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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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In the Matter of the Application of Pacific Bell, a corporation, for authority to increase certain 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)
And Related Matters.	I.85-03-078 (Filed March 20, 1985) OII 84 (Filed December 2, 1980) Case 86-11-028 (Filed November 17, 1986)

OPINION ON JOINT PETITION OF THE DIVISION OF RATEPAYER ADVOCATES AND PACIFIC BELL TO MODIFY DECISION 85-08-047 AND TO DISCONTINUE THE USE OF EQUAL LIFE GROUP DEPRECIATION METHODOLOGY

Introduction

On October 6, 1988 the Division of Ratepayer Advocates (DRA) and Pacific Bell (the Petitioners) filed a Joint Petition (the Petition) seeking modification of Decision (D.) 85-08-047 (the Decision) in two respects. First the Petitioners seek our authorization to discontinue the use of the Equal Life Group (ELG) depreciation method for accounts formerly afforded that treatment under the Decision. Second, Petitioners seek authorization to reduce the amortization level for 1989 for step-by-step and crossbar equipment accounts, in order to reflect current investment and reserve levels.

On the date of filing, DRA and Pacific Bell served copies of the Petition on all parties in Application (A.) 85-01-034 and related proceedings. No party has formally responded to the Petition, and there is no apparent opposition to the relief requested.

Background

The represcription of depreciation rates for Pacific Bell's telephone plant accounts occurs on a triennial basis; the last represcription occurred in 1985, and roughly coincided with the issuance of D.85-08-047. The represcription process includes review of depreciation rates to reflect changes in service life, future net salvage and retirement patterns due to technological changes and growth of telephone plant. Traditionally this Commission and its staff conduct Pacific Bell's triennial intrastate represcription review in the same year the Federal Communications Commission (FCC) conducts its interstate represcription review. However, in California, where this Commission uses the remaining life method, depreciation rates also undergo a "technical update" review annually. The technical update process allows for annual review of depreciation rates to reflect changes in the remaining life of utility plant and growth or decline in the depreciation reserve attributable to passage of time. However, the annual technical update of depreciation rates is not a finding of reasonableness for ratemaking purposes.

Pacific submitted its most recent interstate represcription request to the Federal Communications Commission (FCC) on December 7, 1987, and its intrastate represcription request to this Commission on December 18, 1987.[1] The underlying analytical support for these requests was reviewed by the staffs of both commissions, and three-way represcription meetings among Pacific, the FCC staff, and the DRA were held from February 10-11, 1988.

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1 In companion Resolution T-13030 issued today, we authorize represcription of straight-line remaining life depreciation rates for all Pacific Bell telephone plant. The represcribed rates are effective January 1, 1989.

During the review of intrastate depreciation methodology, Pacific and the DRA agreed to recommend discontinuance of the use of the ELG methodology for the two plant categories currently subject to ELG treatment and return to the vintage group treatment formerly applicable to those accounts, while also providing a schedule of supplemental accruals. The Petition asserts that this agreement effectively reduces the administrative complexities associated with monitoring and updating ELG depreciation rates and incorporating such rates into the ratemaking process. Both Pacific and the DRA assert that the proposed alternative is simpler to review and administer and "achieves the goal of accurate recovery of plant investment in the categories of plant currently subject to ELG treatment." (Petition, p. 3.) As Petitioners note, affirmative action on requested discontinuance of ELG treatment will require alteration or amendment of D.85-08-047, pursuant to Public Utilities Code § 1708.

Current ELG Treatment

During the proceedings culminating in issuance of D.85-08-047, Pacific proposed application of the ELG method on a going forward basis in 1986 for intrastate ratemaking purposes in lieu of the remaining life method. (D.85-08-047, mimeo. pp. 74-83.) The DRA and various interested parties generally opposed adoption of the ELG method due to complexities of administration (id., pp. 77-81). In the Decision, we described the existing remaining life process and provided a rationale for departing from it in favor of the ELG method in two limited instances:

> "We have used what is termed the straightline remaining life (SLRL) method for PacBell since 1954; however, a more technically accurate short description is to call it straightline vintage group remaining life depreciation. Telephone plant is categorized into classes (e.g., small vehicles, electronic central office switches, etc.), and within those classes the plant is segregated by the year it

went into service, or placed into various vintage groups. To develop an average service life for the entire class or category of undepreciated plant, the estimated service life for each vintage group is derived and by weighting it is converted into an average remaining life, and ultimately an annual accrual rate. The equal life group (ELG) method is a straightline remaining life approach, but more detailed or refined because plant added to a category in a given vintage year is periodically broken down or lumped into different groups based on the expected service life."

* * *

"Although...we have repeatedly rejected the wholesale use of the ELG methodology, we believe there is good reason now to adopt ELG for two of the plant categories in Account 221, Electronic Central Office Equipment and Circuit-Other. There are a number of reasons for adopting ELG for just these two categories and no others."

* * *

"We believe everyone would agree that these two plant categories and their level of retirements are probably the most affected by technological change. Regardless of whether PacBell proceeds with network modernization at a fast or moderate pace, these categories are surely going to be affected by technological advancements, but the relative degree to which they will be affected over the next 10-20 years is extremely difficult to confidently predict today (probably only a fortune teller would try). The present theoretical reserve deficiency, regardless of whose "fault" it is, is relatively sizeable for these categories: under PacBell's parameters it is about $826 million, under the parameters we adopt today it becomes somewhat less. This illustrates the difficulty in setting depreciation rates, and we believe it also illustrates why it makes sense to use ELG on a going forward basis for these categories. ELG is indeed a more sophisticated method, some would say a more

tricky method to apply, and while it has faults its predominant virtue is that it tends to mitigate against reserve deficiency buildups. It would, we conclude, be constructive to use ELG for these two more problematical plant categories. If it turns out to be a regulatory nightmare we can, in our view, always return to vintage group treatment for these two categories. Our decision to apply the ELG method under appropriate circumstances, where it is a constructive solution in connection with intrastate ratemaking, illustrates why state commissions should have the jurisdiction and flexibility to determine which depreciation method is appropriate for intrastate ratemaking."

"We will not extend the use of ELG beyond these categories for several reasons. With only very limited staff available to review depreciation rates for utilities, combined with the complexity of ELG (Coughlan's description of it as "bean counting" has an element of validity), we would be overwhelmed if ELG were extended. There are already a lot of problems just trying to administer vintage group depreciation. Also, we believe in gradual trends for revenue requirement change, where we have any control over it, and the revenue requirement "bubble up" from a massive switch to ELG even on a going forward basis should be avoided. The point we want to make clear for the benefit of PacBell and other utilities is that we simply do not have the resources to extend the use of ELG nor do we want to see a statewide surge in utilities' revenue requirement from the wholesale adoption of ELG. So do not ask." (D.85-08-047, mimeo. pp. 74, 81-82.)

Rationale for Elimination of the ELG Methodology

In support of their consensus view that the Commission should return to the vintage group treatment for the Electronic Central Office Equipment and Circuit-Other plant categories, Petitioners assert that the Commission's initial concerns about the complexity of the ELG methodology have been borne out in practice. In particular they cite our experience with the technical

update/Section "M" ELG issues detailed in Resolution T-12007 (1987 attrition) and the subsequent rehearing decision (D.87-12-048 and D.87-12-073 in A.87-04-049). Petitioners also cite our promise that we retained the option of returning to the vintage group treatment if ELG "turns out to be a regulatory nightmare." (D.85-08-047, mimeo. p. 82; Joint Petition, p. 4.)

In recognition of these concerns, Pacific and the DRA propose a return to vintage group treatment for the Electronic Central Office and Circuit-Other plant categories; simultaneously they also propose allocation of supplemental accruals totaling $150 million annually to the two accounts formerly subject to ELG treatment. The Petitioners assert that these supplemental accruals will be reflected in higher reserves, thus affording timely recovery for these accounts.

As part of the total proposal presented to us, Petitioners also request an adjustment to the amortization levels of step-by-step and cross-bar categories. These two plant accounts are not subject to ELG treatment. As Petitioners note, D.85-08-047 contemplated that the amortization levels for the step-by-step and cross-bar accounts would remain constant for three years, and then be reduced as the balance in the account declines. It was contemplated that a new, lower amortization level for these so-called "dying accounts" would be developed during the 1988 represcription. Pacific and the DRA propose a reduced amortization level for 1989 of $75 million associated with cross-bar and step-by-step to reflect current investment and reserve levels. The proposed $75 million amortization level is approximately

$122 million lower than current levels.[2] Pacific and the DRA also contemplate a review of reserve levels in these accounts and a new determination of the appropriate amortization amount during the 1991 represcription process.

We agree with the Petitioners that the implementation of ELG treatment for the Electronic Central Office Equipment and Circuit-Other plant categories has been far from simple or problem-free, as evidenced by the protracted controversies that surfaced during our 1987 operational attrition review (e.g., see discussion of ELG impacts relative to alteration of total mix (ELG/VG) of plant, and the impact of stepped rates applicable to ELG vintages by age, D.87-12-048, mimeo. p. 15). The proposed return to vintage group treatment for all plant categories, as presented by Pacific and the DRA, appears to be a common sense compromise solution to the problem. The proposal also contains approximately offsetting adjustments designed to reflect current investment and reserve levels. There is no known opposition to the relief requested in the Petition. In view of all these factors, we find no impediment to granting this relief.

Findings of Fact

1. In a joint Petition filed October 6, 1988, Pacific and the DRA propose elimination of ELG treatment for the Electronic Central Office Equipment and Circuit-Other plant categories and a

2 This $122 million reduction in the fixed accruals for the two "dying accounts" will offset, to some extent, the $150 million supplemental accruals Petitioners propose to allocate to the accounts formerly subject to ELG treatment (Electronic Central Office Equipment and Circuit-Other). There is also an approximate $28 million supplemental accrual not mentioned in the Petition, but verifed by CACD, associated with discontinuance of ELG treatment for the two plant categories, that would otherwise be recognized for 1989 under Section "M" of the operational attrition formula (D.86-12-099).

return to the vintage group treatment formerly applicable to these plant categories, as well as allocation of supplemental accruals totaling $150 million annually to the two categories in order to offset the reduction in depreciation reserves associated with the elimination of the ELG methodology..

2. Pacific and the DRA also propose a reduced amortization level for the step-by-step and cross-bar accounts for 1989 of $75 million; the proposed amortization level is approximately $122 million lower than current amortization levels.

3. The joint Petition of Pacific and the DRA is a compromise solution designed to address the problems of overcomplexity the Commission has experienced in implementing the ELG method for the Electronic Central Office Equipment and Circuit-Other plant categories, and the proposal embodies approximately offsetting adjustments designed to reflect current investment and reserve levels for the plant categories it addresses.

4. There is no known opposition to the relief requested in the Petition and no impediment to granting the relief requested.

Conclusions of Law

1. The Pacific/DRA consensus proposal recommending elimination of the ELG methodology for Electronic Central Office Equipment and Circuit-Other and reinstitution of the vintage group methodology for these two plant accounts, along with provision of a schedule of supplemental accruals, should be adopted.

2. A reduced amortization level for 1989 of $75 million associated with step-by-step and cross-bar plant accounts, should be adopted to reflect current investment and reserve levels.

3. D.85-08-047 should be modified to the extent necessary to effectuate our intention to grant the relief requested in the Petition.

ORDER

IT IS ORDERED that:

1. The provisions of D.85-08-047 which authorized Pacific to use the ELG depreciation methodology for Electronic Central Office and Circuit-Other plant categories for 1986 and subsequent plant additions, are hereby modified to the extent necessary to effectuate the agreement reached between Pacific and the Commission staff which provides for discontinuance of ELG treatment and reinstitution of the vintage group methodology for the two plant categories. Consistent with the Petition, Pacific is authorized to establish a supplemental accrual of $150 million to offset the reduction in depreciation reserves for the Electronic Central Office and Circuit-Other associated with the elimination of ELG treatment.

2. A reduced amortization level of $75 million for the step-by-step and cross-bar plant categories is hereby adopted for 1989 and subsequent years until further Commission order to reflect current investment and reserve levels, as requested in the Petition.

This order is effective today.

Dated NOV 23 1988, at San Francisco, California.

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

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

Weisser, Executive Director