

SEP 17 1992

Decision 92-09-081 September 16, 1992

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of Alternative
Regulatory Frameworks for Local
Exchange Carriers.

And Related Matters.

ORIGINAL

(Filed November 25, 1987)

7.87-11-033

Application 85-01-034

Application 87-01-002

I.85-03-078

I.87-02-025

Case 87-07-024

(See Appendix B for appearances.)

INTERIM OPINION MODIFYING DECISION 89-10-031

GTE California Incorporated's Request

On July 31, 1992, GTE California Incorporated (GTEC) filed a petition to modify Decision (D.) 89-10-031, dated October 12, 1989. GTEC requests that rather than changing its tariffed rates as required by D.89-10-031, it be permitted to implement its 1993 price cap index rate adjustment by changing its billing surcharges/surcredits.

In support of its petition, GTEC points out that the Commission granted similar modifications of D.89-10-031 for both calendar years 1991 and 1992, by D.90-09-084 dated September 25, 1990 and D.91-09-072 dated September 25, 1991, respectively.

GTEC also argues that:

"The Commission is currently considering GTEC's and Pacific's rate design proposals in the Implementation Rate Design (IRD) portion of Phase III of I.87-11-033. Adjustment of existing tariff rates would thus impact the Commission's IRD decision which is expected to be issued in early 1993. It would be unreasonable to adjust GTEC's tariffed rates as of January 1, 1993, based on its October 1992 price cap index filing, since many of those same rates would have to be increased only a few months later based on the company's new rate design adopted in IRD. Two major rate

changes in such rapid succession would undoubtedly generate both customer confusion as well as irritation with both GTEC and the Commission."

Pacific Bell's Companion Request

On July 31, 1992, Pacific Bell (Pacific) also filed a petition to modify D.89-10-031 to permit it to again use the surcharges/surcredits method to implement its 1993 price cap adjustments, as it was permitted to do for calendar years 1990 and 1991 by D.90-09-084 and D.91-09-072, respectively (supra), which modified D.89-10-031 ((1989) 33 CPUC2d 43, 234 (Ordering Paragraph (O.P.) 14)).

Pacific asserts that:

"...ratepayers would be less confused and irritated by these changes if the 1993 price cap index changes were implemented by adjusting Pacific's billing surcharges/surcredits rather than by changing individual tariff rates."

Also:

"The burden of adjusting and reviewing individual tariff rates to reflect changes as a result of the price cap indexing mechanism for 1993 is particularly unreasonable in light of the changes in tariff rates that will result following the Commission's decision in IRD. Pacific believes that these burdens are especially inappropriate in a situation where customer confusion or frustration may occur."

Pacific also requests the deletion of the O.P. 14a Subsection a. provisions [added by D.91-09-072] relative to the "...proposed adjustments to rates which reflect the intraLATA SPF-to-SLU settlements effects and interLATA SPF-to-SLU revenue shifts" since these adjustments were completed in 1992.¹

¹ SPF (Subscriber Plant Factor) to SLU (Subscriber Line Usage) transition is discussed infra at page 4.

Protest of AT&T Communications of California to Pacific's Petition to Modify D.89-10-031 and its Recommended Alternative Petition to Modify D.89-10-031

On August 13, 1992, AT&T Communications of California (AT&T-C) filed a protest to Pacific's petition stating that it "...is not opposed to allowing Pacific the ability to implement its 1993 price cap adjustments through surcharges and surcredits, [but AT&T-C] is opposed to the deletion suggested by Pacific for Ordering Paragraph 14a [Subsection a.] of D.89-10-031 [added by D.91-09-072] regarding SPF-to-SLU revenue adjustments."

AT&T-C argues that:

"...[T]he Commission should not believe, as Pacific would have it, that this is a minor change to D.89-10-031 nor should it believe Pacific's claim that no further SPF-to-SLU revenue adjustments are warranted. Indeed, as discussed below in AT&T's Petition to Modify D.89-10-031, the adoption of Pacific's modification would represent a major departure from Commission policy regarding local exchange carrier ('LEC') recovery of nontraffic sensitive ('NTS') costs. Therefore, AT&T respectfully requests that the Commission deny Pacific's proposal to modify Ordering Paragraph 14a of Decision 89-10-031 concerning the elimination of the SPF-to-SLU revenue adjustments."

AT&T-C then presented its recommended petition to modify D.89-10-031:

"Specifically, [AT&T-C] requests that the Commission modify D.89-10-031 to recognize a 1993 SLU revenue adjustment until new LEC access rates are implemented at the conclusion of the implementation rate design ('IRD') phase of I.87-11-033. [AT&T-C] requests this modification to D.89-10-031 to ensure that the Commission's policy, enumerated in D.85-06-115, establishing LEC access rates based upon the SLU allocator is maintained. Without this modification, LEC carrier common line ('CCL') switched access rates will not be revised on January 1, 1993, and, if this occurs, LECs will

overrecover their NTS costs to the detriment of all California ratepayers."

In its argument for its proposed retention and continuation of the SPF-to-SLU adjustment, AT&T-C provided the following historical background information for the adjustment:

"In Decision 85-06-115 the Commission ordered a gradual and uniform reduction of the disproportionate assignment of NTS costs to access services (D.85-06-115, O.P. 5., p. [249]). The initial reduction of NTS costs in access services was to be accomplished by transitioning from a 'subscriber plant factor' ('SPF') allocator to a 'subscriber line usage' ('SLU') allocator over a period of seven years -- 1986 through 1992. In transitioning from the SPF to the SLU allocator, LECs were required to file for annual reductions to their CCL access rate elements.

"In ordering the transition from a SPF-based to a SLU-based allocator for purposes of recovering NTS costs, the Commission recognized the resulting harmful long-term effects if uneconomic costs were permanently included in access rates. Specifically, the Commission acknowledged that the recovery of a large amount of NTS costs through access services purchased by interexchange carriers ('IXCs') would encourage IXCs and large business customers to bypass LEC facilities in order to avoid artificially high switched access charges. The result would be higher charges for the remaining users of the LEC network. It was exactly this negative result that the Commission sought to avoid by implementing the transition to the SLU allocator (D.85-06-115, p. [161])."

Protest of the California Bankers Clearing House Association and the County of Los Angeles to Pacific's and GTEC's Petitions

On August 28, 1992, The California Bankers Clearinghouse Association and the County of Los Angeles (CBCHA/County) filed a

protest to the petitions of Pacific and GTEC. In their protest CBCHA/County state that:

"Although CBCHA/County have not objected before [with similar requests over the past two years, all of which have been granted] they must do so now because of the incompleteness of the two LEC positions.

"Ordinarily the petitions of Pacific and GTEC would be non-controversial, as they have been in the past. Unfortunately, the petitions arise this year under an unusual circumstance: the price caps index that the LECs have used in the past, and which they propose to use in their filings this year, is no longer valid. A key component, the 'x' factor adopted to measure LEC productivity, was only approved for 1990, 1991, and 1992. (See D.89-10-031, p. 229; Ordering Paragraph 9.) Since the upcoming price caps filing is for 1993, the LECs do not have any Commission-approved productivity factor to be used in a price caps filing for which they wish to use the surcharge/surcredit mechanism. In essence, their petitions are incomplete because they chose to ignore the productivity factor issue."

CBCHA/County also argue that other parties have protested the LECs' Applications (A.) 92-05-002 (GTEC) and 92-05-004 (Pacific) for review of the New Regulatory Framework (NRF) method of regulation with respect to the productivity factor currently being used (4.5%). CBCHA/County contend that this issue will surely be addressed in the NRF review and it is likely that the Commission will adopt a higher productivity factor, probably in early 1993.

CBCHA/County argue that:

"There would be a large financial windfall to the LECs if they were allowed to make 1993 price caps filings using the old productivity factor of 4.5% and the factor should in fact have been higher."

**MCI Telecommunications Corporation's Support
of AT&T-C's Protest, AT&T-C's Alternative Petition
for Modification of D.89-10-031, and CBCHA/County's
Protest of the Continuing Use of the 4.5%
Productivity Factor**

On August 31, 1992, MCI Telecommunications Corporation (MCI) late-filed its response to Pacific's and GTEC's petitions.

In its response, MCI supported AT&T-C's opposition to Pacific's proposed deletion of O.P. 14a, Subsection a. which would eliminate the requirement for any further adjustments to rates for SPF-to-SLU effects. Accordingly, MCI also supported AT&T-C's recommended petition to continue the adjustment for future SPF-to-SLU effects. MCI argues that: "Elimination of this mechanism will end the benefits available to consumers."

As to CBCHA/County's protest of the use of the 4.5% productivity factor, MCI believes that CBCHA/County's proposal is reasonable and a higher productivity factor should be used for the pending October 1, 1992 price cap filings of GTEC and Pacific, if the Commission concludes in the 1992 NRF review that a higher factor is warranted. Specifically:

"MCI believes CBCHA's proposal is consistent with the Commission's intent in adopting the new regulatory format in California, to create incentives for more efficient local exchange operations and, most importantly, assure that the fruits of those efficiencies benefit consumers in California."

**Response of Pacific to the Protests of
AT&T-C and CBCHA/County**

On August 28, 1992, Pacific responded to the protests of AT&T-C and CBCHA/County stating that it had received no protests to the use of surcharges/surcredits to implement its 1993 price cap adjustments, but did receive protests of AT&T-C and CBCHA/County raising additional issues. Pacific argues that these protests and AT&T-C's petition should be denied.

Pacific asserts that AT&T-C improperly criticizes Pacific's proposed deletion of the SPF-to-SLU language from O.P. 14a of D.89-10-031 regarding the SPF-to-SLU revenue adjustments, which Pacific contends is "entirely appropriate and consistent with prior Commission orders" [D.85-06-115 at O.P. 5, (1985) 18 CPUC2d 113, 249].

Pacific further claims that:

"This language [D.89-10-031 O.P. 14a Subsection a. revised pursuant to D.91-09-072 O.P. 1.a.] is not applicable to a 1993 price cap advice letter filing because the SPF-to-SLU transition was completed in 1992, in accordance with Commission requirements."

Pacific also argues that AT&T-C's proposed alternative petition is inconsistent with the NRF decision which created "...a strong set of incentives for Pacific to manage its operations in the most efficient manner." Pacific contends that AT&T-C's proposal asks the Commission to make a substantial exception to the operation of NRF, "... and return to a traditional revenue requirement-based mechanism to determine CCL rates."

Regarding CBCHA/County's request for the use of a higher productivity factor than 4.5%, Pacific asserts that the Commission has not yet acted on Pacific's A.92-05-004 filing of May 1, 1992, requesting a review of the NRF, and thus has not adopted a productivity factor for use in future price cap filings. Accordingly, Pacific challenges CBCHA/County's request that any new productivity factor adopted next year be applied as if the new productivity factor had been in place on October 1, 1992, as constituting a retroactive application. This should be denied since it would otherwise create an unknown productivity target inconsistent with NRF, according to Pacific.

Pacific also cites D.89-10-031, (1989) 33 CPUC2d 43 at 158 and it asserts that "[T]he Commission determined that the

productivity factor used in the price cap indexing mechanism should be a predetermined 'target'...."

GTEC's Response to CBCHA/County's Protest

On September 1, 1992 GTEC responded to CBCHA/County's protest of the continued use of a 4.5% productivity factor for GTEC in 1993. GTEC argues that CBCHA/County's proposition "...smacks of cost-of-service regulation and would remove the incentives established by D.89-10-031 by introducing substantial uncertainty in the price cap formula."

GTEC urges rejection of CBCHA/County's recommendation, but prior to doing so, acknowledges that its productivity factor is at issue in A.92-05-002, currently pending before this Commission. Accordingly GTEC agrees that:

"If any other 'x' factor is, in fact, adopted as part of the 1992 Review, that productivity adjustment should then be utilized prospectively (presumably beginning with the first price cap filing after the issuance of the final 1992 Review decision)."

Division of Ratepayer Advocates Support of GTEC's and Pacific's Petitions

On September 2, 1992, the Division of Ratepayer Advocates (DRA) filed its response to the petitions, supporting the use of the surcharge/surcredit method for implementing the 1993 price cap adjustments of GTEC and Pacific.

DRA also responded to the CBCHA/County's recommendation for consideration of a higher productivity factor than 4.5% for GTEC and Pacific. DRA states that:

"[It] believes that the existing 4.5% productivity factor should be used with the [January 1,] 1993 price cap filing, subject to prospective adjustments from the effective date of the 1992 NRF review decision[s]."

Discussion

We concur with GTEC and Pacific that application of the price indexing mechanism should continue on a surcharge/surcredit basis for the two utilities' October 1, 1992 filings to become effective January 1, 1993, both for administrative ease and to reduce customer confusion. We granted a similar modification of D.89-10-031 for the 1991 and 1992 price cap filings of the two utilities for similar reasons by D.90-09-084 dated September 25, 1990, and D.91-09-072 dated September 25, 1991, respectively. Furthermore, the protests received on these petitions addressed issues other than the use of surcharges/surcredits to implement the upcoming revenue adjustment envisioned by D.89-10-031.

We disagree with AT&T-C's and MCI's proposed continuation of the SPF-to-SLU settlements effects for the 1993 price cap advice letter filing because the SPF-to-SLU transition was required for only six annual steps starting in 1986 and then for 1988 through 1992. There is no reasonable way to interpret the language of O.P. 5. of D.85-06-115, (1985) 18 CPUC2d 113, at 249, to require a further step adjustment for calendar year 1993. Accordingly, we will deny AT&T-C's recommended modification of D.89-10-031. Nonetheless, the issues surrounding appropriate levels of access and Carrier Common Line Charges (CCLC) are pending issues in the Implementation Rate Design (IRD) phase of this investigation (I.87-11-033) and, therefore, will likely warrant our consideration in future decisions in this proceeding.

Lastly, we agree that the productivity factor to be applied to future price cap filings is a pending issue in A.92-05-002 (GTEC) and A.92-05-004 (Pacific). However, these proceedings have not yet progressed beyond the discovery phase and it is not likely that a final decision will be reached in these proceedings prior to the first quarter of 1993.

Accordingly, while we may be able to consider new levels of future productivity for GTEC in A.92-05-002 and for Pacific in

A.92-05-004, any attempt to do so herein would likely be regarded as inconsistent with D.89-10-031. It would also be speculative on our part to do so at this time prior to the development of an evidentiary record. Therefore, we will continue to use the 4.5% productivity factor for GTEC's and Pacific's 1993 price cap advice letter filings to be made on or before October 1, 1992.

We will do so without prejudice to any party raising these issues at hearings in A.92-05-002 and A.92-05-004 and we will consider the evidentiary record developed in those proceedings in reaching our decision regarding the appropriate productivity factors for GTEC and Pacific to apply to their respective operations after the effective date of the decisions in A.92-05-002 and A.92-05-004.

We recognize CBCHA/County's concern that we not unnecessarily extend the current productivity factor beyond its previously effective schedule. However, we need an evidentiary record to determine whether it is reasonable to apply a different productivity factor in the future. In the absence of an evidentiary record, we choose to extend the currently adopted productivity factor, but only as long as necessary to revisit this issue in A.92-05-002 and A.92-05-004.

In the event that an annual productivity factor other than the current 4.5% level is adopted for GTEC and/or Pacific in the above-captioned proceedings, we will apply that new productivity factor to all applicable utility operations as soon after the effective date of the order(s) as is practicable, rather than await the next annual price cap filing effective date of January 1, 1994.

Having stated our concurrence that GTEC's and Pacific's respective 1992 price cap changes should be applied by way of adjustments to their respective billing surcharge/surcredit mechanisms, our denial of AT&T-C's petition to modify D.89-10-031 to require another (7th step) adjustment for the already completed

SPF-to-SLU transition and our deferral of any consideration of the proper level of future productivity to be required of GTEC and Pacific to the evidentiary record in A.92-05-002 and A.92-05-004, respectively, we need not address the remaining comments and positions of the parties.

Findings of Fact

1. In D.89-10-031, the Commission directed GTEC and Pacific to file advice letters no later than October 1 of each year, beginning in 1990, to update rates for Category I (basic monopoly) services and nonflexibly priced Category II (partially competitive) services and rate ceilings and floors for flexibly priced services according to the price indexing mechanism adopted in that decision, with new rates, ceilings, and floors to be effective the following January 1.

2. In D.89-10-031, the Commission also required that startup revenue adjustments be implemented effective January 1, 1990 for GTEC and Pacific through bill-and-keep surcharges/surcredits applied to intrastate access, intraLATA toll, and local exchange services to which surcharges and surcredits normally apply.

3. GTEC and Pacific have significant surcharges/surcredits currently in effect.

4. It is anticipated that the revenue effect of surcharges/surcredits will be incorporated into rates in the IRD portion of this proceeding.

5. Implementation of the January 1, 1993 price indexing adjustments through adjustments to the surcharges/surcredit will help reduce customer confusion and will be less costly to administer, as compared to specific modifications to tariffed rates.

6. It is reasonable to apply the price indexing mechanism for 1993 on a uniform bill-and-keep surcharge/surcredit basis to all tariffed services to which surcharges and surcredits currently apply, including flexibly priced services.

7. The implementation of the SPF-to-SLU transition in allocation of non-traffic sensitive costs directed to take place, through six annual steps in 1986 and 1988 through 1992, by O.P. 5. of D.85-06-115 was completed on January 1, 1992.

8. The historical treatment of access charges and allocation thereof has been studied and implemented over a longer term than one or two years as evidenced by D.85-06-115, O.P. 5. referenced above.

9. The treatment of access charges and appropriate rates and charges for access to the local exchange telephone companies local networks, for the future, are pending issues for our consideration in the IRD (Phase III) of I.87-11-033.

10. The appropriate productivity factors to be imposed on GTEC and Pacific in the future, as part of NRF, are issues under consideration, in A.92-05-002 and A.92-05-004, respectively.

Conclusions of Law

1. D.89-10-031 should be modified to allow that the price indexing mechanism be applied for calendar year 1993 on a uniform bill-and-keep surcharge/surcredit basis to all tariffed services to which surcharges and surcredits normally apply, in order to reduce customer confusion, and for administrative ease.

2. The appropriate levels of rates and charges for future access to the local exchange telephone companies' local area networks should be considered in the IRD (Phase III) of I.87-11-033.

3. AT&T-C's petition to modify D.89-10-031 to include an additional step of adjustment from SPF-to-SLU for the LECs access services tariff, beyond the six steps required by D.85-06-115,

O.P. 5., should be denied without prejudice to consideration of its position on access issues in the IRD (Phase III) of I.87-11-033.

4. The proper productivity factors for the future operations of GTEC and Pacific under the NRF should be determined in A.92-05-002 and A.92-05-004, respectively.

5. If an annual productivity factor other than 4.5% is adopted in one or both of the above proceedings, the new productivity factor(s) should be applied to GTEC's and/or Pacific's utility operations as soon as practicable after the effective date of the order(s) in those proceedings, without awaiting the beginning of 1994.

6. In order to provide timely implementation of revenue changes required by D.89-10-031, as modified by D.90-09-084, and to comply with the October 1, 1992 deadline of amended O.P. 14a of D.89-10-031, this order should be made effective today.

INTERIM ORDER

IT IS ORDERED that:

1. Ordering Paragraph 14a added to Decision (D.) 89-10-031 by D.90-09-084, dated September 25, 1990 is revised to read as follows:

"GTE California Incorporated (GTEC) and Pacific Bell (Pacific) shall file advice letters in accordance with General Order 96-A no later than October 1, 1992 for Commission consideration and approval to apply the adopted price cap mechanism through adjustments to their surcharges/surcredits to be effective January 1, 1993. In these advice letters, GTEC and Pacific shall:

- "a. Propose revenue adjustments to apply the adopted price cap indexing mechanism for 1993.
- "b. Propose the adjustments required by subparagraph (a) above via a bill-and-keep surcredit/surcharge based on

recorded customer billings for the first eight months of 1992 annualized. The bill-and-keep surcharge/surcredit shall be applied to intrastate access, intraLATA toll and local exchange services to which surcharges and surcredits normally apply.

- *c. Use recorded intrastate ratemaking demand, expenses, and revenues (excluding the effects of temporary surcharges/surcredits) for the first eight months of 1992 annualized to make the revenue adjustments.

*Copies of the advice letters shall be served at the time of filing on all parties currently active in the Phase III (IRD) part of Investigation (I.) 87-11-033 and on anyone requesting such service."

2. Ordering Paragraph 15 of D.89-10-031 previously modified by D.91-09-072 is further modified to read as follows:

*Beginning in 1993, GTEC and Pacific shall file advice letters in accordance with General Order 96-A no later than October 1 of each year for Commission consideration and approval to update rates for basic monopoly services and non-flexibly priced Category II services and rate caps and floors for flexibly priced services according to the adopted price cap mechanism with new rates, caps, and floors to be effective the following January 1. In these advice letters, GTEC and Pacific shall:

- *a. Propose adjustments to December 31 rates which reflect on a revenue-neutral basis any rate rebalancing authorized to be effective on January 1 of the coming year.
- *b. Propose further adjustments to the rates described in (a) to apply the adopted price cap indexing mechanism for the coming year.
- *c. Base demand estimates used in any rate rebalancing on recorded data for as much of the year as possible, with

estimates used for the remaining months.

"Copies of the advice letters shall be served at the time of filing on all parties then active in I.87-11-033 and on anyone requesting such service."

3. GTEC's and Pacific's petitions to modify D.89-10-031 are granted to the extent set forth in this order and in all other respects are denied.

4. AT&T-Communications of California's petition to modify D.89-10-031 is denied.

5. GTEC and Pacific shall use a productivity factor of 4.5% in their respective price cap filings due on October 1, 1992.

6. The ordering paragraphs and other requirements of D.89-10-031 dated October 12, 1989, except as expressly modified here, and by our prior decisions (D.89-12-048, D.90-04-031, D.90-09-084, and D.91-09-072) continue to apply to GTEC and Pacific after the effective date of this order. Appendix A to this order restates the currently applicable ordering paragraphs of D.89-10-031 as modified by this order.

This order is effective today.

Dated September 16, 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

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COMPLETE ORDERING PARAGRAPHS OF D.89-10-031
AS MODIFIED BY D.89-12-048, D.90-04-031,
D.90-09-084, D.91-09-072, and D.92-09-081

1. Local calling areas shall be expanded as proposed by Pacific Bell (Pacific) and residential Touch Tone charges shall be eliminated for all local exchange carriers in California. In metropolitan areas, current Zone Usage Measurement (ZUM) Zone 1 calling areas shall be expanded to include current Zone 2 calling areas. For non-ZUM areas, 0-to-12 mile toll calling bands shall be eliminated for directly dialed calls and Extended Area Service (EAS) charges shall be eliminated for those exchanges where customers currently pay a flat rate EAS increment for 0-to-12 mile routes. Implementation of these changes shall be delayed until statewide revenue impacts are determined in the supplemental rate design proceeding.

2. As developed in Section VII.A.5 of this decision, the principles of unbundling, nondiscriminatory access, imputation, and basing rate structures of monopoly utility services on underlying cost structures are adopted in principle. Local exchange carriers shall impute the tariffed rates and charges of any function deemed to be a monopoly building block in the rates and charges for any bundled tariffed service which includes that monopoly function. Pacific and GTE California Incorporated (GTEC) shall use tariffed rates and charges for Basic Service Elements (BSEs) or other monopoly building blocks in allocating costs to below-the-line services, and shall demonstrate as part of any future request to receive pricing flexibility or to provide additional enhanced services or any new services which face competition that such proposals comply with the principles adopted in this Ordering

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Paragraph. These principles shall be applied to special contracts as well.

3. All local exchange carriers are authorized to file applications in expedited application dockets to request rate flexibility for Category II services, as provided in Section VII.A.6 of this decision. Applications shall comply with Rules 2 through 8, 15, and 16 of the Rules of Practice and Procedure and shall include proposed tariff schedules. A local exchange carrier shall demonstrate that its application complies with the unbundling, nondiscriminatory access, imputation, and rate structure principles adopted in Ordering Paragraph 2. Copies of the applications shall be served separately at the time of filing on the Commission's Advisory and Compliance Division (CACD), Division of Ratepayer Advocates (DRA), and Legal Division, and shall contain or have attached cost support and workpapers. Copies of the applications shall also be served at the time of filing on all parties in I.87-11-033 and on anyone requesting such service. Local exchange carriers are authorized to submit new cost studies to update rate floors after rate flexibility is implemented through advice letters filed in accordance with General Order 96-A. Copies of the advice letters shall be served at the time of filing on all parties in I.87-11-033 and on anyone requesting such service.

4. Local exchange carriers are authorized to change their rates or charges through advice letter filings for services for which pricing flexibility has been implemented. Sections III, IV, V, and VI of General Order 96-A are waived so that such rate changes are effective on ten days' notice to all affected customers if the rate change is a decrease and on 30 days' notice to all affected customers if the rate change is an increase. Any protests shall be filed within eight days after an advice letter is filed, and CACD shall notify the local exchange carrier within ten days

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after an advice letter is filed if its proposed tariff sheets are rejected.

5. The rules adopted in this decision regarding pricing flexibility for Category II services replace on a statewide basis comparable rules adopted in D.88-09-059. In particular, Ordering Paragraphs 2 and 4 and the third sentence of Ordering Paragraph 5 of interim Decision (D.) 88-09-059 are superseded by Ordering Paragraphs 3 and 4 of this order, based on the record developed in Phase II. However, the requirement in D.88-09-059 that connections from an interexchange carrier's or competitor's point of presence to a local exchange carrier's central office be priced at cost in high speed digital special access tariffs for intraLATA purposes is not superseded by this decision. Local exchange carriers shall file advice letters in conformance with General Order 96-A within 90 days after the effective date of this order to conform tariffs of flexibly priced services with the rules adopted in this decision. Copies of the advice letters shall be served at the time of filing on all parties in I.87-11-033 and on anyone requesting such service.

6. Pacific and GTEC shall file applications and supporting testimony annually no later than June 30 of each year, commencing June 30, 1990, for approval of represcription or technical update reviews of depreciation rates to become effective on January 1 of the following year. Applications shall comply with Rules 2 through 8, 15, and 16 of the Rules of Practice and Procedure. Copies of the applications shall be served separately at the time of filing on CACD, DRA, and Legal Division. Copies of the applications shall also be served at the time of filing on all parties in I.87-11-033 and on anyone requesting such service.

7. The Request by the Division of Ratepayer Advocates for Review by the Full Commission of the March 21, 1989 ALJ Ruling

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Granting in Part the February 10, 1989 DRA Motion to Compel Production of Documents is denied.

8. The incentive-based price cap regulatory framework developed in this decision and described in Conclusions of Law 23 - 26, 28, 29, 31 - 43, 50, 57 - 61, 65, 68, and 74 is adopted.

9. A productivity adjustment of 4.5% for 1990, 1991, and 1992 is adopted for use in the price cap index.

10. A market-based rate of return of 11.50% is adopted for purposes of determining startup revenue requirements for 1990 and as a basis for the benchmark rate of return.

11. A benchmark rate of return 150 basis points above the adopted market-based rate of return is adopted for use in the adopted sharing mechanism to be effective January 1, 1990.

12. The Federal Communication Commission's (FCC) currently written Part 64 cost allocation rules (47 Code of Federal Regulation § 64.901) and cost manuals currently adopted by the FCC for Pacific (Exhibit A-18) and GTEC (Exhibit A-136) are adopted for use at this time, as modified by Conclusions of Law 44a and 44b, to separate intrastate costs between below-the-line services and those subject to the sharing mechanism. The Part 64 methodology shall be applied using Part 32 (Uniform System of Accounts) as modified and adopted by this Commission.

13. Pacific's proposal to invest \$404 million through 1992 to upgrade its network through replacement of electro-mechanical and electronic switches and associated analog carrier interoffice facilities is adopted to the extent that Pacific is authorized to place \$11 million of expenses related to switch replacements into rates effective January 1, 1990, as provided in Ordering Paragraph 14.

14. Pacific and GTEC shall make compliance filings in I.87-11-033 no later than October 26, 1989 to implement the adopted startup revenue adjustment on an intrastate ratemaking basis, the

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1990 interLATA SPF-to-SLU revenue shift, and the 1990 intraLATA SPF-to-SLU settlements effects, and, for Pacific, to place \$11 million of expenses related to switch replacements into rates effective January 1, 1990. In these compliance filings, Pacific and GTEC shall:

- a. Propose revenue adjustments which (i) would have yielded the adopted 1990 market-based rate of return in 1989, (ii) reflect an adjustment to rates for the 1990 intraLATA SPF-to-SLU settlements effects, and (iii) reflect an adjustment to rates for the 1990 interLATA SPF-to-SLU revenue shift.
- b. Propose further revenue adjustments to (i) apply the adopted price cap indexing mechanism for 1990 and (ii) for Pacific, reflect the adopted \$11 million in expenses related to switch replacement.
- c. Propose the adjustments required by subparagraphs (a) and (b) above via a bill-and-keep surcredit/surcharge based on recorded customer billings using the same period annualized used for calculation of the startup revenue adjustment. The bill-and-keep surcredit/surcharge shall be applied to intrastate access, intraLATA toll, and local exchange services as discussed in this decision.
- d. Use recorded intrastate ratemaking demand, expenses, and revenues (excluding the effects of temporary surcharges/surcredits) for the first eight months of 1989 annualized to make the revenue adjustments.
- e. Propose which time period, publisher, and specific measure of GNP-PI should be used in the price cap indexing mechanism.

The compliance filings shall contain or have attached earnings data for the first eight months of 1989, all workpapers,

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and proposed tariff schedules. Pacific and GTEC shall file an original and 12 copies of the compliance filings in the Docket Office. The filings shall comply with the applicable rules in Article 2 of the Rules of Practice and Procedure and shall have attached a certificate showing service by mail on all parties in I.87-11-033. Copies of the compliance filings shall also be served at the time of filing on the ALJ, the assigned Commissioner, CACD, Legal Division, and on anyone requesting such service.

Other parties may file comments on the filings no later than November 9, 1989. Copies of the comments shall be served separately at the time of filing on the ALJ, the assigned Commissioner, CACD, Legal Division, all parties in I.87-11-033, and on anyone requesting such service.

14a. GTEC and Pacific shall file advice letters in accordance with General Order 96-A no later than October 1, 1992 for Commission consideration and approval to apply the adopted price cap mechanism through adjustments to their surcharges/surcredits to be effective January 1, 1993. In these advice letters, GTEC and Pacific shall:

- a. Propose further revenue adjustments to apply the adopted price cap indexing mechanism for 1993.
- b. Propose the adjustments required by subparagraph (a) above via a bill-and-keep surcredit/surcharge based on recorded customer billings for the first eight months of 1992 annualized. The bill-and-keep surcharge/surcredit shall be applied to intrastate access, intraLATA toll and local exchange services to which surcharges and surcredits normally apply.
- c. Use recorded intrastate ratemaking demand, expenses, and revenues (excluding the effects of temporary surcharges/surcredits) for the first eight months of 1992 annualized to make the revenue adjustments.

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Copies of the advice letters shall be served at the time of filing on all parties currently active in the Phase III (IRD) part of I.87-11-033 and on anyone requesting such service.

15. Beginning in 1993, GTEC and Pacific shall file advice letters in accordance with General Order 96-A no later than October 1 of each year for Commission consideration and approval to update rates for basic monopoly services and non-flexibly priced Category II services and rate caps and floors for flexibly priced services according to the adopted price cap mechanism with new rates, caps, and floors to be effective the following January 1. In these advice letters, GTEC and Pacific shall:

- a. Propose adjustments to December 31 rates which reflect on a revenue-neutral basis any rate rebalancing authorized to be effective on January 1 of the coming year.
- b. Propose further adjustments to the rates described in (a) to apply the adopted price cap indexing mechanism for the coming year.
- c. Base demand estimates used in any rate rebalancing on recorded data for as much of the year as possible, with estimates used for the remaining months.

Copies of the advice letters shall be served at the time of filing on all parties then active in I.87-11-033 and on anyone requesting such service.

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16. Pacific and GTEC shall file advice letters in accordance with General Order 96-A no later than April 1 of each year, commencing in 1991, which evaluate whether the prior year's operations were such that sharable earnings exist and, if so, specify the bill-and-keep surcredit with duration of up to 12 months which should be applied to basic monopoly services except switched and low speed special access and services normally excluded from surcredits. The sharing calculation shall be based on recorded intrastate results that reflect the Commission's ratemaking adjustments, shall compare the adopted benchmark rate of return and earned rates of return, and (if sharable earnings exist) reflect appropriate interest. Interest shall be based on the 90-day commercial paper rate as published by the Federal Reserve Statistical Release and shall be calculated using the methodology and formulas as discussed and set forth in D.88-09-028 for the labor productivity sharing for Pacific and GTEC. Copies of the advice letters shall be served at the time of filing on all parties in I.87-11-033 and on anyone requesting such service.

17. The monitoring and reporting requirements in Section XI.A.2 of this decision are adopted.

18. All local exchange carriers shall cooperate fully with Commission staff in providing information necessary for monitoring, audits, and investigations.

19. CACD shall initiate as soon as feasible and chair workshops to provide more information to the Commission regarding current ratemaking adjustments, the format of annual filings by which Pacific and GTEC should report the prior year's earnings and any sharable earnings which might exist, and reporting requirements necessary to implement the adopted monitoring plan. The workshop

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report(s) which CACD shall file as a compliance filing in I.87-11-033 shall include at least the following information:

- a. A description of each report currently provided to the Commission, what sections of Commission staff use the report and for what purpose, and CACD's recommendations regarding whether the report should be revised, consolidated with other reports, or eliminated;
- b. Any other modifications to local exchange carrier reporting requirements or Commission monitoring activities which CACD recommends, including collection of relevant market power information for Category II and Category III services and reports to be filed regarding annual operating results and an evaluation of whether sharable earnings exist;
- c. A description of each current ratemaking adjustment and parties' positions regarding whether each one should be reflected in the sharing calculation;
- d. CACD's recommendations regarding service-specific cost allocation and tracking programs.

CACD shall file its workshop report(s) on all parties in I.87-11-033. Parties shall be given an opportunity to file comments and reply comments on CACD's workshop reports, and shall provide detailed reasons for any remaining areas of disagreement. If Pacific or GTEC objects to the collection and/or submission of specific data or reports suggested in CACD's workshop reports, it shall state in its opening comments whether the data is currently collected and shall provide an estimate of the incremental cost of meeting the proposed collection or reporting requirements.

20. Pacific and GTEC are authorized to file applications to request recategorization of existing services for pricing purposes

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or to request that existing services be included in the sharing mechanism or, alternatively, be given below-the-line accounting treatment. Applications shall have supporting testimony attached and shall comply with Rules 2 through 8, 15, and 16 of the Rules of Practice and Procedure and, if tariff changes are proposed, shall include proposed tariff schedules. Copies of the applications shall be served separately at the time of filing on CACD, DRA, and Legal Division, and shall contain or have attached cost support and workpapers. Copies of the applications shall also be served at the time of filing on all parties in I.87-11-033 and on anyone requesting such service.

21. If 30-year Treasury bond rates differ from current levels by 250 basis points for at least three consecutive months, Pacific and GTEC shall file applications and supporting testimony within 60 days following the end of the three month period stating their positions regarding whether the benchmark rate of return should be modified. In the first applications, Pacific and GTEC shall each address whether a short-term debt component should be included in the capital structure. In each application, Pacific and GTEC shall submit analyses of the cost effectiveness of both their proposed capital structure and a range of alternate capital structures. Applications shall comply with Rules 2 through 8, 15, and 16 of the Rules of Practice and Procedure. Copies of the applications shall be served separately at the time of filing on CACD, DRA, and Legal Division. Copies of the applications shall also be served at the time of filing on all parties in I.87-11-033 and on anyone requesting such service.

22. Pacific and GTEC shall file applications and supporting testimony no later than May 1, 1992 for review of operations of the adopted incentive-based regulatory framework. Pacific and GTEC shall each include at least the following information in its application:

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- a. Operating results for 1990 and 1991;
- b. Discussion of whether the GNP-PI and the manner in which it is applied in the adopted indexing mechanism provide an adequate reflection of economywide inflation in rates;
- c. Review of the productivity adjustment, recommended productivity adjustment for the upcoming period, and discussion of the frequency with which it should be updated;
- d. Comparison of service quality measurements before and after implementation of the adopted incentive-based regulatory framework;
- e. Review of monitoring and reporting requirements; and
- f. Discussion of ongoing need for a sharing mechanism.

Applications shall comply with Rules 2 through 8, 15, and 16 of the Rules of Practice and Procedure. Copies of the applications shall be served separately at the time of filing on CACD, DRA, and Legal Division. Copies of the applications shall also be served at the time of filing on all parties in I.87-11-033 and on anyone requesting such service.

23. Pacific and GTEC are authorized to request authority to provide enhanced services, BSEs, and any new services comparable to BSEs which might be offered due to the adopted unbundling principles through applications processed according to the Expedited Application Docket procedure. Applications shall comply with Rules 2 through 8, 15, and 16 of the Rules of Practice and Procedure and shall include proposed tariff schedules. Copies of the applications shall be served separately at the time of filing on CACD, DRA, and Legal Division, and shall contain or have

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attached cost support and workpapers. Copies of the applications shall also be served at the time of filing on all parties in I.87-11-033 and on anyone requesting such service.

24. Pacific and GTEC shall request authority to provide new services dependent on a fiber-to-the-customer infrastructure prior to making any investment in fiber beyond the feeder system, other than small-scale trials or fiber which is cost effective in the provision of traditional local exchange carrier services. Such requests shall be through applications and supporting testimony filed in compliance with Rules 2 through 8, 15, and 16 of the Rules of Practice and Procedure and shall include proposed tariff schedules. Copies of the applications shall be served separately at the time of filing on CACD, DRA, and Legal Division, and shall contain or have attached cost support and workpapers. Copies of the applications shall also be served at the time of filing on all parties in I.87-11-033 and on anyone requesting such service.

25. Pacific and GTEC shall file advice letters in accordance with General Order 96-A to request authority before they invest in fiber beyond the feeder system due to unusual physical conditions. Copies of the advice letters shall be served at the time of filing on all parties in I.87-11-033 and on anyone requesting such service.

26. Pacific and GTEC shall file applications in the Expedited Application Docket to request authority before they invest in fiber beyond the feeder system to provide traditional local exchange carrier services. Copies of the applications shall be served separately at the time of filing on CACD, DRA, and Legal Division, and shall contain or have attached cost support and workpapers. Copies of the applications shall also be served at the time of filing on all parties in I.87-11-033 and on anyone requesting such service.

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27. Parties in I.87-11-033 may file comments no later than November 2, 1989 and reply comments no later than November 16, 1989 on the proposed definition of "feeder" set forth in Section XI.B.2 of this decision. Copies of the comments and reply comments shall be served at the time of filing on CACD, Legal Division, all parties in I.87-11-033, and on anyone requesting such service.

28. The Center for Public Interest Law is eligible to request compensation for its participation in I.87-11-033.

29. Pacific's appeal of the March 21, 1989 Administrative Law Judge's ruling regarding receipt into evidence of certain Pacific planning document excerpts as part of the public record in Phase II of I.87-11-033 is granted and the document shall remain under seal.

30. If Pacific or GTEC requests that a new or existing service be placed in Category III for pricing purposes, its application or advice letter, as applicable, shall address whether various market power criteria are applicable and, if so, shall include the relevant information. The market power criteria addressed shall include, but shall not be limited to, the following:

Market share;

Ease of entry and exit:

-Number of competitors, trends,

-Estimations of capital investments
necessary to compete,

-Status of unbundling efforts by the local
exchange carriers;

Facilities ownership;

Size and growth capability of competitors;

Local exchange carrier return on equity;

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-Rate of return on marginal investment;

Competitors' earnings (to the extent available);

Substitutable services and studies regarding the cross elasticities of demand;

Rates, terms, and conditions of substitutable services; and

Whether a utility affiliate offers a competitive service.

(END OF APPENDIX A)

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