

ORIGINAL

Decision 88 12 039 DEC 9 1988

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of )  
AT&T COMMUNICATIONS OF CALIFORNIA, )  
INC., a corporation, for authority )  
to increase certain intrastate )  
rates and charges applicable to )  
telecommunications services )  
furnished within the State of )  
California (U 5002 C). )

Mailed

Application 85-11-029  
(Filed November 18, 1985)  
DEC 12 1988

(See Decision 86-11-079 for appearances.)

OPINION ON MOTION TO REOPEN PROCEEDING  
FOR AN ATTRITION REVIEW

Summary

On August 4, 1988 the Commission's Division of Ratepayer Advocates (DRA) filed a "Motion to Reopen Proceeding to Provide for an Attrition Review" (Motion). DRA contends that AT&T Communications of California (AT&T-C) will enjoy increasing volumes of business with simultaneously decreasing access costs resulting in earnings on rate base substantially greater than those currently authorized. Therefore, DRA recommends that Application (A.) 85-11-029 be reopened to determine an appropriate attrition mechanism for AT&T-C.

This decision denies DRA's Motion without prejudice to a possible submission of another pleading after careful review and monitoring of AT&T-C's earnings experience under the pricing flexibility currently being considered in A.87-10-039.

DRA's Position

In its August 4, 1988 Motion DRA pointed out that by Decision (D.) 88-06-036 dated June 17, 1988 we authorized<sup>1</sup> AT&T-C a rate of return of 14% on equity and 12.35% on its (California intrastate) rate base.

DRA contends that there has been a significant change in economic conditions since DRA and AT&T-C formulated their respective showings in this 1986 general rate case. For example, there has been significant growth in the interLATA toll market since 1986, primarily resulting from Subscriber Plant Factor (SPF) to Subscriber Line Usage (SLU)<sup>2</sup> price reductions and the direct assignment of Wide Area Telephone Service (WATS) and WATS/800 and due to the Tax Reform Act of 1986.

DRA asserts that because of the elasticity effects of SPF-SLU and other reductions, call volumes have increased along with simultaneously reduced access costs. This growth in revenues should significantly reduce rates according to DRA. DRA also claims that AT&T-C's proposed method of refunds reflects a 40% rate reduction for a six-month period, coupled with a further reduction in January 1, 1989.

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1 D.88-06-036 reconfirmed the rate of return we previously authorized for AT&T-C by D.86-11-079 dated November 14, 1986.

2 The change from SPF to SLU allocation factors, on a gradual implementation plan, results in an annual reduction in access charges to AT&T-C for each year until 1992.

SPF is an allocation factor in which the minutes of use are weighted by a complex formula which reflects the average length of haul of each call. This factor was prescribed by the 1971 (Ozark Plan) Telephone Separations Manual.

SLU is an allocation factor which is a measure of the relative usage of each subscriber of exchange and toll telephone service. It is based on the actual minutes of use of each service. This factor dates back to the 1947 Telephone Separations Manual.

DRA argues that as a result of this refund strategy and the further decrease in prices, it may be expected that AT&T-C will not only increase its sales to existing customers, but will capture new business from customers switching from other interexchange carriers to take advantage of AT&T-C's lower prices. DRA argues that further and greater elasticity effects will result from these price reductions and it contends that an attrition adjustment would help customers realize the long awaited benefits of the SPF to SLU phase down.

DRA asserts that the rate of return reported to the Commission is considered proprietary by AT&T-C, and while those figures are untested, the combination of those earnings with improved productivity, significantly reduced workforces, and other possible adjustments, demonstrates that AT&T-C will collect about \$100 million of revenues in excess of its currently authorized return, absent an attrition adjustment.

For these reasons DRA recommends that the Commission reopen A.85-11-029 for the purpose of determining an appropriate attrition mechanism for AT&T-C as it has done for every other large energy and communications utility in California.

#### AT&T-C's Response

AT&T-C argues that DRA's Motion is procedurally and substantively invalid, and is inconsistent with the Commission's effort to find a viable alternative to rate-base rate of return regulation for AT&T-C.

In support of its argument on procedure, AT&T-C asserts that following eight weeks of hearings in 1986 and 1987, the Commission issued D.88-06-036 on June 17, 1988. Thereafter, pursuant to various applications for rehearing, the Commission granted limited rehearing only on the issue of AT&T-C's refund method. AT&T-C asserts that all other issues were finally and effectively disposed of by D.88-06-036, and therefore DRA's Motion

is out of order under Rules 43 and 85 of the Commission's Rules of Practice and Procedure.

AT&T-C further asserts that DRA's action in filing the Motion is a blatant disregard of the Commission's effort in Investigation (I.) 85-11-013 to find a viable alternate to traditional cost-of-service regulation for AT&T-C. Specifically I.85-11-013 and A.87-10-039 were designed to determine the extent to which the Commission's regulation of AT&T-C should be relaxed. Therefore, AT&T-C pleads that DRA's Motion is fundamentally inconsistent with the Commission's observation approach under the market flexibility concept, and should be rejected.

As to the merits of DRA's Motion based on the high first quarter 1988 rate of return, AT&T-C contends that further analysis shows extreme volatility of earnings for other recent periods which must also be considered. As examples AT&T-C points to its 1985 monthly earnings which fluctuated from -24.25% to +27.86%; for 1986 the range was -24.13% to +33.22%; and for 1987 the low was -62.86% to a high of +60.96%. In addition, AT&T-C claims that for two of the three years, AT&T-C's intrastate earnings were substantially below its authorized rate of return.

Therefore, high earnings for a single quarter cannot possibly be relevant for rate making purposes, and do not provide an indication of actual annual earnings, according to AT&T-C.

#### Discussion

We recognize the concern AT&T-C has expressed over the exclusive use of the traditional return on rate base for its California intrastate operations. Other concerns were also voiced in the concurring opinion of Commissioners Victor Calvo and Donald Vial in D.86-11-079. After commenting on AT&T-C's small California intrastate rate base as compared to its overall expense level these Commissioners opined that: "In the next year (1987), the Commission will be re-examining its proper role in the regulation of the interLATA market generally and of AT&T specifically."

Now that we are in the midst of reviewing AT&T-C's A.87-10-039 for pricing flexibility, it is important that we focus our attention on implementing a decision in that proceeding before addressing a brief period of high earnings based on past rates.

More specifically, we have recently struggled with the question of AT&T-C's status as a dominant carrier in a competitive market. The record in this proceeding is replete with situations where AT&T-C's business judgments are necessarily conditioned by competitive pressures; however, we have conducted this rate case in the traditional manner usually applied to a monopoly utility.

We addressed these concerns directly in D.87-07-017, where we laid out a regulatory framework under which AT&T-C could apply for pricing flexibility. In A.87-10-039, we are considering AT&T-C's application in which AT&T-C proposes pricing bands under the observation approach, which was one option offered to it in D.87-07-017.

If AT&T-C is granted pricing flexibility in A.87-10-039, then we will expect parties, including DRA, to participate actively in the monitoring program. We will also expect to receive periodic reviews by DRA and AT&T-C of the benefits that customers are receiving due to pricing flexibility and the greater competitiveness we hope to foster. In addition to the factors that will be explicitly considered in the monitoring program, DRA will be free to observe any other indicators of market behavior that it believes relevant.

For these reasons we believe that DRA's Motion to reopen this proceeding for an attrition review is untimely. We are just now reviewing the application that would implement D.87-07-017, and currently there is no experience under the observation approach to evaluate. Depending on the results once D.87-07-017 is implemented, it may become appropriate to conduct an attrition review; alternatively, it may be reasonable to continue pricing flexibility or to expand it further. DRA will be free to make such proposals or arguments based on the full range of factors that have been outlined for the monitoring program as well as any others DRA believes to be significant.

We will not set a firm schedule for such review at this time. A.87-10-039 is still pending, and we neither wish to constrain DRA from raising this issue at any appropriate time nor designate a review date that could be premature. However, we do believe that a year or more of experience under the observation approach would seem to be a minimum requirement for assessing its results. We may offer further guidance in this regard when we render a decision in A.87-10-039.

Finally, in an effort to address AT&T-C's claims of significant periods of poor earnings contrasted with brief periods of higher than authorized earnings, DRA should analyze the earnings results for the entire period, since the beginning of AT&T-C's reorganization on January 1, 1984 until the end of the observation period. DRA should then measure and contrast the overall periods of high earnings versus poor earnings, against the earnings necessary to satisfy the then authorized rate of return, in preparing its recommendations for our consideration.

Findings of Fact

1. The Commission has stated its concern that AT&T-C's California intrastate rate base is small in comparison to its overall revenue and expense levels and therefore may no longer be a proper base for determination of AT&T-C's authorized earnings.

2. High earnings for one quarter, without analysis of actual earnings versus those authorized for other prior years, do not yield a complete comparison to determine reasonableness of rates.

3. We are currently considering certain parameters for pricing flexibility of AT&T-C's California intrastate services. Any reasonable review of earnings of AT&T-C would entail monitoring the experience of AT&T-C under the yet-to-be-authorized pricing flexibility for a year or more.

4. D.88-06-036 was intended to resolve all remaining issues carried over to Phase II of AT&T-C's Test Year 1986 rate application (A.85-11-029) and that decision is final and effective, except for the limited rehearing of AT&T-C's refund plan.

5. Application 85-11-029 incorporated a 1986 test year during which AT&T-C's operations and organization were quite different than those planned for 1989 and subsequent years; thus it would be unreasonable to reopen a record involving such a stale test period to observe rate of return for AT&T-C's changed present and future operations.

Conclusions of Law

1. DRA's Motion to reopen a completed 1986 test year record, in order to review rate of return, in the face of AT&T-C's changed organization and operations, is untimely and should be denied.

2. One-quarter year of higher earnings is not an adequate justification for reopening this record; therefore DRA's Motion should be rejected.

3. In view of the changing regulatory environment planned for AT&T-C, including limited pricing flexibility, DRA should be encouraged to carefully monitor AT&T-C's market power as well as the costs and benefits of its services to its customers. Based on a full analysis of a year or more of operation with such pricing flexibility, DRA should be free to raise an issue of excessive rates or earnings if it believes such exist at that time.

ORDER

IT IS ORDERED that:

1. The Division of Ratepayer Advocates' "Motion to Reopen Proceedings to Provide for an Attrition Review" is denied without prejudice.

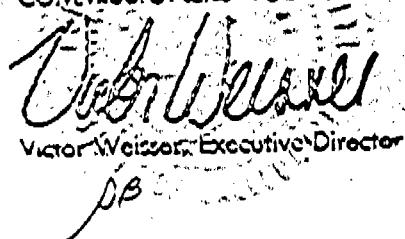
2. Future pleadings for similar attrition reviews, or to initiate Orders Instituting Investigations into the reasonableness of earnings, or pricing of services by AT&T Communications of California, Incorporated (AT&T-C) should be based on a full historical analysis of rates of return enjoyed from the time of AT&T-C's initial reorganization (January 1, 1984) to the time when a year or more of experience under whatever pricing flexibility is granted to AT&T-C under A.87-10-039 is available for analysis by the Commission and its staff.

This order becomes effective 30 days from today.

Dated DEC 9 1988, at San Francisco, California.

STANLEY W. KULETT  
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

  
Victor Weissman, Executive Director  
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