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Decision 92-07-076 July 22, 1992

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.	ORIGINAL Application 85-01-034 (Filed January 22, 1985; amended June 17, 1985, and May 19, 1986)
And Related Matters. (Telesis Audit Phase)	I.85-03-078 (Filed March 20, 1985) OII 84 (Filed December 2, 1980) Case 86-11-028 (Filed November 17, 1986)

(See Decision 90-12-026 for appearances.)

I N D E X

INTERIM OPINION

1. Summary

In this decision, we approve and adopt a settlement agreement between the Commission's Division of Ratepayer Advocates (DRA) and Pacific Bell resolving most of the issues in the five-year-old Telesis Audit Phase of this proceeding. The audit deals with alleged ratepayer subsidy of development costs for certain competitive products that, because of divestiture, did not provide a revenue return to ratepayers. The settlement requires that Pacific Bell refund to customers approximately $57 million (calculated at $19.1 million annually since January 1, 1990); requires a prospective reduction in rates of $19.1 million thereafter; and implements new procedures for tracking and allocating product development costs so that ratepayers do not subsidize new programs and products unless they also get a return on their investment. The settlement calls for later adjudication of whether a refund is required for a product called Public Packet Switching, and it also provides procedures for dealing with the Commission's withholding of $4 million annually from Pacific Bell's revenue requirement pending resolution of the audit dispute.

2. Background

This is the second time that DRA and Pacific Bell have appeared before us to jointly move for approval of a settlement agreement in the long-standing Telesis Audit dispute. In Decision (D.) 91-11-023, on November 6, 1991, we rejected the first proposed settlement on grounds that it was not in the public interest. We determined that the proposed settlement did not deal adequately with whether a refund was due ratepayers for alleged past subsidies of competitive services.

It is not necessary to recount the history and controversy that have marked this lengthy proceeding. That history is summarized in D.91-11-023. (See, pp. 18-22.) It is sufficient here to note that DRA and its predecessor, the Public Staff Division, had attempted, since December 1987, to audit Pacific Bell's joint ventures, strategic alliances, and research and development (R&D) programs to determine whether ratepayers had subsidized competitive products that ultimately benefited only shareholders of the corporation or its affiliates. (See, Re Pacific Bell (1987) 27 CPUC 2d 1, 140.)

Because of discovery delays, DRA's audit report was not completed until October 30, 1990. DRA concluded that cross-subsidies indeed had taken place in certain programs. DRA made six recommendations intended, it said, to remedy past subsidies and guard against future subsidies. It recommended:

1. A rate reduction of $15.6 million (later adjusted to $19.1 million) to eliminate recovery of expenses related to competitive products.

2. A refund of $37 million for expenses incurred since 1986 for competitive products.

3. Identification of competitive products in the development stage so that costs can be properly allocated.

4. Prior Commission approval of new service offerings by Pacific Bell Directory if the offerings affect rates.

5. Exclusion from rates of development costs of products that could violate modified final judgment (MFJ) restrictions.[1]

6. Periodic reports by Pacific Bell to DRA on developmental projects and products, and changes by the utility in its tracking and accounting controls.

Pacific Bell denied the allegations of the DRA audit and urged their dismissal. However, on February 1, 1991, Pacific Bell and DRA jointly proposed a settlement of all issues raised by the audit. Under the proposed settlement, the utility would reduce rates prospectively by $18.8 million, exclude from ratemaking the costs of certain competitive products, and establish the tracking and reporting procedures for new product development that had been recommended by DRA.

2.1 Commission Rejection of Initial Settlement

We welcomed that part of the settlement agreement that developed a new method for tracking and allocating future R&D costs for competitive products.[2] However, we agreed with three parties objecting to the settlement--Toward Utility Rate Normalization (TURN), AT&T Communications of California, Inc. (AT&T), and MCI Telecommunications Corporation (MCI)--that the settlement failed to address the audit's refund recommendations. The settlement called for a prospective rate reduction of $18.8 million, which the

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1 MFJ refers to the procedures and decisions developed in the federal court telephone company divestiture case. United States v. American Tel. and Tel. Co. (D.D.C. 1982) 552 F. Supp. 226, aff'd mem. sub nom. Maryland v. United States (1983) 460 U.S. 1001, modified, United States v. Western Elec. Co. (D.D.C. 1987) 673 F. Supp. 525, aff'd in part and revised in part (D.C.Cir. 1990) 900 F. 2d 283.

2 D.91-11-023, p. 2.

settling parties stated was a fair resolution of all the monetary recommendations. We disagreed, stating:

> "Pacific and DRA claim that the Agreement resolves all monetary claims. However, the Agreement is internally inconsistent in that regard. The Agreement states that $18.8 million is the amount of the cross-subsidy. The Agreement, by reducing rates prospectively only by exactly $18.8 million, in essence declares that cross-subsidies are to be avoided in the future but were tolerated in the past. That is clearly not the message we have been sending to Pacific since 1986....
>
> "The history of this audit shows that we are not willing to overlook past cross-subsidies. The narrowly defined goal and object of this audit process was intended to determine the amount in question and to adjust rates accordingly." D.91-11-023, pages 28-29 (emphasis in original).

Our order denied the joint motion to approve the settlement and directed that hearings be conducted. Specifically, we required the parties to address these questions:

1. What is the amount of the alleged cross-subsidy identified by the audit for four enhanced services - Voice Mail, PB Connection (electronic messaging), California Call Management (voice store and forward), and SMART Desktop (information services)? What amount is now reflected in rates (and thus could be the subject of a prospective rate reduction) and what amount has been reflected in rates in the past (and thus could be the subject of a refund)?

2. If a refund is deemed appropriate, for what period of time should it be measured?

3. What disposition should be made of the $4 million that we directed be withheld from

Pacific Bell's gross revenue requirement[3] pending completion of the audit?

4. Should a refund be required for Public Packet Switching development costs, and what legal issues are posed by the seeming inconsistent treatment of these product costs in our decisions in D.90-05-045, D.87-12-067, and D.86-01-026?

2.2 New Settlement Agreement

Consistent with our order in D.91-11-023, a prehearing conference was conducted on January 10, 1992, to set dates for hearing on the audit report and on the four issues set forth above. At that time, DRA announced that it had initiated discussions with Pacific Bell about "trying to settle the matter along the lines expressed by the Commission in its decision." (Tr., p. 625.)

Following an informal meeting with other parties on January 15, 1992, Pacific Bell and DRA noticed a settlement conference on January 24, 1992, pursuant to Rule 51.1 of the Rules of Practice and Procedure. The settling parties state that, at the conference, they responded to questions and made modifications to a proposed new agreement based on comments from the California Bankers Clearing House Association, the California Cable Television Association (CCTA), MCI, AT&T, and GTE California, Inc. (GTEC). On February 7, 1992, the settling parties moved for adoption and approval of the proposed new settlement.

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3 In D.86-01-026, dated January 10, 1986, we withheld $4 million from the gross revenue requirement to express our displeasure with the position taken by Pacific Bell, Pacific Telesis, and PacTel Corporation in refusing to produce records as part of the audit. The $4 million revenue requirement adjustment remains in place pending final disposition of this Telesis Audit Phase proceeding. (See Re Pacific Bell (1987) 27 CPUC 2d at 114-15.)

DRA and Pacific Bell state that the agreement resolves three of the four issues raised by the Commission in D.91-11-023. The one issue not resolved concerns what we have called "the seeming inconsistency on the subject of refunds in D.90-05-045 and D.86-01-026 and D.87-12-067" with respect to the utility's Public Packet Switching program. (See D.91-11-023, pp. 3, 37.) DRA and Pacific Bell urge that this issue be set for briefing and for later disposition. At a prehearing conference on February 21, 1992, the assigned administrative law judge directed the parties to file briefs on the Public Packet Switching issue by March 30, 1992, with replies due April 15, 1992. At the same conference, parties were directed to file comments on the proposed settlement by March 9, 1992, with replies due March 24, 1992.

2.3 Terms of the New Settlement Agreement

The settlement agreement is attached to this decision as Appendix A. Its major provisions are as follows:

1. Pacific Bell's customers will receive a refund of $19.1 million annually, plus interest, for the period beginning January 1, 1990, and ending 60 days after adoption of the settlement agreement (the refund date). Thus, the total refund will be in excess of $57 million.

2. Pacific Bell agrees to reduce its annual rates by $19.1 million effective one day after the refund date described above. This translates into a reduction of about 7 cents per month in the average residential bill.

3. Pacific Bell agrees to exclude from annual sharing calculations the revenues and development costs for products that the Commission classifies as Category III

competitive products[4] that are excluded from ratemaking.

4. The utility agrees to exclude from its annual sharing calculations product revenues and development costs for enhanced service products[5] if product development is discontinued before the product is offered to customers.

5. The utility agrees to exclude from its annual sharing calculations the revenues and development costs for products for which Pacific Bell seeks and fails to obtain a waiver of restrictions imposed in the telephone company divestiture case in federal court.

6. Pacific Bell Directory would provide a description of new product development activities sufficient to permit the Commission to track these costs for ratemaking purposes.

7. Pacific Bell agrees to track investment and direct expenses, subject to DRA review, for all new products starting no later than the feasibility analysis stage of the product.

8. The utility will provide an annual report to the Commission on development activities for all products that incur a cumulative $1 million or more in capital investment and expenses.

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4 Under the new regulatory framework, when Pacific Bell earns a return above 13%, it must "share" half its earnings above that amount with ratepayers. All earnings above 16.5% must be returned to ratepayers. Thus, under the settlement agreement, to the extent costs exceed revenue for competitive products, these costs will not reduce earnings subject to the sharing formula. Conversely, of course, if revenues for a new competitive product are greater than costs, that revenue is not "shared" with ratepayers.

5 Enhanced service products, generally, are computer-related services offered over telephone lines. (See 47 CFR 64.702.)

With the exception of the $19.1 million annual refund requirement, all of these provisions were contained in the original settlement agreement. Additionally, the settling parties agreed that Pacific Bell will proceed immediately with filings seeking to lift the $4 million holdback from the utility's gross revenue requirements that we have imposed since 1986 pending completion of this audit proceeding.[6]

The settlement agreement states that it is a compromise of disputed issues intended to avoid the risks and costs of protracted litigation. Pacific Bell denies all allegations of wrongdoing, as it has since the beginning of this matter, and it states that it "continues to believe it did not act improperly by including enhanced service costs and revenues in its start-up revenue adjustment." (Motion to Adopt and Approve Settlement, p. 3.)

DRA for its part agrees that, with some exceptions, it will not pursue further any claim arising from its audit. The exceptions that DRA may continue to pursue include two issues pending in Application (A.) 90-12-052: (1) whether ratepayers should receive any of the value of Pacific Bell's Information Services Group and, if so, the amount; and (2) whether ratepayers are entitled to a refund for expenses for Call Management, Voice Mail, and PB Connection programs allegedly used to compute rates between 1986 and 1989.

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6 The utility states that it will file a petition to modify D.87-12-067 to eliminate the $4 million holdback provision. Additionally, it has filed Advice Letter 16144 proposing a refund and prospective rate reduction to account for a failure to exclude the $4 million for the period January 1, 1990 through February 1, 1992. This refund, plus interest, would amount to about $1 per residential ratepayer (or 4 cents per month), and the prospective rate reduction would amount to about 2 cents per month for residential ratepayers until the Commission acts upon the petition for modification.

2.4 Method for Refund and Rate Reduction

As noted, the settlement agreement calls for a refund to ratepayers of $19.1 million annually, plus interest,[7] for the period beginning January 1, 1990, and ending 60 days after Commission approval of the settlement. Pacific Bell further agrees to decrease its annual rates by $19.1 million prospectively, beginning one day after the refund date. To accomplish the refund, Pacific Bell would file an advice letter increasing its existing surcredit for a period of one year beginning on the refund date. To accomplish the prospective rate reduction, Pacific Bell would increase the existing surcredit effective one day following the refund date. The utility contemplates accomplishing the prospective rate reduction through its Tariff Rule 33 ("Billing Surcharges") mechanism. However, Pacific Bell states that, if appropriate, the prospective rate reduction may be incorporated into the Implementation Rate Design proceeding in Investigation (I.) 87-11-033.

3. Comments and Objections to Proposed Settlement

Only one party has objected to the proposed settlement. CCTA filed comments pursuant to Rules 51.4 and 51.5. Pursuant to Rule 51.4, DRA, Pacific Bell, and AT&T have replied to the CCTA comments. None of those parties objecting to the first settlement--TURN, AT&T, and MCI--has filed comments objecting to the second settlement, and thus each has waived any objection to the proposed settlement now before us. (Rule 51.5.)

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7 Interest for the period between January 1, 1990 and the refund date would be calculated based on the average Federal Reserve statistical release 90-day commercial paper rate in effect during that period. Interest for the period between the refund date and the date the refund is complete would be calculated on a declining balance basis at the Federal Reserve statistical release 90-day commercial paper rate then in effect.

CCTA argues that, except for the refund provision and dollar revisions, the second proposed settlement is essentially the same as the one rejected earlier by the Commission. CCTA states that "(t)he fact that this new proposed settlement agreement only contains minor clarifications is evidence that it, like its predecessor, is not in the public interest and should be rejected." AT&T responds that the current settlement's addition of a $19.1 million annual refund "is hardly minor."

CCTA does not address the refund or rate reduction amounts. However, it does attack the methods established for tracking product development costs and for dealing with sharable earnings treatment for competitive products, for discontinued enhanced services and for products potentially affected under the federal court divestiture rulings.

DRA and Pacific Bell respond that the first settlement contained two categories of provisions. The first dealt with a prospective rate reduction. The second dealt with procedures to ensure that product development costs would be properly tracked, monitored, and accounted for in the new regulatory framework. In rejecting the first settlement, DRA and Pacific Bell state, the Commission focused on the lack of refunds for alleged past subsidies of competitive products. On the other hand, the settling parties state, the Commission looked with favor on the provisions

dealing with product development tracking.[8] The settling parties state:

> "The new Settlement retains the original settlement's provisions related to the future treatment of product development expenses, which the Commission believed were in the public interest. Yet, [CCTA] now attacks those provisions. This attack is particularly surprising since [CCTA] did not object to the same provisions in the original settlement, even though ... a party to the proceedings. The Commission must reject [CCTA's] attempt to needlessly delay adoption of the new Settlement and its procedures for future treatment of product development expenses." (Reply of DRA and Pacific Bell, p. 5.)

Specific objections by CCTA and our analysis of those objections follow.

3.1 Tracking Provisions

CCTA contends that the settlement's tracking provisions are inadequate because (1) Pacific Bell initially determines whether a product is potentially excluded from rates ("tantamount to a wolf left to guard the hen house"); (2) products are initially recorded above the line pending categorization by the Commission; and (3) the tracking provisions are not sufficiently specific.

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8 The Commission stated in D.91-11-023, pp. 2-3:

> "All five parties to the case supported the portion of the agreement which develops a new methodology for tracking and allocating future R&D costs to competitive services. These new tracking procedures will safeguard monopoly ratepayers from future cross subsidies for research, development and deployment expenses for competitive products. We recognize both the effort entailed in reaching agreement on the tracking system and the unanimous support of the parties for the new procedure. We believe it would be in the public interest to adopt those provisions of the settlement which pertain to future treatment of product development expenses."

CCTA's first objection, essentially, is that it must be assumed that Pacific Bell will act in bad faith, and procedures must be in place to guard against this. We are not willing to make that assumption. Even if we were, the settlement's requirements that Pacific Bell make annual filings for review by DRA safeguard the public interest. If it appears that Pacific Bell is attempting to circumvent the spirit of the settlement, any party (including CCTA) can petition the Commission to take appropriate action.

As to initially recording product costs above the line, the settlement requires Pacific Bell to track "all new Products," and it applies a cost method (Part 64 cost methodology) that can be applied retroactively at the time of Commission categorization. In other words, while we have permitted Pacific Bell to include initial development costs of products above the line,[9] we have required also that when competitive products emerge, the costs and revenue (if any)--all of which will have been tracked--must be moved below the line (that is, excluded from ratemaking).

CCTA seeks more specific tracking provisions, but it fails to suggest how this can be accomplished. In fact, the tracking provisions were discussed extensively by the parties during the first settlement discussions, and DRA and Pacific Bell agreed to a TURN suggestion and provided that tracking begin at the company's feasibility and analysis stage. After that change, no party--including CCTA--objected to the tracking provisions of the first settlement agreement, which are identical to those now before us. Again, if DRA or any other party detects shortcomings in the

9 See, e.g., D.89-10-031, p. 209: "However, we stress that Pacific Bell and GTEC should isolate and track all future development costs for new services as soon as they are incurred, so that they can be removed from the sharing mechanism if below-the-line treatment is authorized." (Emphasis added.)

tracking procedure once it is in place, that party may file an appropriate petition to seek to correct those shortcomings.

3.2 Refund and Rate Reduction

CCTA criticizes the surcharge mechanism through which Pacific Bell and DRA propose to pass along the rate reduction and refund generated by the settlement. It urges that "ratepayer dollars inappropriately extracted...be placed back in the hands of the monopoly ratepayer who was initially deprived of those dollars." Again, however, CCTA presents no alternative to the surcharge/surcredit mechanism proposed by the settling parties.

Until the refund and reduction are incorporated in the final Implementation Rate Design for the new regulatory framework in I.87-11-033, the surcharge/surcredit mechanism may again be used to pass these savings to ratepayers. In D.90-03-075, the Commission directed Pacific Bell to use the Rule 33 surcharge to implement a modernization settlement with DRA. In D.90-11-058, the Commission authorized a Rule 33 surcharge to recoup revenues lost from eliminating Touch-Tone charges and expanding local calling areas.

3.3 Sharable Earnings Treatment

CCTA asserts that the proposed settlement is not clear about whether all costs incurred prior to the Commission's categorization of a Category III product will be removed from sharable earnings. The same criticism is expressed as to provisions for discontinued enhanced services and for products potentially affected by the federal court divestiture case requirements.

In fact, the settlement agreement addresses costs for all three of these product categories and provides that, if such products are removed from the ratemaking process, Pacific Bell "will exclude its then-current-year revenues and developmental costs for the Product in its next annual Sharable Earnings Advice Letter." If the amount of sharable earnings in any previous year,

dating to 1990, is changed because of cost exclusions, the settlement agreement provides that the amount of that change, plus interest, will become an adjustment in the utility's next annual Price Cap filing.

We read the settlement agreement to provide that all of the development costs of a subsequently classified competitive product must be captured when the revenues and expenses are placed below the line. CCTA suggests restructuring this requirement into a five-part test, but it has not persuaded us that its belated revision of Sections 2, 3, and 4 of the settlement will serve its objective any better than the provisions to which the settling parties have agreed.

3.4 Other Criticisms

CCTA asserts that Pacific Bell in its annual report of product development could "manipulate" the $1 million reporting threshold, topping out a product at $999,000 and carrying over $1,000 to the next year. The criticism overlooks the settlement's requirement that the annual report reflect cumulative expense and capital. If a product is not included in the first year's report because it has not reached $1 million in capital investment and expenses, the settlement requires that it must be in the second year's report if the cumulative costs exceed $1 million.

CCTA also asserts that it and other parties should, along with Commission staff, have access to Pacific Bell's annual report on product development. We agree with the DRA and Pacific Bell response to this suggestion:

> "This is the type of information that competitors' dreams are made of. The Commission must not require Pacific to release this highly sensitive information to third parties. The responsibility for the ongoing monitoring of California's public utilities has been given by the Constitution and Legislature to the Commission, not [CCTA]." (Reply of DRA and Pacific Bell, p. 12.)

3.5 Comments Are Insufficient

Rule 51.5 requires that a party contesting a proposed settlement must specify the portions of the settlement that it opposes, the legal basis of its opposition, and the factual issues that it contests. Rule 51.6 provides for hearings on any contested material issue of fact and for briefs on any contested issue of law successfully raised by a protesting party.

CCTA has not requested a hearing on any material issue of fact raised by the proposed settlement. Indeed, the association presents us with no material factual contention about the settlement. By the same token, CCTA's comments are heavy on "what if" scenarios and conclusory remarks, but the association presents no authority to support its contention that, as a matter of law, the settlement is not in the public interest.

Accordingly, we find that CCTA has failed to raise a contested material issue of fact requiring hearing pursuant to Rule 51.6(a) and that CCTA has failed to show a contested issue of law requiring briefing under Rule 51.6(b).

4. Discussion

We turn then to the fundamental question. Under Rule 51.1(e), we must decide whether the proposed settlement should be approved as one that is (1) consistent with the law; (2) reasonable in light of the whole record; and (3) in the public interest. Unless the settlement meets all of these tests, it must be rejected.[10]

The settlement is consistent with the law. The encouragement of settlements has always been part of the strong public policy of our state. Fisher v. Superior Court, et al.

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10 Re Commission's Rules of Practice and Procedure (1987) 26 CPUC 2d 96, 98: "We...place parties on notice that we will reject without hearing any...settlement which is not in the public interest."

(1980) 103 Cal. App. 3d 434. California courts regard it as the policy of the law to discourage litigation and to favor compromises and voluntary settlements of doubtful rights and controversies. (See, 12 Cal. Jur. 3d, Compromise § 53.)

Whether the settlement is reasonable in light of the whole record depends on a number of tests. In the Diablo Canyon nuclear power plant settlement between DRA and Pacific Gas and Electric Company (30 CPUC 2d 189 (1988)), we identified factors that should be considered and balanced in evaluating a settlement. Among them:

> "The most important element in determining the fairness of a settlement is the relationship of the amount agreed upon to the risk of obtaining the desired result." 30 CPUC 2d at 267.

The DRA Audit Report concluded that Pacific Bell should be required to reduce rates immediately by $15.6 million (adjusted by the parties to $19.1 million) in order to stop what DRA asserts is a cross-subsidy of competitive products. This amount allegedly was included in the start-up revenue requirement adopted in D.89-12-048, and is currently being charged to ratepayers as part of the Category I (noncompetitive products) sharing mechanism established in D.89-10-031.

The Audit Report also recommended that Pacific Bell be required to refund $37 million to compensate ratepayers for their past funding of competitive products. DRA stated that this amount includes $21.3 million for Public Packet Switching, with the remainder for expenses related to Voice Mail, PB Connection, California Call Management, and SMART Desktop. (See D.91-11-023, p. 26.)

The settling parties tell us that the refund amount "specifically addresses the Commission's concern about $19.1 million being included in rates between January 1, 1990 and the Refund Date for enhanced services and SMART Desktop costs." (Settlement Agreement, p. 4.) As to Public Packet Switching, the

settlement carves out that issue for separate briefing. (Settlement Agreement, p. 2.) We take official notice that, in their concurrent briefs on Public Packet Switching, DRA continues to urge an additional refund in excess of $20 million, while Pacific Bell continues to assert that Public Packet Switching costs were resolved by prior Commission decisions and no further refund is justified.

While we are not privy to how the settling parties calculated the $19.1 million refund amount (see Rule 51.9), that amount appears to reach all or virtually all of the refund costs alleged in the Audit Report for Voice Mail, PB Connection, California Call Management, and SMART Desktop. Similarly, it matches the $19.15 million/year calculation by AT&T in the original round of pleadings. (See D.91-11-023, p. 30.)

The settlement calls for refund of an annual $19.1 million since January 1, 1990, but it does not require refunds for any period earlier than 1990. As noted, however, the question of refund for Public Packet Switching costs (and the duration for refund, if any) is reserved by the parties for separate briefing. Paragraph 8(b) of the settlement agreement provides that DRA and other parties may continue to pursue ratepayer refunds for the period 1986-1989 for California Call Management, Voice Mail, or PB Connection as part of the proceeding in A.90-12-052 (Application of Pacific Bell for Authorization to Transfer Specified Personnel and Assets).

Thus, the amount agreed upon for refund and rate reduction is at or about that amount claimed by DRA in its initial pleadings. The length of time for which the refund is calculated starts at the date of the NRF (new regulatory framework) start-up

revenue adjustment.[11] The settlement permits DRA and other parties to seek refunds for earlier periods in other proceedings. In the absence of any objection as to the refund and rate reduction, the amount agreed upon meets the initial test set forth in the Diablo Canyon settlement case. Moreover, the amount agreed upon responds to the first two questions posed by our order in D.91-11-023, addressing the amount and duration of the refund.

The amount agreed upon for refund and prospective rate reduction is reasonable in light of the record before us.

Finally, we consider whether the public interest is best served by the settlement agreement before us. In the Diablo Canyon case, we stated:

> "In order to determine whether the settlement is fair, adequate and reasonable, the court will balance various factors which may include some or all of the following: the risk, expense, complexity, and likely duration of further litigation; the amount offered in settlement; the extent to which discovery has been completed so that the opposing parties can gauge the strength and weakness of all parties; the stage of the proceedings; the experience and views of counsel; the presence of a governmental participant; and the reaction of the class members to the proposed settlement." 30 CPUC 2d at 222, citing Officers for Justice v. Civil Service Commission of the City and County of San Francisco (9th Cir. 1982) 688 F. 2d 615, 625.

Discovery in this case appears complete. Each of the settling parties by now knows intimately the strengths and weaknesses of the other's case. Counsel for DRA and Pacific Bell

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11 Report on the Research and Development, Joint Ventures, and Strategic Alliances of Pacific Bell and Pacific Telesis Companies, A.85-01-034. Start-up revenue adjustment was effective January 1, 1990.

are experienced litigators, as are counsel for the other parties that have examined this settlement proposal.

While the cost of further litigation appears relatively modest, it is likely that further hearings and briefing would extend through the end of this year. In contrast, the settlement will result in an immediate refund and decrease in rates to all of Pacific Bell's ratepayers. Perhaps just as important for ratepayers in the long run, the settlement establishes a procedure for ensuring that Pacific Bell's product development costs are fairly treated in the sharing mechanism created by D.89-10-031, and Pacific Bell will modify its product development tracking in a manner that will permit more effective monitoring by DRA and by other parties.

We recognize, nonetheless, that monitoring of product development tracking places a burden on DRA and other parties to uncover any inappropriate accounting and financial practices. That fact may create a perverse incentive for utilities, such as Pacific Bell, to delay the date for determining that a product is a Category III service. Such an approach would be inconsistent with the overall philosophy of the New Regulatory Framework and causes us concern. However, the revised settlement agreement provides a remedy. The settlement, itself, permits Pacific Bell or DRA to readdress the process and procedures for auditing competitive services in the 1992 review of the New Regulatory Framework now pending before us. We expect the parties to raise this issue in the 1992 review.

As discussed above, our desire to see prompt return to ratepayers of the refunds which are entirely deserved, and long overdue, is one factor militating in favor of approval of the settlement. However, the settlement affects still another interest in a positive, though indirect, manner -- that of the firms competing with Pacific Bell for development of Category III

services. It is hard to estimate the impact Pacific Bell's cross-subsidies may have on competing firms. Millions of dollars may have significant impacts on a small entrepreneurial firm that is competing in the same market as Pacific Bell; for such a firm remedial action by this Commission in the form of refunds may be too little and too late. The best protection here, as for ratepayers, is prevention. We underscore that processes and procedures which promote the proper behavior of the utilities are essential to implementing the New Regulatory Framework.

We note that none of the parties objecting to the original settlement--TURN, AT&T, and MCI--has filed any objection to the revised settlement agreement. CCTA objects to certain tracking and sharing provisions of the settlement, but we do not regard those objections as sufficient for us to deny approval of the revised settlement. Most of the concerns expressed by CCTA are ones that can be brought before us by way of petition if CCTA, or any other party, alleges an attempt to circumvent the spirit of the settlement agreement.

We conclude that the settlement is reasonable. The refund provisions respond to the concerns we expressed in our earlier rejection of the initial settlement proposal. Other terms agreed upon appear to be a fair compromise between the positions of the parties. Ratepayers are treated uniformly. The good faith of the settling parties is not in dispute and therefore is presumed. (Fisher v. Superior Court, et al., 103 Cal. App. 3d at 449.) In sum, we find that the settlement is reasonable in light of the whole record, consistent with the law, and in the public interest.

Findings of Fact

1. In D.86-01-026, the Commission directed staff to continue and complete its audit of Pacific Bell's affiliates to determine whether ratepayers were funding any Pacific Telesis ventures into competitive services.

2. In D.86-01-026, signalling disapproval of the failure of Pacific Telesis to cooperate with the staff audit, the Commission withheld $4 million from Pacific Bell's rates pending completion of the audit of Pacific Bell affiliates.

3. In D.87-12-067, at the conclusion of a Phase Two audit, the Commission directed staff to complete an audit of Pacific Bell's joint ventures, strategic alliances, and R&D projects.

4. The audit directed in D.87-12-067 was suspended in mid-1988 because of a discovery dispute over documents alleged to be subject to the attorney-client privilege. The audit resumed in May 1990.

5. DRA completed its Audit Report on October 30, 1990.

6. The DRA Audit Report made six basic recommendations intended to remedy what it alleged were past cross-subsidies, stop current and future cross-subsidies, and facilitate monitoring by the Commission and its staff.

7. The DRA Audit Report recommended that the Commission order Pacific Bell to do the following: (1) reduce rates by $15.6 million; (2) refund $37 million to ratepayers; (3) identify competitive products at the development stage; (4) seek prior approval of certain Pacific Bell Directory offerings; (5) exclude costs for projects that could violate MFJ restrictions; and (6) modify internal controls for project cost tracking.

8. Of the $37 million refund recommended in the DRA Audit Report, $21.37 million was attributed to Public Packet Switching.

9. Pacific Bell filed its response to the DRA Audit Report on December 21, 1990, denying that any refund or rate reduction is justified and urging dismissal of all recommendations except the one related to MFJ restrictions.

10. Pacific Bell in its response corrected the $15.6 million figure for expenses identified in the Audit Response to $18.8 million in expenses for Voice Mail, PB Connection, and California Call Management.

11. On February 1, 1991, DRA and Pacific Bell filed a settlement agreement with the Commission and moved jointly for its approval and adoption.

12. The 1991 settlement agreement called for a reduction in rates by Pacific Bell of $18.8 million annually, exclusion of certain product and program costs from annual sharing calculations, and new procedures for tracking the costs of product and program development.

13. TURN, AT&T, and MCI objected to the alleged failure of the settling parties to address in the settlement agreement the DRA Audit Report recommendation for a ratepayer refund.

14. The settling parties stated that the DRA Audit Report recommendation on ratepayer refund was considered and made part of their agreement on prospective rate reduction.

15. In D.91-11-023, the Commission denied the joint motion for adoption and approval of the 1991 settlement agreement.

16. In D.91-11-023, the Commission found that the 1991 settlement agreement was not in the public interest, primarily because of its failure to adequately deal with the Audit Report refund recommendation. The Commission ordered further hearings to investigate the refund issue, among others.

17. On February 7, 1992, DRA and Pacific Bell presented a revised settlement agreement and jointly moved for its adoption and approval.

18. The revised settlement agreement provides for a refund of $19.1 million annually, plus interest, for the period January 1, 1990, to a date 60 days after adoption of the agreement; a reduction in annual rates of $19.1 million following the refund; and, generally, the same exclusions for product costs and the same tracking and report requirements that were set forth in the 1991 settlement agreement.

19. The settling parties also propose that the question of whether adjustments are required with respect to Public Packet

Switching should be the subject of separate briefing and later disposition by the Commission.

20. The settling parties also propose that Pacific Bell proceed with separate filings to permit the Commission to consider and dispose of the issue of the $4 million annual revenue holdback.

21. TURN, AT&T, and MCI have not objected to the revised settlement agreement.

22. Pursuant to Rule 51.4, CCTA filed comments contesting parts of the revised settlement agreement.

23. CCTA does not object to the amounts of the proposed refund and rate reduction in the proposed settlement, but it does argue that more stringent rules should be adopted for product expense tracking, sharable earnings treatment, and reporting requirements.

24. DRA, Pacific Bell, and AT&T replied to CCTA's comments, stating generally that the association's recommendations are not required, that CCTA failed to object to essentially the same provisions at the time of the 1991 settlement proposal, and that the objections made by CCTA could be the subject of an enforcement petition at a later time should that become necessary.

25. The revised settlement agreement is attached to this decision as Appendix A.

Conclusions of Law

1. No hearing is required pursuant to Rule 51.6(a) to consider contested material issues of fact in the proposed settlement agreement.

2. No further briefing is required pursuant to Rule 51.6(b) to consider a contested issue of law, except for the settling parties' agreement that the refund issue related to Public Packet Switching shall be the subject of further briefing and later Commission disposition.

3. The public policy of this state strongly favors settlement and the avoidance of litigation.

4. The settlement agreement should be found to be reasonable in light of the record as a whole in this proceeding.

5. The settlement agreement should be found to be consistent with the law.

6. The settlement agreement should be found to be in the public interest.

7. Since the settlement's refund to ratepayers and the ongoing reduction in rates will become effective following Commission adoption and approval of the proposed settlement, the public interest is served by making this order effective immediately.

INTERIM ORDER

IT IS ORDERED that:

1. The joint motion of the Division of Ratepayer Advocates and Pacific Bell that the Commission adopt and approve the settlement agreement attached hereto as Appendix A is approved.

2. Pacific Bell shall file an advice letter, in accordance with General Order 96-A, on or before 60 days following the date of this order, to effect a refund of $19.1 million annually, plus interest, for the period commencing January 1, 1990, and ending 60 days after the date of this order, to be applied as a surcredit under Pacific Bell's Rule No. 33, "Billing Surcharges." The refund amount shall be uniformly applied as a surcredit for local exchange (Rule 33, Part 1.A), intraLATA toll (Rule 33, Part 1.B), and access (Rule 33, Part 1.C) services.

3. In that same filing, Pacific Bell shall reduce its rates prospectively by $19.1 million, beginning one day after the period of refund described in Ordering Paragraph 2, as a surcredit under Pacific Bell's Rule No. 33, "Billing Surcharges." The reduction amount shall be uniformly applied as a surcredit for local exchange

(Rule 33, Part 1.A), intraLATA toll (Rule 33, Part 1.B), and access (Rule 33, Part 1.C) services.

4. Pacific Bell is directed to reduce its currently requested startup annual revenue requirement for the Implementation Rate Design proceeding in Investigation (I.) 87-11-033, by $19.1 million. The necessary information to adopt this adjustment as a permanent substitute for the surcredit in Ordering Paragraph 3 shall be provided by Pacific Bell in a summary exhibit prior to the submission of the record in the current Implementation Rate Design phase of I.87-11-033, in compliance with this order.

5. The assigned administrative law judge shall accept briefs and reply briefs on the subject of Pacific Bell's Public Packet Switching program and shall direct such further briefing, hearings, or conferences as may be required in the public interest.

6. The Telesis Audit Phase of this proceeding shall remain open until resolution by the Commission of the Public Packet Switching matter described in Ordering Paragraph 5.

This order is effective today.

Dated July 22, 1992, at San Francisco, California.

DANIEL Wm. FESSLER
President
JOHN B. OHANIAN
PATRICIA M. ECKERT
NORMAN D. SHUMWAY
Commissioners

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

NEAL J. SHULMAN, Executive Director

APPENDIX A

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of PACIFIC BELL (U 1001 C), a corporation, for authority to increase intrastate rates and charges applicable to telephone services furnished within the State of California. (Telesis Audit Phase)	Application No. 85-01-034
And related matters.	I.85-03-078 OII 84 Case No. 86-11-028

SETTLEMENT AGREEMENT

BACKGROUND

In December 1987, the Commission ordered the DRA to perform an audit in order to examine Pacific's joint ventures, strategic alliances, and research and development projects (D.87-12-067, p. 284). When the Commission ordered the audit, Pacific operated under a traditional rate base/rate-of-return regulatory framework.

A prehearing conference was held on April 26, 1990, to determine how the audit should proceed. A schedule was established to have the DRA complete the audit and issue its report in approximately six months. The DRA and Pacific followed the

schedule set forth in the prehearing conference and on October 30, 1990, the DRA filed its Report with the Commission.

The DRA's Report contained six basic recommendations: (1) Pacific should refund approximately $37 million to ratepayers for expenses incurred since 1986 for competitive products; (2) Pacific's current rates should be reduced by $15.6* million to eliminate recovery of expenses related to Category III services; (3) Potential Category III services should be identified in the development stage and ratepayers or stockholders should be allowed to recover development costs if the service is recategorized when it is first offered to customers; (4) Pacific Bell Directory should seek prior Commission approval to include new service offerings in the results of operations for ratemaking purposes; (5) All future development costs for products that could potentially violate MFJ restrictions should be excluded from results of operations for ratemaking purposes; (6) Pacific should provide the DRA with a periodically updated list of all projects and/or products and should enhance its internal controls for project cost tracking and accounting.

On December 21, 1990, Pacific filed its response to the DRA's Report. In that response, Pacific argued that the Commission, based upon its previous decisions, should dismiss all but one of the recommendations in the DRA's Report. Pacific also argued that the remaining issue, related to development activities in areas subject to MFJ uncertainty, should be handled with written

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* When a jurisdictional allocation is eliminated, the DRA's rate reduction recommendation equals $19.1 million.

pleadings, rather than hearings.

On February 1, 1991, Pacific and the DRA jointly proposed to the Commission a settlement of all issues raised in the DRA's Report and D.87-12-067 as it relates to Pacific's joint ventures, strategic alliances and R&D projects. In D.91-11-023, the Commission rejected the DRA's and Pacific's proposed settlement and called for hearings to address the following issues:

a. The amount of cross-subsidy both prospective and refund including SMART Desktop;

b. How far back the refund can be calculated;

c. The disposition of the $4 million holdback;

d. A full airing of the legal issues posed by the seeming inconsistency on the subject of refunds of D.90-05-045 with D.86-01-026 and D.87-12-067.

Pacific continues to believe there was no inappropriate cross-subsidy in its start-up revenue adjustment. Nevertheless, in light of the Commission's clear direction in D.91-11-023, the DRA and Pacific have negotiated a new settlement which includes, in addition to the provisions of the February 1, 1991 proposed settlement, a $19.1 million annual refund, plus interest*, for the period beginning January 1, 1990 and ending 60 days after the Commission approves the settlement (the "Refund Date"). This

*For purposes of the refund, "interest" for the period between January 1, 1990 and the "Refund Date" is calculated based on the average Federal Reserve statistical release 90-day commercial paper rate in effect during that period. Interest for the period between the "Refund Date" and the date the refund is complete will be calculated on a declining balance basis at the Federal Reserve statistical release 90-day commercial paper rate then in effect.

refund specifically addresses the Commission's concern about $19.1 million being included in rates between January 1, 1990 and the Refund Date for enhanced services and SMART Desktop costs.

The refund, a $19.1 million prospective rate reduction beginning one day after the Refund Date, and the other terms of the settlement resolve all but one of the claims pending before the Commission related to or arising out of the DRA's audit of Pacific's strategic alliances, joint ventures and research and development, including issues raised in: 1) D.87-12-067, and 2) the DRA's Report. The one issue left unresolved concerns what the Commission has called "the seeming inconsistency on the subject of refunds in D.90-05-045 and D.86-01-026 and D.87-12-067" (see D.91-11-023, p.3, 37). The DRA and Pacific recommend that this issue be set for briefing. The settlement, an opportunity to brief the one remaining unresolved issue, Advice Letter 16144*, and Pacific's forthcoming petition to modify D.87-12-067 to remove the $4 million holdback eliminate the need for further hearings on the issues listed in D.91-11-023.

SCOPE OF THE AGREEMENT

Pacific and the DRA hereby agree to settle all claims related to or arising out of the Report and D.87-12-067 as it

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* Advice Letter 16144 proposed a refund and prospective rate reduction to properly account for the $4 million holdback. Additionally, Pacific will file a petition to modify D.87-12-067 to eliminate the $4 million holdback immediately. Advice Letter 16144 and the petition to modify will dispose of the issue regarding the $4 million holdback.

relates to Pacific's joint ventures, strategic alliances, and research and development activities, except the issue of the "seeming inconsistency on the subject of refunds in D.90-05-045 and D.86-01-026 and D.87-12-067." The terms of this Agreement shall be effective upon adoption by the Commission and shall be applied only prospectively.

The terms of the Agreement set forth below shall apply only to Pacific's development of products and services to be offered to customers for a charge (collectively "Products"). The terms of this Agreement do not apply to development activities, such as network enhancements, quality improvement, or operations support system improvements, which are not directly assignable to new Products offered to customers. Pacific and the DRA agree that reporting and tracking of development activities not associated with new Products will be accomplished through the Commission's ongoing monitoring mechanism.

TERMS OF AGREEMENT

1. Refund and Rate Reduction. Pacific agrees to refund to ratepayers $19.1 million annually, plus interest*, for the period beginning January 1, 1990 and ending 60 days after Commission approval of this Settlement (the "Refund Date"). Pacific further agrees to decrease its annual rates by $19.1 million prospectively, beginning one day after the Refund Date. The refund and decrease

* For purposes of the refund, "interest" is defined in the footnote on p. 3 of this Agreement.

in rates will be implemented by increasing Pacific's existing surcredit not later than 60 days after the Commission's approval of this Agreement. To accomplish the refund, Pacific will file an advice letter to increase the existing surcredit for a period of one year beginning on the Refund Date. Pacific will file an advice letter to remove the refund surcredit at the end of the one year period. To accomplish the prospective rate reduction, Pacific will increase the existing surcredit, effective one day following the Refund Date. Pacific presently contemplates accomplishing the prospective rate reduction through its Rule 33 surcharge mechanism. However, if possible and appropriate, the prospective rate reduction may be incorporated into the Implementation Rate Design.

2. Sharable Earnings Treatment for Category III, Below-the-Line Products. Pacific agrees to exclude from annual sharing calculations, the revenues and developmental costs for Products which the Commission classifies as Category III and below-the-line for ratemaking purposes. Pacific will exclude the revenues and developmental costs for such a Product in the following manner:

a. Pacific will exclude its then-current-year revenues and developmental costs for the Product in its next annual Sharable Earnings Advice Letter;

b. If the amount of sharable earnings in any previous year, commencing with the year 1990, is changed when the Product revenue and developmental costs for that year are excluded, Pacific will include the amount of that change, plus interest*, as a one-time Z factor

* For purposes of sections 2, 3, and 4 of this Agreement, "interest" is computed by using the Federal Reserve statistical release 90-day commercial paper rate.

adjustment in its next annual Price Cap filing pursuant to D.89-10-031.

3. Sharable Earnings Treatment for Discontinued Enhanced Services. For Products which, if offered, would meet the FCC's definition of Enhanced Services*, Pacific agrees to exclude from its annual sharing calculations Product revenues and development costs if Product development is discontinued before the Product is offered to customers. Pacific will exclude the revenues and developmental costs for such a Product in the following manner:

a. Pacific will exclude its then-current-year revenues and developmental costs for the Product in its next annual Sharable Earnings Advice Letter;

b. If the amount of sharable earnings in any previous year, commencing with the year 1990, is changed when the Product revenue and developmental costs for that year are excluded, Pacific will include the amount of that change, plus interest, as a one-time Z factor adjustment in its next annual Price Cap filing pursuant to D.89-10-031.

If disputes arise concerning whether or not a discontinued Product would have been an enhanced service, Pacific and the DRA agree to use their best efforts to informally resolve the dispute. If they are unable to resolve the dispute, the DRA may seek resolution by

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* Enhanced Services are defined by the FCC as: "services, offered over common carrier transmission facilities used in interstate communications, which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different, or restructured information; or involve subscriber interaction with stored information." 47 CFR 64.702.

filing an application in the open forum investigation (I.90-02-047).

4. Sharable Earnings Treatment for Products Potentially Affected by the MFJ. The DRA raised concerns regarding Products potentially affected by the MFJ. Therefore, in addition to the procedures set forth in section 3 above, if Pacific requests and is denied a waiver of an MFJ* restriction that is required in order to provide a Product, Pacific agrees to exclude from annual sharing calculations the revenues and developmental costs for that Product. Pacific will exclude the revenues and developmental costs for that Product in the following manner:

a. Pacific will exclude its then-current-year revenues and developmental costs for the Product in its next annual Sharable Earnings Advice Letter;

b. If the amount of sharable earnings in any previous year, commencing with 1990, is changed when the Product revenues and developmental costs for that year are excluded, Pacific will include the amount of that change, plus interest, as a one-time Z factor adjustment in its next annual Price Cap filing pursuant to D.89-10-031.

5. Tracking, Reporting, and Approval Requirements for Pacific Bell Directory. Pacific agrees to include a description of Pacific Bell Directory Product development activities in the annual report on Product development described in section 7 below. Pacific and the DRA agree that the annual report on product development and the

* Modification of Final Judgment, United States v. American Tel. and Tel. Co., 552 F. Supp. 226 (D.D.C. 1982), aff'd mem. sub nom. Maryland v. United States, 460 U.S. 1001 (1983), modified United States v. Western Elec. Co., 673 F. Supp. 525 (D.D.C. 1987), 714 F. Supp. 1 (D.D.C. 1988), affirmed in part and reversed in part 900 F.2d 283 (D.C. Cir. 1990).

current Commission reporting and approval requirements for Pacific Bell Directory, as contained in Ordering Paragraph 7 of D.85-12-065 and as reaffirmed in D.90-09-085, are sufficient to provide the Commission with the necessary information to exercise its jurisdiction pursuant to section 728.2 of the Public Utilities Code. This section 5 and section 7 below set forth all tracking, reporting, and approval requirements for Pacific Bell Directory Product development.

6. Product Development Tracking. Pacific will track, as described below, capital investment and direct expenses for all new Products being developed. In addition, if and when Pacific determines that a Product is potentially a Category III and below-the-line Product, Pacific will apply Part 64, fully loaded cost methodologies to establish the Product's costs and such costs will be recorded on an above-the-line basis.

Tracking will begin, at the latest, at the beginning of the feasibility and analysis stage of Product development. During the feasibility and analysis stage, Pacific:

- determines feasibility, fit, and potential of the Product based on customer and company criteria (e.g., new technology, market timing, MFJ and regulatory issues);
- identifies and evaluates resources and strategies for developing the product; and
- utilizes primary market research.

7. Annual Report on Product Development. Pacific agrees to provide by the end of the first quarter of each year, a report describing Pacific's and Pacific Bell Directory's Product development activities during the preceding calendar year for those

Products which incur $1 million or more of cumulative capital and expense. Pacific's report will include: the name and a complete functional and operational description of each Product being developed, preliminary categorization of each Product, previous year's expense and capital (by account) for each Product, current year's budget for each Product, cumulative expense and capital for each Product, and a year-to-year reconciliation to identify and describe continuing, completed, added, and discontinued Products.

8. General Provisions

a. No Admission. This Agreement is entered into in full compromise of all issues related to the DRA's Report or arising out of D.87-12-067 as it relates to Pacific's joint ventures, strategic alliances, or R&D, except the issue of "the seeming inconsistency on the subject of refunds in D.90-05-045 and D.86-01-026 and D.87-12-067." It is acknowledged by the DRA and Pacific that the execution of this Agreement is not and shall not be construed as an admission of imprudence, wrong-doing, or liability and that this Agreement reflects a mutual desire to move expeditiously in resolving the issues in the interest of all parties.

b. No Precedent. This Agreement represents a compromise, and the DRA and Pacific have entered into it on the basis that the Commission's adoption of the terms and conditions set forth herein not be construed as a precedent regarding any principle or

issue in any current or future proceeding. In particular, this Agreement does not dispose of the following two issues that are currently pending in A.90-12-052 (Application of Pacific Bell for Authorization to Transfer Specified Personnel and Assets):

(1) whether or not ratepayers should receive any portion of the value of Pacific's Information Services Group (ISG) as a going concern and, if so, the amount; and

(2) whether or not ratepayers are entitled to a refund for any expenses for California Call Management, Voice Mail, or PB Connection allegedly used to compute rates between 1986 and 1989.

This Agreement shall not preclude any party in A.90-12-052, including Pacific, from arguing in that proceeding any position with respect to the two issues above.

The issues resolved by this Agreement should not be construed as reflecting the DRA's or Pacific's views or position except as a reasonable and appropriate compromise of the issues involved.

c. Inadmissibility. In accordance with Rule 51.9 of the Commission's Rules of Practice and Procedure, no discussion, admission, concession or offer to stipulate or settle, whether oral or written, made

during any negotiation regarding a stipulation or settlement shall be subject to discovery or admissible in any evidentiary hearing against any participant who objects to its admission.

d. Release. Provided that Pacific implements the requirements of this Agreement and except as otherwise provided in section 8a, subsections (1) and (2) of section 8b, and section 8d herein, the DRA agrees that it will not pursue any claim, demand, cause of action, damage, liability of any nature whatsoever embodied in its Report or the joint venture, strategic alliance or research and development phase of this proceeding. The DRA or Pacific may, if necessary, readdress the process and procedures set forth in sections 2,3,4,6, or 7 of this Agreement during the Commission's review of the incentive-based regulatory framework pursuant to Ordering Paragraph 22 of D.89-10-031.

e. Obligations Imposed By Commission. Unless specifically set forth in this Agreement, neither party intends to alter or change its obligations imposed by the orders, rules, regulations, or decisions of the Commission.

f. Further Documents. The DRA and Pacific agree to execute such other or further documents or instruments and to take such other or further action

as may be necessary or desirable to implement the terms and provisions of this Agreement.

g. Entire Agreement. This writing constitutes the entire agreement between the DRA and Pacific. No modification or waiver of this Agreement shall be valid unless in writing and approved by the Commission. Neither the DRA nor Pacific shall be bound by any representation, promise, statement or information unless it is specifically set forth herein.

h. Statutory Obligations. Nothing contained herein shall modify the Commission's statutory obligations to regulate Pacific.

i. Interpretation. This Agreement shall in all respects be interpreted, enforced and governed exclusively by and under the laws of the State of California in effect when this Agreement is approved by the Commission. This Agreement is to be deemed to have been jointly prepared by the DRA and Pacific, and all uncertainty or ambiguity existing herein shall not be interpreted against either party.

j. Execution. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which, together shall constitute one and the same instrument.

k. Approval by CPUC. This Agreement shall be effective upon approval by the Commission.

APPENDIX A

IN WITNESS WHEREOF, the parties execute this Agreement on this 7th day of February, 1992.

DIVISION OF RATEPAYER ADVOCATES

By: Thomas H. Thayer

Title: Staff Counsel

Date: 2/7/92

PACIFIC BELL

By: Daniel D. Mosley

Title: Senior Counsel

Date: 2/7/92

APPENDIX A

CERTIFICATE OF SERVICE

I, Alex Kositsky, certify that the following is true and correct:

I am a citizen of the United States, State of California, am over eighteen years of age, and am not a party to this proceeding.

My business address is 140 New Montgomery Street, San Francisco, California 94105.

On February 7, 1992, I caused the enclosed "Motion to Adopt and Approve Settlement" to be served on all parties on the attached Service List for Telesis Audit Phase of Application 85-01-034. True copies of this document were placed in envelopes addressed to the parties as indicated on the attached service list. The envelopes, with postage thereon fully prepaid, were then sealed and deposited in a mailbox regularly maintained by the United States Government in the City and County of San Francisco, State of California.

Executed this 7th day of February, 1992, at San Francisco, California.

PACIFIC BELL
140 New Montgomery Street
San Francisco, CA 94105

By: _____
Alex Kositsky

APPENDIX A

SERVICE LIST FOR TELESIS AUDIT PHASE OF
APPLICATION 85-01-034

The Hon. Glen Walker
Administrative Law Judge
CALIFORNIA PUBLIC UTILITIES
COMMISSION
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APPENDIX A

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(END OF APPENDIX A)