC states that the proposed August 22, 1988 submittal date for its testimony will be difficult for GTEC to meet. It notes that comments on the Joint Ruling and comments on the ALJ's proposed decision in GTEC's general rate case were due the same day and that, as a result, its resources have been considerably stretched. GTEC states that it will make every effort to submit its policy testimony describing the company's overall plan as proposed, but requests permission to file the testimony of its technical support witnesses by September 19 if the company cannot reasonably complete the work by August 22. In GTEC's view, this would still allow parties to file reply testimony by October 17, as proposed in the Joint Ruling.

The Smaller Independents believe that a Phase II schedule should not be set until a Phase I decision is issued, for several reasons. In their view, the Phase I decision will reflect the Commission's reaction to the settlement and offer guidance on the

extent to which settlement is an appropriate device for resolution of Phase II issues. The Joint Ruling also suggests that the Phase I decision may alter the scope of Phase II testimony. Finally, the Smaller Independents state that the Phase I decision could well affect the content of Phase II testimony even if the list of issues is not redefined. They recommend that a prehearing conference be held after the Phase I decision is issued, at which time Phase II scheduling could be determined based on input from all participants.

DRA believes that the timetable for submittal of testimony set forth in the Joint Ruling is adequate, but expresses concern about the anticipated schedule for the hearings and beyond. Given the complexity of the issues and the multitude of likely parties, DRA envisions the potential for protracted hearings. Since the Phase II issues involve the entire structure of the industry and may have impacts for many years to come, DRA hopes the Commission will not impose an arbitrary deadline or restriction on hearing time, but rather allow as much time as needed for the full consideration of these weighty matters.

As discussed previously, MCI believes that the Commission should go forward with rate design proceedings for Pacific and GTEC before considering Phase II issues. As a result, MCI does not endorse the procedural schedule envisioned in the Joint Ruling. Furthermore, MCI states that, even if the Commission rejects MCI's proposal in this respect, the proposed schedule should be adjusted for other reasons. The proposed schedule does not, in MCI's view, allow sufficient time for discovery on the local exchange carriers' initial filings. MCI recommends that the dates for submittal of initial testimony by interested parties and for reply testimony by all parties should be extended to October 1 and November 1, 1988, respectively. MCI concludes that hearings could commence on approximately November 15, 1988.

Discussion

Parties' comments do not convince us that the schedule set forth in the Joint Ruling should be modified at this time. The comments, in general, request more time for an individual party's preparation at the expense of other parties' schedules. We believe the schedule in the Joint Ruling is reasonable. If problems such as anticipated by GTEC or MCI arise a party may request that the schedule be adjusted. We urge all parties to cooperate fully in undertaking and responding to discovery and to make every effort to forestall the need for any schedule modifications. In order to provide flexibility without further Commission action, the assigned Commissioner or assigned ALJ may modify the schedule for Phase II testimony as needed.

We see no need to maintain the requirement established in the OII that testimony be filed with the Docket Office. We believe that submittal to assigned Commissioner Wilk, assigned ALJ Ford, and all parties is sufficient.

As a final matter, a service list for the consolidated proceedings was attached to the Joint Ruling. The following party was inadvertently omitted and should be added:

BROBECK, PHLEGER, & HARRISON
Robert N. Lowry, Atty.
Spear Street Tower
One Market Plaza
San Francisco, CA 94105

Findings of Fact

1. In the OII, the Commission initiated an investigation divided into three phases: Phase I: pricing flexibility for services subject to competition; Phase II: alternative ratemaking for basic rates; and Phase III: pricing flexibility and competition for intraLATA message toll and related services.

2. In the OII, the Commission provided that rate design for major revenue requirement changes for Pacific occurring after issuance of an order in Phase 2 of A.85-01-034 (due to the tax

reform investigation, USOA rewrite, inside wire, and attrition) would be developed in a supplemental rate design phase of A.85-01-034 and that similar rate design changes for GTEC would be developed in A.87-01-002.

3. In the OII, the Commission provided that hearings would be held in the following sequence: Phase I, Pacific's supplemental rate design proceeding, Phase II, and finally Phase III.

4. In the OII, the Commission provided that revenue requirement changes for Pacific occurring subsequent to an order in Phase 2 of A.85-01-034 would accumulate in a memorandum account earning interest at 3-month commercial paper rates.

5. D.88-07-022 in Phase 2 of A.85-01-034 did not adopt costs of specific services.

6. A settlement reached among some of the parties in Phase I does not establish criteria for determination of competitive market conditions.

7. Neither an expeditious supplemental rate design proceeding nor a Phase II based on adopted criteria for assessment of competitive market conditions is possible at this time.

8. GTEC has made an advice letter filing required by D.88-01-061 in I.86-11-019 to implement a billing surcredit/surcharge to reflect 1987 revenue requirement adjustments due to tax reform. Commission action is pending.

9. D.88-01-061 as modified by D.88-04-065 provides that to the extent GTEC's 1988 general rate case decision does not fully reflect effects of tax reform, GTEC shall record the difference in a memorandum account.

10. D.87-12-063 in I.87-02-023 provided that revenue requirement changes for GTEC and other utilities due to USOA changes would accrue in memorandum accounts.

11. The magnitude of the net result of all the upcoming revenue changes for GTEC is not clear at this time.

12. Consolidation of further rate design proceedings for Pacific and GTEC with the investigation would enhance the Commission's ability to formulate consistent rate design policies for the two companies and to implement any regulatory changes which may be adopted on a consistent basis.

13. Delay in reflecting revenue changes due to tax reform, USOA changes, and other upcoming revenue changes for inside wire, 1989 attrition, and 1989 intraLATA and interLATA SPF-to-SLU adjustments until completion of a supplemental rate design proceeding could result in unreasonably large accruals in memorandum accounts.

14. The intent of I.87-11-033 is to look at alternatives or refinements to the current cost-of-service approach to setting revenue requirements and establishing rates.

15. GTEC's USOA adjustment is expected to result in a rate increase.

16. Pacific's memorandum account balance is negative.

17. A finding of effective competition may not be a necessary precursor to adoption of alternative regulatory proposals for local exchange service.

18. Dun & Bradstreet's petition that Phase II include examination of the local exchange carriers' policies and practices regarding use and availability of the telephone companies' subscriber data for directories, business lists, and other competitive or potentially competitive information services does not fall within the scope of I.87-11-033.

Conclusions of Law

1. It is reasonable to defer further rate design for GTEC and Pacific until after Phase II.

2. It is reasonable to implement GTEC's upcoming rate case revenue changes on a surcredit basis.

3. A.85-01-034, A.87-01-002, I.87-11-033, and related proceedings should be consolidated.

4. It is reasonable that memorandum account balances for Pacific and GTEC be reflected in rates on a bill-and-keep basis effective January 1, 1989.

5. It is reasonable that authorized on-going revenue changes currently given memorandum account treatment be reflected in rates on a bill-and-keep basis using an estimated 1989 billing base through a surcredit/surcharge mechanism effective January 1, 1989.

6. It is reasonable that the surcredit/surcharge mechanism apply to all local exchange carrier services (access, interLATA toll, toll private line, and exchange services) except those currently excluded from existing surcredits and surcharges.

7. It is reasonable that AT&T pass through to its customers changes in access charges resulting from Pacific's and GTEC's advice letters.

8. The notice provisions in PU Code § 454 apply to GTEC's USOA rate increase.

9. It is reasonable that customer notice of a proposal by Pacific to reflect memorandum account balances and on-going revenue changes in rates be through a bill insert in the first bill reflecting the change if the proposed rate change is a decrease. If Pacific proposes a rate increase, the notice provisions in PU Code § 454 apply.

10. It is reasonable that parties be allowed to file in Phase II their entire regulatory proposals, including regulatory strategies for those services originally slated for consideration in Phase II and Phase III.

11. Dun & Bradstreet's petition for modification of OII 87-11-033 should be denied.

12. Except to the extent granted herein, DRA's motion filed June 17, 1988 should be denied.

13. In order to allow Phase II to proceed expeditiously, this order should be effective today.

INTERIM ORDER

IT IS ORDERED that:

1. Application (A.) 85-01-034, A.87-01-002, Investigation (I.) 87-11-033, and related proceedings are consolidated.

2. Pacific Bell (Pacific) and GTE California (GTEC) shall each file an advice letter no later than October 1, 1988 to develop surcredit/surcharge mechanisms on a bill-and-keep basis using an estimated 1989 billing base to implement authorized revenue changes on an ongoing basis. The advice letters shall also propose a method to close out existing memorandum account balances either by use of the surcredit/surcharge mechanism or by means of a refund. The surcredit/surcharge shall become effective on January 1, 1989 following Commission approval and shall apply to services rendered on or after the effective date.

3. GTEC shall provide notice of its advice letter filing through customer bill inserts pursuant to Public Utilities Code Section 454.

4. If Pacific's advice letter filing would result in a rate decrease, Pacific shall provide notice through bill inserts in the first month's bill reflecting the decrease. Otherwise, Pacific shall provide notice pursuant to Public Utilities Code Section 454.

5. AT&T Communications of California, Inc. shall file an advice letter no later than October 15, 1988 to pass through to its customers any access charge changes which would occur as a result of the Pacific and GTEC advice letters, including the effects of attrition and interLATA and intraLATA SPF-to-SLU changes. AT&T's rate changes shall become effective on January 1, 1989 following Commission approval and shall apply to services rendered on or after the effective date.

6. To the extent not otherwise granted by this order, Division of Ratepayer Advocates' Motion to Defer Supplemental Rate Design filed on June 17, 1988 is denied.

7. The Petition of The Dun & Bradstreet Corporation, The Reuben H. Donnelley Corporation and Donnelley Information Publishing, Inc. for Modification of Order Instituting Investigation is denied.

8. Parties shall submit prepared testimony in Phase II of I.87-11-033 as set forth in this interim opinion.

This order is effective today.

Dated AUG 10 1988, 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

List of Additional Appearances

Respondents: Daniel J. McCarthy, and Michael D. Sasser, Attorneys at Law, for Pacific Bell; Kenneth K. Okel and Richard E. Potter, Attorneys at Law, for GTE California, Incorporated; Messrs. Cooper, White & Cooper, by E. Garth Black, and Mark P. Schreiber, Attorneys at Law, and A. A. Johnson, for Roseville Telephone Company; Messrs. Pelavin, Norberg & Beck, by Alvin H. Pelavin, Jeffrey F. Beck, and Lizbeth M. Morris, Attorneys at Law, for Calaveras Telephone Company, California-Oregon Telephone Company, C. P. National, Ducor Telephone Company, Foresthill Telephone Company, Happy Valley Telephone Company, Hornitos Telephone Company, Kerman Telephone Company, Pinnacles Telephone Company, The Ponderosa Telephone Company, Sierra Telephone Company, The Siskiyou Telephone Company, and The Volcano Telephone Company; and Messrs. Orrick, Herrington & Sutcliffe, by Robert Gloistein, Attorney at Law, for Continental Telephone of California.

Interested Parties: James L. Lewis, for MCI Telecommunications Corporation; Messrs. Graham & James, by David J. Marchant and Martin A. Mattes, Attorneys at Law, for California Payphone Association and for California Hotel & Motel Association; Mmes. Gauthier & Hallett, by Mary Lynn Gauthier, for Gauthier & Hallett; Messrs. Armour, St. John, Wilcox, Goodin & Schlotz, by Thomas J. MacBride, Jr., Attorney at Law, for Telephone Answering Services of California; William M. Winter, Attorney at Law, for California Cable T.V. Association; Earl Nicholas Selby, Attorney at Law, for Bay Area Teleport; Messrs. Chickering & Gregory, by C. Hayden Ames, Attorney at Law, for Chickering & Gregory; James K. Hahn, City Attorney, by Shelley I. Rosenfield, Assistant City Attorney, for City of Los Angeles; John Witt, City Attorney, by William Shaffran, Deputy City Attorney, for the City of San Diego; Louise Renne, City Attorney, by Leonard Snaider, Deputy City Attorney, for the City and County of San Francisco; William G. Irving, for the County of Los Angeles; James Wheaton, Attorney at Law, for the Center for Public Interest Law; Phyllis A. Whitten, Attorney at Law, for US Sprint Communications Company; Messrs. McCutchen, Doyle, Brown & Enersen, by William J. Newell, Attorney at Law, for McCutchen, Doyle, Brown & Enersen; Messrs. Kilpatrick, Johnston & Adler, by Robert G. Johnston, Attorney at Law, for Wang Communications, Inc.; Cecil O. Simpson, Jr., Attorney at Law, for U.S. Department of Defense and all other Federal Executive Agencies; Messrs. Brobeck, Phleger & Harrison, by Robert N. Lowry, for The Dun & Bradstreet Corporation, Reuben H. Donnelley Corporation, and Donnelley Information Publishing, Inc.; Messrs. Jackson, Tufts, Cole & Black, by William H. Booth, Attorney at Law, for

California Bankers Clearing House Association, and Tele-Communications Association; Joseph Miller, Attorney at Law, for The Williams Companies; Messrs. Thelen, Marrin, Johnson & Bridges, by Timothy E. O'Leary, Attorney at Law, for Wiltel of California; Messrs. Shea & Gould, by Alan Pepper, Attorney at Law, for Western Burglar & Fire Alarm Association; Richard Bromley and Randolph Deutsch, Attorneys at Law, for AT&T Communications of California; Benjamin H. Dickens, Jr., Attorney at Law, Jerry M. O'Brien, and Diane Martinez, for API Alarm Systems; Public Advocates, by Robert Gnaizda, Attorney at Law, for League of United Latin American Citizens, American G.I. Forum of California, Filipino American Political Association, Chinese for Affirmative Action, Oakland Citizens Committee for Urban Renewal, and Center for Southeast Asian Refugee Resettlement; Mark Barmore, Attorney at Law, for Toward Utility Rate Normalization (TURN); Messrs. Thelen, Marrin, Johnson & Bridges, by Ellen S. Deutsch, Kathellen Abernathy, Hal Kluis, and John Engel, Attorneys at Law, for Citizens Utilities Companies; Mary Lynn Gauthier, for Ranger Telecommunications; Norman T. Stout, for Northern Telecom, Inc.; Messrs. Rubenstein, Bohachek & Johns, by Jose E. Guzman, Jr., Attorney at Law, for American Television and Communications Corporation; Robert Jacobson, Principal Consultant, for Assembly Utilities & Commerce Committee; August A. Sairanen, Jr., for State of California, Department of General Services, Telecommunications Division; and Morrison & Foerster, by Marc P. Fairman, Attorney at Law, for McCaw Communications.

Division of Ratepayer Advocates: Rufus G. Thayer, Attorney at Law.

(END OF APPENDIX A)

not believe that GTEC's revenue changes to be approved in its rate case should be delayed until these other changes are finalized; our decision in the rate case will implement the rate case revenue changes on a surcredit basis.

Some specifics of placing current balances and amounts accruing in the memorandum accounts into rates are best decided in the context of a detailed proposal in which the complete impacts on rates can be determined. However, certain basic attributes can be established at this time. We will require that Pacific and GTEC make advice letter filings no later than October 1, 1988 and that the Commission's Advisory and Compliance Division (CACD) hold workshops shortly thereafter, to develop bill-and-keep surcharge/surcredit mechanisms to be effective January 1, 1989 which coordinate with 1989 attrition and interLATA and intraLATA SPF-to-SLU changes, and which use an estimated 1989 billing base. The surcharge/surcredit mechanism should implement on an ongoing basis all revenue changes authorized as of October 1, 1988 which are receiving memorandum account treatment as of that date. Existing balances should also be closed out. Whether the account balances should be amortized or refunded will depend on the magnitude of the balance and on the effort involved in calculating a one-time refund. We will decide this issue in the context of the advice letter filings. We agree with parties that the surcharge/surcredit mechanism should apply to all local exchange carrier services (access, intraLATA toll, toll private line, and exchange services), with the exception of those services currently excluded.

To prevent over- or undercollections for AT&T as a result of the surcredits or surcharges emanating from Pacific's and GTEC's advice letter filings, we also require that AT&T file an advice letter by October 15, 1988 to pass on to its customers the resulting changes in access charges it pays to the local exchange carriers, with the effective date to also be January 1, 1989.

Pacific differentiates on some unspecified basis between "major" and "minor" revenue changes and recommends that minor revenue changes accumulate in the memorandum accounts until a supplemental rate design decision. The Joint Ruling explicitly contemplated pass-through of USOA, tax reform, attrition, and inside wire revenue changes; we do not know whether Pacific considers any of these minor. We anticipate that any additional revenue changes for these items authorized subsequent to implementation of the surcredit/surcharge will be reflected immediately in rates through adjustments to the surcredit/surcharge mechanism as needed, to prevent further accruals and reduce the size of future amortizations. Any decision authorizing such revenue changes will discuss how the change will be reflected in rates.

Parties may protest the advice letter filings and request hearings if they believe that hearings are required. However, based on the comments of the parties, we see no need to plan prehearing conferences or evidentiary hearings at this time.

Notice requirements for the advice letter filings depend on whether the underlying requested rate changes are increases or decreases. Public Utilities (PU) Code Section (§) 454 requires that customer notice be given of any proposed rate increase; we conclude that this notice requirement applies to GTEC's USOA changes. GTEC should provide notice of its advice letter filing through a customer bill insert pursuant to § 454. For a proposed decrease, as is anticipated for Pacific, customer notice through a bill insert in the first bill reflecting the decrease, as DRA suggests, will suffice.

D. Scope of Phase II

The assigned Commissioners recommend that parties be allowed to file in Phase II their regulatory proposals in toto, including regulatory strategies for those services originally slated for consideration in Phase I and Phase III. Parties would

INTERIM ORDER

IT IS ORDERED that:

1. Application (A.) 85-01-034, A.87-01-002, Investigation (I.) 87-11-033, and related proceedings are consolidated.

2. Pacific Bell (Pacific) and GTE California (GTEC) shall each file an advice letter no later than October 1, 1988 to develop surcredit/surcharge mechanisms on a bill-and-keep basis using an estimated 1989 billing base to implement authorized revenue changes on an ongoing basis and to close out existing memorandum account balances. The surcredit/surcharge shall become effective on January 1, 1989 following Commission approval and shall apply to services rendered on or after the effective date.

3. GTEC shall provide notice of its advice letter filing through customer bill inserts pursuant to Public Utilities Code Section 454.

4. If Pacific's advice letter filing would result in a rate decrease, Pacific shall provide notice through bill inserts in the first month's bill reflecting the decrease. Otherwise, Pacific shall provide notice pursuant to Public Utilities Code Section 454.

5. AT&T Communications of California, Inc. shall file an advice letter no later than October 15, 1988 to pass through to its customers any access charge changes which would occur as a result of the Pacific and GTEC advice letters. AT&T's rate changes shall become effective on January 1, 1989 following Commission approval and shall apply to services rendered on or after the effective date.

6. To the extent not otherwise granted by this order, Division of Ratepayer Advocates' Motion to Defer Supplemental Rate Design filed on June 17, 1988 is denied.