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Decision 90 08 069 JUN 20 1990

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Pacific Bell, a corporation, for authority to increase certain 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) C.86-11-028 (Filed November 17, 1986)

(See D.86-12-099 for appearances.)

I N D E X

INTERIM OPINION

This decision addresses remaining issues in our investigation of inside wire maintenance (IWM) for California local exchange companies (LEC). These issues concern the effect of deregulation on regulated rates, appropriate demarcation points, the appropriate treatment of standard network interfaces (SNI or SNI/RID), and related matters regarding the provision of inside wire services, including a complaint filed by The Extension Connection, Inc. (TEC).

Our decision today requires California's local telephone companies to reduce their rates by the amount of revenues collected for providing IWM services. We deny utility requests to accelerate programs for the installation of SNI/RID devices, and find that utility transfers of IWM operations to unregulated affiliates are void. We also order the utilities to tariff their IWM services. The proceeding remains open to review Pacific Bell's (Pacific) pricing policies and consider appropriate pricing policies for IWM services.

I. Background

In this proceeding, we examine the effects of "detariffing," or removal from direct rate regulation, of the maintenance of telephone inside wire. Generally, inside wire is the telephone wire that connects the customer premises equipment to the telephone network at a demarcation point, such as the utility's protector on the outside of a single-family residence.

The Federal Communications Commission (FCC) has detariffed the installation and maintenance of both simple and complex inside wire. The FCC ordered detariffing in its 1983 Report and Order in Docket No. 82-681 and in the 1986 Second Report and Order in Docket No. 79-105.

We first determined that detariffing the maintenance and installation of inside wire would be in the public interest in Decision (D.) 86-07-049. We ordered the LECs to detariff inside wire in D.86-12-099. The intended purpose of these actions by the Commission and the FCC was to promote competition for IWM services by promoting entry and pricing practices whereby customers who incur costs pay for them.

At the time we issued D.86-12-099, we perceived certain potential problems with the FCC's course of action. We were primarily concerned that the inside wire of residential and certain business customers might be so integral to the utilities' operations that the utilities would have a natural competitive advantage over other firms in providing maintenance services. To partially address this concern, D.86-12-099 required the utilities to treat revenues and expenses from IWM "above-the-line," that is, part of the regulated revenue requirement. We also petitioned the FCC on December 11, 1986, in an Emergency Motion for Partial Stay and a Petition for Reconsideration of the FCC's deregulation decisions. The Commission filed a similar pleading with the U.S. Court of Appeal (Second Circuit) on December 30, 1986.

On December 31, 1986, the FCC denied the emergency motion, but in so doing recognized the Commission's jurisdictional right to treat costs and revenues above-the-line for ratemaking purposes.

Later, the California Legislature confirmed the Commission's view that IWM revenues and expenses should be treated above-the-line. SB 155 (Public Utilities (PU) Code § 461.2) directs the Commission to continue its adopted ratemaking treatment.

More recently, the U.S. Court of Appeals addressed the Commission's petition for reconsideration, finding in favor of the Commission on several issues (National Association of Regulatory Utility Commissioners v. Federal Communications Comm., 880 F. 2d

422, July 7, 1989). In that decision, the Court found that the FCC's preemption of state authority over regulation of IWM had not been accompanied by a showing that such preemption was necessary in order to promote federal policy of establishing a competitive IWM market. The Court also found that the states could require local exchange companies to act as providers of last resort where no competition developed. The Court remanded the case back to the FCC. The FCC has taken no further formal action on the subject.

Hearings were held in this proceeding November 2 through November 19, 1987 to examine outstanding issues. The case was submitted on February 23, 1988.

One topic of review in this proceeding was whether this Commission has authority to require the utilities to act as providers of last resort. The Court has settled that issue, as discussed above, and we therefore need not address it further except to say that we will not approve of utility service abandonments absent a showing that reasonable alternatives exist in a given area.

Division of Ratepayer Advocates (DRA) requests a clarification of earlier decisions. DRA correctly states that our intent in D.86-12-099 and D.86-07-049 was that both maintenance and installation of both complex and simple inside wire be detariffed. In addition, complex inside wire associated with deregulated terminal equipment was fully deregulated, effective January 1,1988, when full deregulation of customer premises equipment became effective. DRA is also correct that we do not intend to treat complex inside wire associated with deregulated terminal equipment above-the-line.

In this decision, we consider several issues which were still unresolved at the time we issued D.86-12-099:

1. Ratemaking treatment of IWM.

2. Treatment of IWM services by unregulated affiliates.

3. Identification of the demarcation point.

4. Utility SNI programs.

5. Utility IWM services outside their franchise areas.

6. Alleged anticompetitive behavior by Pacific in the IWM market.

II. Complaint of TEC

On November 17, 1986, TEC filed a complaint against Pacific and GTE California Incorporated (GTEC). TEC was an independent telephone system installer and repairer which competed with utility IWM services. TEC's complaint alleges that (1) Pacific's use of its billing envelope to advertise IWM services is anticompetitive and (2) Pacific's continuing use of its "611" (repair service) telephone number for obtaining IWM repairs is anticompetitive.

Pacific and GTEC filed motions to dismiss. Pacific asserts that its billing inserts were pursuant to Commission order in D.86-07-049. As to the use of 611, Pacific alleges complainant's allegations are vague and speculative. GTEC seeks dismissal of the complaint as to GTEC because the complaint does not allege that GTEC is acting improperly.

On March 27, 1987, TEC's complaint was consolidated with the Commission's ongoing investigation of inside wiring issues in Order Instituting Investigation (OII or I.) 84, Application 85-01-034, and I.85-03-078. TEC participated in these consolidated hearings maximizing its opportunity to address issues of concern to it. During these hearings, TEC proposed that the Commission require the utilities to structurally separate their IWM operations, and that the utilities be required to inform 611 callers that alternatives to utility IWM services are available. TEC objected to Pacific's cost allocation methodology. Finally,

TEC alleged that utility protector devices are faulty and urged deferral of accelerated SNI/RID installation programs until better devices are available.

TEC's recommendations are discussed further in appropriate sections of this decision.

III. Lawfulness of Detariffing

This Commission ordered detariffing of IWM services in D.86-12-099. That decision presumed that the FCC's detariffing order would go into effect simultaneously and that, because of the nature of the service, the utilities could not detariff interstate offerings pursuant to FCC orders, and retain tariffs for intrastate offerings.

Since the time of our decision, the U.S. Court of Appeals found generally that the FCC could not preempt state regulation of IWM absent a finding that state regulation of IWM would frustrate federal policy. The Court also found that the FCC did not have the evidence to support such a finding and remanded the matter back to the FCC. Since the time of the Court's decision, the FCC has taken no further action. This Commission therefore is fully within its authority to determine the scope of its regulatory oversight.

Because the Commission is not preempted from regulating IWM, the Commission is obligated to regulate IWM. PU Code § 489 addresses requirements regarding utility tariffs:

> "The commission shall...require every public utility other than a common carrier to file with the commission...and to print and keep open to public inspection, schedules showing all rates, tolls, rentals, charges, and classifications collected or enforced, or to be collected or enforced, together with all rules, contracts, privileges, and facilities which...affect or relate to rates, tolls, rentals, classifications, or service."

In D.88-08-059, which addressed rate flexibility for certain local exchange company services (adopted subsequently in D.88-09-059), the Commission found that the language of § 489 is clear and unambiguous, and that all rates to all customers must be part of public documents. The only exception to this rule is where unusual circumstances render application of general tariff provisions unreasonable or impractical. (Stanislaus Food Products Co. v. Pacific Gas and Electric Company, (1979) 2 Cal PUC 2d 304.) Such exceptions would not apply in this case.

In light of the recent Appeals Court ruling, we must require the utilities to tariff IWM rates and service conditions. Although we determined in D.86-07-049 that detariffing was in the public interest, we do not have discretion to order detariffing absent federal preemption or changes in the law.

For GTEC and Pacific, we must determine which pricing category should include IWM pursuant to the guidelines set forth in D.89-10-031. D.89-10-031 initially considered all inside wire services to be Category III in part because they were detariffed. Because IWM services must be tariffed, we reconsider their status. It is clear from the record that IWM is not a monopoly service. Yet, the prior monopoly position of the LECs fits with the other evidence in this proceeding to demonstrate that GTEC and Pacific likely still have significant market power, or at least that the service is not as yet fully competitive. Therefore, IWM should be classified as a Category II service and GTEC and Pacific should file tariffs on that basis. (Installation of simple wire remains a Category III service.)

For the LECs other than GTEC and Pacific, there is no provision for the flexible pricing of a tariffed service.

IV. Ratemaking Treatment of IWM

A major issue in this proceeding was how to treat IWM revenues and costs for ratemaking purposes. Most LECs in California have always treated IWM services as part of utility operations. Others, including Citizens Utilities Company of California (Citizens), Evans Telephone Company (Evans), and Happy Valley Telephone Company (Happy Valley), now offer IWM services through unregulated affiliates. Treatment of affiliated costs and revenues are discussed separately in Section V below.

Several parties commented on the appropriate methodology to be used in determining any ratemaking adjustments which should be adopted as a result of detariffing.

A. Positions of the Parties

1. Division of Ratepayer Advocates (DRA)

DRA developed a methodology for determining IWM revenues and costs which was the primary focus of the proceeding. DRA states its methodology is designed to discourage IWM repair pricing below or above cost. In summary, DRA proposes a two-step process for determining the change in revenue requirements that should be ordered by the Commission for each utility. The first step is the determination of a "deregulated revenue requirement." This method identifies IWM costs separate from the 1986 separated results of operations and settlement pools. The result of this methodology is a rate reduction for all LECs except Pinnacles (for which a $34 increase is required.) For Pacific, the reduction would be about $23 million. For GTEC, the reduction would be about $9 million. DRA recommends that IWM be removed fron the settlements process.

The second step is the determination of the "stand-alone revenue requirement." In determining the stand-alone revenue requirement, DRA uses 1987 figures for inside wiring billings, expenses, and investments. In order to promote pricing based on costs, DRA recommends the stand-alone revenue requirement be based

on an imputation of billings sufficient to cover the costs (within 10%), including a rate of return, of inside wire services.

Using the stand-alone methodology, reductions in revenue requirement would occur, according to DRA, in either of two situations. The first is where the utility does not charge enough to cover the costs of its IWM services. The second is where, as in the case of Roseville Telephone Company, the utility's profit on IWM services exceeds its authorized rate of return.

DRA estimates that the stand-alone methodology would result in an additional decrease in the revenue requirement of every utility. For Pacific, the reduction would be about $24 million. GTEC would realize a $3 million reduction.

DRA explains the basis for its cost and revenue estimates. For each of the 22 LECs, DRA reviewed utility filings and agreed with their estimates with some exceptions. DRA takes issue with Pacific's use of an "avoided cost" approach under which Pacific did not allocate any costs to IWM except those which would be avoided if Pacific did not offer IWM services (e.g. in a case where a premise visit is made for inside wire purposes and another activity, Pacific did not allocate any travel time or vehicle expenses to IWM). Citizens applied similar assumptions for some cost categories. DRA believes this approach grossly understates the cost of IWM activities and allocated costs to IWM services accordingly.

DRA proposes that any rate reductions adopted in this proceeding be applied equally to all rates except those associated with carrier access.

2. Pacific

Pacific takes issue with DRA's cost estimates. Pacific states that, contrary to DRA's assumption, its cost estimates were not based on avoided costs, but rather avoided functions. Where it identified a function that it would not need to undertake if IWM was not offered, it applied fully distributed costs to those

functions. Therefore, according to Pacific, it was appropriate to disinclude from its cost estimates those costs such as those for travel labor time in circumstances where an employee might perform more than one service.

Pacific objects to any revenue requirement adjustment at this time. Its estimate of the "deregulated" revenue requirement is close to DRA's, about $20 million in reductions. Pacific's estimate of the "stand-alone" portion of DRA's estimate would require a rate increase of about $20 million. These estimates are preliminary. In any event, Pacific states it has not, as DRA assumes, experienced a "windfall" as a result of IWM detariffing. Along with increased revenues, Pacific argues, it has experienced higher costs, including those associated with advertising, more extensive discussions with customers calling 611 repair services, and setting up new accounts.

Moreover, Pacific objects to implementation of DRA's "stand-alone" principles. According to Pacific, DRA would impose upon the utilities' shareholders a double penalty and confer upon ratepayers a double benefit. This is because when revenues exceed costs, ratepayers receive the benefit. When costs exceed revenues, however, shareholders would bear the loss. Pacific argues this principle of ratemaking unfairly allocates all risk to the utility without providing any opportunity for realizing a corresponding benefit. The methodology is also, according to Pacific, inconsistent with SB 155 and Commission decisions, which require revenues and expenses be treated above-the-line for ratemaking purposes. Pacific characterizes DRA's proposal as "no above-the-line treatment plus a revenue requirement disallowance."

Pacific believes DRA's rationale -- that Pacific may engage in anticompetitive, below-cost pricing -- is not supported by any evidence. In fact, according to Pacific, its market share is declining as customers opt to make their own IWM repairs or hire Pacific's competitors to do the work.

If the Commission orders a revenue requirement reduction in this proceeding, Pacific asks that the Commission apply that reduction to intraLATA toll rates.

3. GTEC

GTEC asserts that the Commission has no authority to impute into utility revenue requirement any costs or revenues associated with a product that is provided by a utility affiliate whether or not the affiliate is a utility subsidiary. Along the same lines, GTEC argues the FCC has preempted the Commission's authority to dictate IWM pricing policies. DRA's proposal is, according to GTEC, a "bald and bold" attempt to regulate IWM pricing "dressed in the guise of an imputation program."

GTEC shares Pacific's view that the DRA proposal imposes on shareholders the potential for a double loss. Not only would utility shareholders be at risk for actual losses, but, according to GTEC, for fictitious imputed revenues which the utility never recovered. GTEC also comments that DRA's proposal is contrary to SB 155.

4. Continental Telephone Company (Contel)

Contel comments that the Commission may fulfill the mandates of SB 155 and its own policy statements in one of two ways. It may either reduce rates according to the incremental revenue experienced following detariffing or it may remove IWM costs from the revenue requirement. Contel calculates that for either of these options, its revenue requirement would fall by slightly over $1 million for each of the years 1987 and 1988. Contel asks that the Commission hold these amounts in a deferred account pending a determination of the revenue requirement for the deployment of SNI/RIDs in a second phase of this proceeding.

Contel makes comments substantially similar to those of Pacific and GTEC regarding DRA's proposal.

5. Roseville Telephone Company (Roseville)

Roseville comments that no rate reduction is appropriate for it because its revenues and expenses will not have changed because of detariffing. Such an adjustment is more appropriate, according to Roseville, during its next general rate case. Roseville also argues that DRA's proposal, which is allegedly designed to guard against overpricing and underpricing, does not make sense because if Roseville underprices IWM, it will lose revenues. If it overprices IWM, it will lose customers to competitors. Accordingly, Roseville argues that no adjustment is necessary at this time.

6. Small Telephone Companies

Nineteen small telephone companies participated jointly. Among those, Citizens states that no revenue adjustment is appropriate if its IWM costs and revenues are treated above-the-line rather than outside of the ratemaking environment as they are now with Citizens' affiliate CSCSI offering IWM services.

The remaining small companies did not have up-to-date cost information and recommended that the Commission use 1987 booked figures when they become available.

Small Telephone Companies' arguments regarding DRA's proposal are similar to those presented by Pacific, namely that the proposal is punitive and would result in confiscation of utility property.

7. Toward Utility Rate Normalization (TURN)

TURN argues that Pacific's avoidable cost approach to estimating costs is inconsistent with the goal of fostering competition because it underestimates costs. Further, TURN believes DRA's approach to ratemaking is inadequate and recommends the Commission require the utilities to "completely expunge" their IWM services from regulated costs. TURN makes several related recommendations discussed in subsequent sections.

8. TEC

TEC shares concerns that Pacific's avoidable cost approach is potentially anticompetitive. Specifically, TEC objects to Pacific's failure to allocate any 611 services (repair) or travel time for maintenance services to IWM service costs. Although TEC believes DRA's ratemaking approach is superior to Pacific's, TEC believes Pacific could engage in short-term anticompetitive pricing even under DRA's proposed framework.

TEC proposes structural separation of IWM operations in order to insure against anticompetitive behavior and facilitate cost accounting.

B. Discussion

When we issued D.86-12-099, we hoped to address concerns that a competitive market might not develop in the IWM market. Accordingly, we approved detariffing IWM but directed the utilities to place costs and revenues above-the-line. Our view that IWM should be treated above-the-line was confirmed by the State Legislature in its enactment of SB 155.

DRA's ratemaking methodology was a major focus of this proceeding. Under its proposal, a revenue requirement would be set equal to a level of assumed revenue, notwithstanding utility prices. This treatment is intended to encourage the utilities to set prices equal to costs. As a further incentive for proper pricing, DRA's proposal would lower utility revenue requirements in the subsequent periods if actual revenues exceed costs and when costs exceed actual revenues. In cases where costs exceed revenues, the revenue requirement reduction is in addition to losses already incurred during the previous period.

While DRA's proposal may promote cost-based pricing, it also presents several problems. First, DRA's proposal is inconsistent with SB 155 which directs that IWM revenues and expenses are to be treated above-the-line:

> "For purposes of establishing rates for a telephone or telegraph corporation, the commission shall include all revenues and expenses of the corporation from the installation and maintenance of that simple inside wiring which is subject to the order of the Federal Communication Commission deregulating that wiring."

We agree with the utilities' view that DRA's proposed methodology effectively places expenses and revenues below-the-line in cases where expenses and revenues do not match (give or take 10%).

Second, it is unfair to require shareholders to bear risks in cases where they have no corresponding opportunity to benefit from that risk. DRA's proposal would promulgate just such an inequity by placing the utilities at risk going forward for costs and retroactively for demand levels. In fact, the utilities are penalized doubly when costs exceed revenues.

Finally, DRA's proposal is too complicated. It appears to require ongoing monitoring and ratemaking adjustments, memorandum accounts, and dispute over appropriate levels of imputed costs and revenues. We hesitate to undertake such exacting oversight, especially considering the dollar amounts at risk. This view is consistent with our recent decision modifying our regulatory program for local exchange telephone companies. In D.89-10-031, we adopted a program which seeks to simplify our oversight of Pacific and GTEC and provide ongoing incentives for more efficient utility operations. We do not foresee a general rate case for the major local exchange companies. Rather, we have set forth a formula under which tariffed rates are annually adjusted based primarily on economic indicators and productivity factors. For these reasons, we decline to adopt DRA's ratemaking proposal.

We likewise decline to adopt Pacific's suggestion that total IWM revenues and incremental costs are a "wash" and that the Commission should forego any rate reductions. Utility memorandum accounts information was submitted pursuant to a ruling issued January 26, 1990. That information clearly indicates that substantial revenues have been collected since detariffing in January 1987. Neither do we agree with Pacific's apparent request for reimbursement of incremental expenses incurred prior to the issuance of D.86-12-099. Pacific must be aware that such Commission action would violate prohibitions on retroactive ratemaking. Pacific incurred those expenses willingly and must accept some measure of regulatory risk associated with its actions.

A simple and fair way to resolve this matter is to adjust utility revenue requirements according to the net balances in the memorandum accounts established in D.86-12-099. The utilities already had IWM costs included in their rates at the time of detariffing. We therefore do not need to adjust the costs, with the exception that incremental costs associated with IWM detariffing may be deducted from total revenues. Such incremental costs may include costs associated with customer notices and marketing which are directly attributable to detariffing. Revenues from IWM services are not included in revenue requirements because no separate IWM revenues were collected prior to January 1, 1987.

Because past rates have not reflected increased revenues from IWM services, other rates have been higher than they would have otherwise been. We will therefore adjust rates to reflect this set of circumstances. The balances in the accounts at the time of the rate adjustment will represent those revenues collected and incremental costs incurred from the time of detariffing until the time of the rate adjustment for all companies except GTEC. For GTEC, the ratemaking adjustment will be only for account balances up to the time of its intervening rate case decision, D.88-08-061. That decision incorporated total inside wire expenses and revenues

pursuant to our decision in D.86-12-099 which ordered that IWM costs and revenues be treated above-the-line, and consistent with SB 155. Accordingly, the revenue requirement adjustment we make today should not include costs incurred and revenues received since GTEC's general rate case decision. For Pacific the adjustment should not include costs and revenues received since Pacific's recent "true up," ordered by D.89-12-048 because that decision incorporated both IWM costs and revenues.

We also need to make an adjustment for revenues and costs going forward. A reasonable measure of this adjustment, prior to the utilities' next general rate cases (for those that will have them), is the net revenue in each utility's memorandum account during 1989. Accordingly, in addition to the adjustment for existing account balances, the utilities' rate adjustments should reflect that estimate for costs and revenues going forward. The exception to this requirement again would be for GTEC, which has already included in rates the total costs and revenues of IWM pursuant to D.88-08-061. Similarly, Pacific need not make any adjustment for costs and revenues going forward because its "true up" decision, D.89-12-048, already reflected such an adjustment.

To implement these rate adjustments, the utilities shall make revenue requirement reductions equal to the amount of the revenue collected since January 1, 1987 until the date of the rate adjustment. The utilities may deduct from these amounts incremental expenses which were incurred following detariffing on January 1, 1987. The ratemaking adjustments should be based on total unseparated revenues and incremental costs. Finally, IWM expenses should be removed from the settlements process as several parties suggest.

We will require Pacific and GTEC to file this memorandum account information in their first annual updates, established in D.89-10-031. Alternatively, they may, at an earlier date, implement IWM rate adjustments in connection with rate changes in

other proceedings. We will require the smaller companies to file such adjustments by way of annual attrition adjustments, or for those who do not file for attrition year adjustments, advice letters which shall be filed within 60 days of the effective date of this order. The adjustments for past revenues (i.e., not those going forward) should be amortized over a one-year period and should include interest on amounts collected. The utilities may file to adjust their rates after the one-year period. For Pacific and GTEC, this adjustment would occur in their second annual updates.

We do not believe the memorandum accounts serve any further purpose under the framework for rate adjustments adopted today. We will therefore order the utilities to close the accounts at the time IWM ratemaking adjustments are made. Of course, the utilities will continue to enter costs and revenues in existing accounts, which will be subject to review in general rate cases or, in the case of Pacific and GTEC, other future investigations.

On the subject of costs, we agree with DRA and TURN that Pacific's use of avoidable costs is inappropriate in this case. Whether Pacific's methodology is properly called "avoidable costs" or "avoidable functions," the result is the same: significant joint costs are eliminated from the cost calculation. We cannot imagine the development of a competitive market where Pacific's prices are lower than total costs, especially because Pacific's name recognition and historical customer relationship already provide it with a significant market advantage. Although we do not need to use specific cost information to make revenue requirement changes ordered today, we warn Pacific that resolution of any disputes over anticompetitive pricing practices, if they arise, will rely on a more realistic view of costs than Pacific has presented in this proceeding.

Pacific and GTEC should use direct embedded cost methodologies in determining IWM cost which is the standard set in D.89-10-031, below which prices may be considered anticompetitive. Where joint costs are incurred, they should be allocated to IWM services according to the percentage of use attributable to IWM costs.

Although we do not find utilities' pricing policies unreasonable in this decision, we will monitor Pacific and GTEC's pricing practices pursuant to D.89-10-031. If it appears the utilities' IWM services are being subsidized by the general body of ratepayers, or if prices appear unreasonably high, we will not hesitate to order changes to the utilities' tariffs. We address this issue further in Section IX of this decision.

Finally, we are not prepared to require, as TURN suggests, the utilities to divest their IWM operations. Because we are not convinced a fully competitive market has developed for IWM service, we prefer to maintain some oversight over IWM operations. Moreover, such action might also eliminate certain cost savings assocated with joint provision of IWM services and other utility services.

V. Treatment of IWM Services Offered by Unregulated Affiliates

Several parties to this proceeding addressed the appropriate treatment of IWM operations which some utilities have transferred to unregulated affiliates or subsidiaries.

A. Positions of the Parties

1. DRA

DRA expressed particular concern with the transfer by several utilities of their IWM operations to unregulated affiliates. Companies which had made such transfers by the time this proceeding was submitted include Citizens, Happy Valley,

Evans, Hornitos Telephone Company (Hornitos), Sierra Telephone Company (Sierra), and Volcano Telephone Company (Volcano).

DRA believes that these transfers were unlawful because they were effected without necessary Commission approval and are thus void under PU § 851. DRA cites several cases in which the Commission required authority for similar types of transfers. It also cites D.82-05-038, in which we voided a transfer by Citizens of its mineral and timber rights because Citizens had not received Commission approval for the transfer as required by § 851.

2. GTEC

GTEC objects to DRA's interpretation of § 851, stating that the Commission has no jurisdiction over the transfer of utility IWM operations because they are not necessary or useful in the performance of a utility's duty to the public. Moreover, the Commission has no authority over an IWM affiliate since such an affiliate is not a public utility.

3. Small Telephone Companies

Small Telephone Companies argue that § 851 does not apply in this case because IWM operations are not utility functions and are not "necessary and useful" in the performance of utility operations, as § 851 requires. Small Telephone Companies add that the Commission has no authority over utilities' unregulated affiliates and that no evidence presented in this proceeding demonstrates that such resources as customer records or utility good will have benefited IWM affiliates.

B. Discussion

PU Code § 851 states in pertinent part:

> "No public utility...shall sell, lease, assign, mortgage, or otherwise dispose of or encumber the whole or any part of its...plant, system, or other property necessary or useful in the performance of its duties to the public...without first having secured from the commission an order authorizing it so to do. Every such sale, lease...made other than in accordance with the order of the commission

> authorizing it is void... Nothing in this section shall prevent the sale, lease, encumbrance or other disposition by any public utility of property which is not necessary or useful in the performance of its duties to the public..."

GTEC and Small Telephone Companies argue that § 851 does not apply because IWM operations are not necessary to the utilities' public duties. The utilities are incorrect. IWM operations have been part of utility rate bases, and associated expenses have been included in rates. The fact that this Commission detariffed IWM services in no way changes the simple fact that they are part of utility operations until and unless the Commission has determined to the contrary.

In D.82-05-038, we found that Citizens' transfer of mineral and timber rights to an unregulated affiliate was void under § 851. We found that those rights were part of the utility operation because they had been included in rate base even though the property in question was not used for the express purpose of providing utility services (in that case, water services).

Other decisions confirm that ratepayers may have a financial interest in property which was included in rate base but will no longer be part of a utility's regulated enterprise (New York Water Service Company v. Public Service Commission, (1960) 208 NYS 2d 857 and Southern California Gas Company, 84 Cal. PUC 405).

IWM services have traditionally been considered integral to the provision of telephone service by regulated utilities. There may be some question regarding whether IWM services are still "necessary" to a public utility's duties in cases where competition exists. There can be no doubt, however, that they continue to be "useful" to a public utility's duties. The utilities' own witnesses testified that telephone services cannot be offered without functioning IWM. These questions, however, do not need to be answered for the purpose of determining whether a public utility

must receive authorization for transferring them out of the utility operations. Where property has been included in rate base, and in rates, the utility cannot transfer it out of its regulated operations without prior authorization from this Commission unless the utility has properly transferred the property out of rate base to retirements, plant held for future use, or some similar account appropriate for property which is no longer used and useful for providing utility service. We find, therefore, that the transfers undertaken by Happy Valley, Citizens, Volcano, Hornitos, Evans, and Sierra are void pursuant to § 851. Each of these utilities shall effect reconveyance of IWM operations within 30 days of the effective date of this decision and shall file a report with Commission Advisory and Compliance Division (CACD) describing and confirming the process of reconveyance.

Because utility transfers of IWM operations are void, all utilities shall follow the revenue requirement adjustment methodology discussed in Section III of this decision and shall take immediate steps to incorporate fully IWM operations within the utility corporate structure. If and when utilities are authorized to make transfers of their IWM operations, we will consider related ratemaking issues.

VI. Identification of the Demarcation Point

This proceeding included review of "demarcation points." The demarcation point is that point beyond which the utility's responsibility for repairs and maintenance lies.

The proposed decision of the administrative law judge set forth guidance for the establishment of demarcation points. We generally concur with the treatment of the demarcation point in the proposed decision. Since the time the decision was issued, however, the FCC issued a decision on the subject of demarcation points. (CC Docket No. 88-57, Report and Order and Further Notice

of Proposed Rulemaking, Adopted June 8, 1990.) We are not aware at this time how or whether the FCC's decision may affect the establishment of the demarcation points by California utilities. Therefore, we will defer our resolution of the issue until a subsequent decision.

VII. Utility SNI/RID Programs

The SNI/RID allows the utility to determine whether trouble is in the inside wire or in the utility network without having to make a premises visit. Customers who have an SNI/RID device may diagnose a problem without calling the utility. SNI/RIDs have been installed by the utilities in all new buildings and under limited circumstances in existing buildings.

The potential benefits of the SNI/RID are twofold. First, the devices may save time and money for the utilities whose premises visits would be less frequent. Along the same lines, a customer may avoid a utility charge for a premises visit when the problem turned out to be with customer-owned equipment or IWM. Second, the presence of SNI/RID devices promotes competition because the utility representative will not be on the premises when an inside wire problem is discovered. The customer is more likely therefore to shop around for a competitive repair vendor.

These benefits notwithstanding, the issue of SNI/RID programs is controversial, in large part because of the cost of their installation in existing buildings. The devices also pose security problems because third parties may be able, through the SNI/RID, to access customer telephone lines and thereby either use the line without authorization or overhear customer calls. Related issues, such as whether nonutility entities may install the devices, were also raised during this proceeding.

A. Positions of the Parties

1. Pacific

Pacific supports a trial program for the installation of SNI/RID devices in order to determine whether they are cost-effective. The trial would also allow the utilities to evaluate the security of SNI/RIDs, according to Pacific. Pacific believes the security issue, which raised considerable controversy but for which little evidence was available, should be studied to determine whether outside access to customer lines is a problem.

Pacific does not believe third parties should be able to install SNI/RIDs. Pacific believes such installations would compromise the demarcation point concept which confers upon the utilities the responsibility over the jacks on the utility side of the inside wire. If someone other than a utility employee installs a facility on the utility side, the telephone company should not be required to bear responsibility for that equipment. Pacific urges the Commission to reject proposals for third-party installation of SNI/RIDs.

2. Contel

Contel urges the Commission to reject proposals which would permit the installation of demarcation points by nonutility employees for the same reason put forth by Pacific.

3. Roseville

Roseville also argues that the Commission should not permit third parties to install demarcation points.

4. DRA

DRA believes SNIs are necessary to foster the development of competition for IWM services. DRA argues, however, that an installation program should be in the form of a trial which would be used to explore alternative devices and to assess security problems.

DRA also recommends that the Commission adopt a rule prohibiting disconnection for nonpayment of charges associated with detariffed services as it has for other services. Finally, DRA suggests that utility tariffs should clearly define the applicability of visit charges when an SNI is in place. DRA presented specific tariff language for both of these proposals. It recommends additional hearings following the SNI deployment trial to explore the results of that trial.

5. TURN

TURN objects to SNI installation programs because they have not been demonstrated to be cost-effective. Pacific, according to TURN, appears already to have installed many more devices than would be predicted under the Commission's existing rules. TURN comments that the costs of SNIs are being borne by the regulated side while the benefits will accrue to unregulated inside wire services. TURN recommends that utility tariffs more carefully spell out when replacements for SNIs are appropriate.

TURN also expresses concern over security issues related to SNIs and argues that necessary locks add to customer costs and responsibilities for utility property.

6. TEC

TEC cites security concerns with Pacific's SNI/RID installations, and suggests the Commission defer the proposed SNI trial until adequate modifications to the SNI design are made. TEC also comments that the RID, which responds to control signals from the utility center, may be unreliable. TEC proposes the Commission approve a new network interface which does not have the problems of the utilities' existing designs.

7. WBFAA

WBFAA is critical of utility SNI deployment proposals, believing the devices will not be readily accessible to most customers, thereby frustrating the development of competition. WBFAA suggests widespread deployment of SNIs with customer

notification and appropriate testing of the device. The Commission should permit third parties to install the devices in order to hasten the process, although the equipment should belong to the utility.

B. Discussion

We are not convinced that widespread retrofitting of SNI/RIDs on existing buildings is wise at this time. The devices do not appear to be cost-effective in such cases and, as many parties comment, may create security problems for customers. Because the average inside wire repair occurs every 10 to 15 years, customers may never become familiar with the devices or benefit from them. We agree that they may hasten the pace of a more competitive IWM market. We will not, however, ask ratepayers to spend more to promote a competitive market than they might ultimately save if that market were to develop.

Because of our concerns over the cost of SNI/RIDs, we will not expand the utilities' deployment programs at this time, even by way of a trial. If the utilities seek more information regarding security issues, they may undertake studies of existing installations. We encourage them to do so. The utilities, therefore, should not include in rate base SNI/RID devices which are deployed in the future except those installed under existing tariffs, and for new structures. If a utility can demonstrate clear net benefits from an expanded deployment program, and has evidence that security problems are not serious, it may apply to this Commission for approval of a more aggressive deployment program.

Our resolution of this matter does not apply to Pacific and GTEC. Both are free, under D.89-10-031, to make investments which they believe are cost-effective. D.89-10-031 reached this conclusion because, under the regulatory framework the decision adopted, Pacific and GTEC are at risk for their investment decisions. Pacific and GTEC are therefore not constrained by our

ruling today regarding investments in and deployment of SNI/RID devices. We warn Pacific and GTEC in advance, however, that we expect them to monitor and mitigate potential fraudulent calls resulting from SNI/RID devices.

On the issue of third-party installations, we agree with the utilities that such installations present problems regarding responsibility for proper handling and ongoing maintenance. If a utility owns and is responsible for a demarcation device, it must be able to oversee installation of that device. We will not require the utilities to permit third parties to install demarcation devices which are to be the responsibility of the utilities absent agreements with the utilities.

DRA's suggestion that the utilities should include in their tariffs provisions prohibiting disconnection for nonpayment of IWM services would be reasonable if IWM services were to be untariffed. Since they must be tariffed, the utilities should be permitted to disconnect service for nonpayment of IWM rates and charges.

Finally, with regard to TEC's proposal that we approve its SNI/RID device, we note that we will not in this case assess the engineered benefits of specific equipment. Although we appreciate TEC's insights about possible problems with existing devices, we will leave it up to utility management to determine the viability of particular products. On the other hand, if we discover that the utilities are purchasing equipment which is inferior in quality to other products, or which is more costly, we are within our authority to disallow inclusion of associated costs in utility rates.

VIII. Utility IWM Programs Outside Their Franchise Areas

The assigned administrative law judge sought comments by the parties regarding whether a utility can offer IWM services outside the utility's franchise service territory.

A. Positions of the Parties

1. Pacific

Pacific believes there is nothing prohibiting it from offering IWM services in other areas. Pacific bases its view on the fact that the service would be nontariffed and unregulated, offered to customers who are not subscribers of the utility. For the same reasons, Pacific argues the costs and revenues of the services would not be subject to the above-the-line treatment adopted by the Commission. Potential cross-subsidy problems would not arise, according to Pacific, because Pacific would not be responsible for diagnosing the trouble or able to access the protector of another utility.

2. GTEC

GTEC's comments are similar to Pacific's. It adds that the Commission does not have the authority to regulate nonutility IWM services or providers in any way, and accordingly, could not regulate a utility providing such services outside of its franchise service territory.

3. Roseville

Roseville's arguments are similar to Pacific's.

4. Small Telephone Companies

Small Telephone Companies argue that the Commission does not have authority to regulate IWM activities outside a franchise service territory except to the extent such regulation is necessary to protect the utility's regulated operations and ratepayers.

B. Discussion

We are not convinced by the utilities' arguments that we have no authority to regulate IWM services offered outside utility service territories. Pacific itself argues that IWM service is "part of exchange service." If that is the case, the utilities are required by PU Code § 1001 to file for approval of service extensions.

The U.S. Appeals Court has confirmed our authority to regulate IWM services generally. In any event, we are within our authority to oversee utility operations outside the franchise territory for the simple reason that the utilities might jointly use utility resources to provide those services. Pacific's argument that the cross-subsidy problem disappears does not withstand scrutiny. Pacific may still use utility vehicles, marketing services, and technical expertise in providing IWM services outside its franchised area. We would therefore be within our authority to regulate those services in order to prevent cross-subsidization.

On the other hand, we recognize that utility involvement in other areas of the state may facilitate the development of competition in those areas and will consider those competitive effects if and when the circumstance is before us.

If the utilities seek to offer IWM services outside their franchise service territories, they shall file for authority to do so. At that time, we will consider whether their operations should be subject to structural separation or accounting requirements. In making this determination, one consideration may be the form of regulation to which the LEC is subject.

IX. Alleged Anticompetitive Behavior of Pacific in the IWM Market

DRA and TEC allege that Pacific engaged in anticompetitive practices in the IWM market. We are very concerned about these allegations. At the time of the hearings, Pacific had the lion's share of the market and an aggressive marketing program.

Over two years have passed since the hearings took place in this proceeding and no record exists as to Pacific's conduct or the development of the market during the intervening period. Moreover, at the time of hearings only a short time had passed since the time of detariffing. Therefore, a competitive market may not have had time to develop. Finally, we have expressed our concerns that the market for IWM services may not, by its nature, be truly competitive. Pacific's market dominance may have resulted as much from market characteristics as from anticompetitive activities at least in the short run. For these several reasons, we cannot find at this time that Pacific engaged in anticompetitive practices.

Although the record does not support a finding of anticompetitive behavior by Pacific, and we have some doubts about a truly competitive market developing in the short term, we still intend to promote an environment that would permit competition to develop, and will consider complaints which provide evidence of unlawful behavior.

In the interim, we will require the utilities to inform their customers that competitive alternatives may be available. This notification should be provided during customer calls to 611 repair services and when a repair employee is on the customer's premises and has identified a possible inside wire problem.

We will also continue these proceedings for the purpose of updating cost information and pricing policies. As discussed earlier, we anticipate ongoing monitoring of pricing practices

pursuant to D.89-10-031. In this case, however, a potential problem has already been identified which we believe requires our early attention. Accordingly, we will direct Pacific to submit to CACD and DRA cost information, consistent with the costing principles for Category II services adopted D.89-10-031 and in this decision. We will also direct CACD to comment on whether it believes Pacific's prices are reasonable. Other parties may also comment. Based on those comments, we will consider whether additional hearings are necessary in this proceeding.

Findings of Fact

1. The FCC detariffed IWM in its 1983 Report and Order in Docket No. 82-681 and in the 1986 Second Report and Order in Docket No.79-105.

2. The Commission ordered the state's local exchange companies to detariff IWM in D.86-12-099.

3. D.86-12-099 ordered the utilities to keep memorandum accounts of IWM revenues and incremental expenses associated with detariffing.

4. In response to the Commission's Emergency Motion for Partial Stay and a Petition for Reconsideration, filed December 11, 1986, the FCC found that the state's were not prohibited from treating IWM costs and revenues above-the-line.

5. In response to the Commission's Petition for Review of the FCC's orders preempting the states from regulating IWM, the U.S. Court of Appeals found that the FCC had not demonstrated that its preemption of state regulation was necessary to promote federal goals, and that the states were within their authority to require utilities to act as providers of last resort.

6. D.86-12-099 directed the state's telephone companies to treat IWM costs and revenues above-the-line for ratemaking purposes.

7. The California State Legislature enacted SB 155, which requires that IWM costs and revenues of public utilities are to be treated above-the-line.

8. DRA's proposal for IWM ratemaking adjustments may promote cost-based pricing. However, it imposes significant risk upon the utilities without providing a commensurate opportunity for reward, is complex, and requires substantial ongoing oversight of utility IWM accounts.

9. Current pricing practices, whereby utilities charge for IWM services, are an improvement over past practices because customers who impose system costs pay for them and because they may promote competition for IWM services.

10. The utilities are already being reimbursed through rates for the costs of IWM services.

11. Utilities which imposed a charge or increased a charge for IWM services since the Commission ordered detariffing are receiving revenues which have not been included in the revenue requirement calculation.

12. The IWM cost and revenue data in the memorandum accounts for 1989 is adequate for estimating future costs for ratemaking purposes until such time the utilities' accounts are reviewed in general rate cases or other investigations.

13. Pacific's use of "avoidable functions" in estimating IWM costs fails to include certain common costs associated with IWM services. DRA's cost allocation is a more realistic assessment of IWM costs.

14. Because IWM costs have historically been included in rates and associated risks borne by utility ratepayers, they are part of utility operations.

15. Hornitos, Citizens, Sierra, Volcano, Evans, and Happy Valley have all transferred their IWM operations to unregulated affiliates. None applied to the Commission for approval of the transfers.

16. D.82-05-038 found that utility property transfers were void pursuant to § 851 even though the property was not required to perform utility services because the property had been included in rate base.

17. The courts have found that ratepayers may have a financial interest in property which was included in rate base but which will no longer be part of a utility's regulated enterprise.

18. SNI/RID devices permit utilities to determine the source of trouble from a remote location, thereby reducing the number of premises visits by utilities.

19. SNI/RID devices present some security risk for building occupants because the devices may allow third parties to access customer lines without authorization.

20. The record does not demonstrate that widespread deployment of SNI/RID devices would be cost-effective for utility ratepayers.

21. The evidence in this proceeding does not support expanded SNI/RID deployment programs, even on a trial basis.

22. If utilities offer IWM services outside their franchise service territories, they may be able to jointly use utility resources for those operations.

23. The record in this proceeding does not allow a determination of whether Pacific engaged in anticompetitive behavior in the IWM market.

Conclusions of Law

1. It is reasonable to treat IWM services as Category II services, as defined by D.89-10-031, because those services are offered in markets which are partly competitive.

2. The Commission is within its authority to require the utilities to act as providers of last resort.

3. The Commission is within its authority to fully regulate the provision of IWM services.

4. D.86-12-099 and D.86-07-049 intended that both simple and complex wiring maintenance and installation be detariffed. This decision refers to maintenance of simple inside wire as inside wire maintenance (IWM).

5. PU Code § 489 requires the utilities to make part of public documents all utility rates and services to all customers. D.88-08-059 confirmed this interpretation of § 489.

6. The utilities should be ordered to tariff IWM services.

7. DRA's proposal for ratemaking adjustments related to IWM costs and revenues is contrary to SB 155 (PU Code § 461.2).

8. Reimbursing the utilities for incremental expenses incurred prior to January 1987, and which were therefore not entered into memorandum accounts, would be a violation of the prohibition on retroactive ratemaking.

9. A reasonable interim measure of IWM revenues and incremental costs, to be used for estimating revenue requirement prior to a utility's general rate case, is the net balance for each utility for the year 1989.

10. The utilities should be ordered to adjust their rates according to the net balances in the memorandum accounts established by D.86-12-099, plus the net balance for the year 1989 to reflect costs and revenues going forward and prior to utility general rate cases. GTEC should be required to make adjustments only for account balances involved prior to D.88-08-061.

11. Pacific and GTEC should be ordered to make rate adjustments set forth in Conclusion of Law 9 in their first annual updates, established in D.89-10-031.

12. Other telephone utilities should be ordered to include ratemaking adjustments set forth in Conclusion of Law 9 in their annual attrition advice letter filings. Those utilities which do not file for attrition adjustments should be ordered to include adjustments in either (a) advice letters within 60 days of the effective date of this order or (b) as an offset against the revenue requirement that would otherwise result from their next California High Cost Fund Advice Letter filings.

13. The transfers of IWM operations to unregulated affiliates by Hornitos, Happy Valley, Evans, Citizens, Sierra, and Volcano are void pursuant to PU Code § 851.

14. Hornitos, Happy Valley, Evans, Citizens, Sierra, and Volcano should be ordered to effect, within 30 days of the effective date of this order, reconveyance of IWM operations to the utility, and to file, within 15 days thereafter, a report with CACD describing and confirming the reconveyance.

15. The utilities should not be permitted to include in rate base or rates costs associated with accelerated retrofitting of SNI/RID devices absent prior Commission approval.

16. Nonutility installers should not be permitted to install demarcation devices absent agreements with utilities because the utilities are responsible for the operation and maintenance of the devices.

17. The utilities should be ordered to include in their tariffs provisions providing for disconnection of service for nonpayment of rates and/or charges for IWM services.

18. The Commission is within its authority to oversee utility IWM offerings in areas outside a utility's own franchise service territory.

19. Respondent utilities should be ordered to submit to CACD and DRA, within 60 days of the effective date of this order, IWM cost information, consistent with the costing principles set forth in D.89-10-031 for Pacific and GTEC, and consistent with the costing principles set forth in this proceeding for other respondents. The filings should reflect current IWM pricing practices.

20. CACD should be ordered to submit to all parties of record in this proceeding comments on the information submitted by Pacific pursuant to Conclusion of Law 21. The CACD submittals should be made within 90 days of the information set forth in Conclusion of Law 21.

21. This proceeding should remain open to consider whether additional hearings are warranted on the subject of whether Pacific's IWM prices are reasonable or whether they may be set below cost so as to discourage a competitive market.

22. TEC's complaint should be denied except to the extent granted herein.

23. The utilities should be ordered to inform customers of possible alternatives for IWM services, as set forth in this decision.

INTERIM ORDER

IT IS ORDERED that:

1. The respondent utilities shall, within 60 days of the effective date of this decision, submit tariffs, by way of advice letter, setting forth rates and terms of service for inside wire maintenance (IWM).

2. Pacific Bell (Pacific) and GTE California Incorporated (GTEC) shall, in their first annual update proceeding, established in Decision (D.) 89-10-031 or sooner, adjust their revenue requirements by the net amounts, including interest, entered into the memorandum accounts established pursuant to D.86-12-099, plus the net balance for the year 1989 in those accounts, as set forth in this decision. Their filings shall provide supporting documentation for account balances.

3. Other respondent telephone companies shall adjust their revenue requirements by the net amounts, including interest, entered into the memorandum accounts established pursuant to D.86-12-099, plus the net amounts for the year 1989 in those accounts, as set forth in this decision. Those adjustments shall be made in each utility's next attrition year filing or, for those companies which do not make such filings, within 60 days of the effective date of this order. Alternatively, they shall apply IWM revenues as an offset against the revenue requirement which would otherwise result in their next annual California High Cost Fund

filings. Their filings shall provide supporting documentation for account balances.

4. Hornitos Telephone Company, Citizens Utilities Company of California, Happy Valley Telephone Company, Evans Telephone Company, Volcano Telephone Company, and Sierra Telephone Company shall, within 30 days of the effective date of this order, effect reconveyance of IWM operations to the utility, and within 15 days thereafter submit to Commission Advisory and Compliance Division a report describing and confirming the reconveyance.

5. The respondent utilities shall amend their tariffs, by way of advice letters filed within 60 days of the effective date of this order, to provide that customers shall be subject to disconnection of service for nonpayment of rates and charges for IWM services.

6. Pacific shall, within 60 days of the effective date of this order, submit to all parties of record cost and pricing information as set forth in this decision.

7. The Commission Advisory and Compliance Division shall, within 90 days of Pacific's providing information pursuant to Ordering Paragraph 7, submit to all parties of record and the assigned administrative law judge comments on that information regarding whether Pacific's prices are reasonable.

8. This proceeding shall remain open for the purpose of determining whether additional hearings are required to review Pacific's pricing practices and the lawfulness of detariffing IWM services.

9. The respondent utilities shall direct their employees to inform customers that they may have competitive alternatives available for IWM services, as set forth in this decision.

10. Except to the extent granted herein, the complaint of The Extension Connection, Inc. is denied.

This order is effective today.

Dated JUN 20 1990, at San Francisco, California.

FREDERICK R. DUDA
STANLEY W. HULETT
JOHN B. OHANIAN
PATRICIA M. ECKERT
Commissioners

President G. Mitchell Wilk, being necessarily absent, did not participate.

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

NEAL J. SHULMAN, Executive Director

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