Decision No. 92703 FEB 18 1981

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a corporation, for authority to increase certain intrastate rates and charges applicable to telephone services furnished within the State of California.	Application No. 58223 (Filed July 14, 1978)
Investigation on the Commission's own motion into the rates, tolls, rules, charges, operations, costs, separations, inter-company settlements, contracts, service, and facilities of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a California corporation; and of all the telephone corporations listed in Appendix A, attached hereto.	OII 21 (Filed July 25, 1978)

(See Decision No. 90642 for appearances.)

Additional Appearance

Antone S. Bulich, Jr., Attorney at Law, for the California Farm Bureau Federation, interested party.

OPINION AND ORDER UPON PARTIAL REHEARING OF DECISIONS NOS. 90642 AND 90919

Synopsis of Opinion

This opinion and order is the result of a rehearing of Decisions Nos. 90642 and 90919 on the limited and specific rate-making issue of whether the delay granted in implementing the Zone Usage Measurement Plan (ZUM) resulted in unsupported and excess revenues to The Pacific Telephone and Telegraph Company (Pacific). The cities of Los Angeles, San Diego, and San Francisco (Cities) jointly filed a petition for rehearing of Decision No. 90919 on November 8, 1979 and the Commission by Decision No. 91355 dated February 13, 1980 ordered this limited rehearing.

Based on the evidence and argument offered in this limited reopened hearing, we find that our order in Decision No. 90919 granting an additional 90-day delay in the implementation of ZUM, while permitting an increase in other rates to go into effect on a non-concurrent basis resulted in unsupported revenues of $20.9 million flowing to Pacific. We will require that this overcollection be refunded, plus applicable interest to all current ZUM customers, customers receiving service as of the effective date of this decision, in the form of bill credits proportional to recurring exchange charges. Pacific will be required to make such refunds within 60 days after the effective date of this order.

Background

In Decision No. 90642 the Commission originally authorized a 90-day implementation period for introduction of ZUM. None of the parties filing petitions for rehearing of that decision alleged that this 90-day period was unreasonable. However, the order on modification, Decision No. 90919, added an additional 90 days to the original 90-day implementation period.

Decision No. 90919 was an order on rehearing of Decision No. 90642. On November 8, 1979 Cities filed a petition for rehearing of Decision No. 90919. The Commission reviewed the allegations raised in the petition and concluded in Decision No. 91355 that sufficient grounds had been shown for rehearing, limited to resolving issues concerning the revenue impact of the orders delaying the implementation of the ZUM plan by Pacific.

Prehearing conference on the reopened hearing was held on June 16, 1980 before Administrative Law Judge K. Tomita (ALJ), in San Francisco. The Cities took the position that the only additional evidence necessary was the dates when the rates in Decisions Nos. 90642 and 90919 went into effect and when ZUM went into effect and the rest was a matter of argument. Pacific sought to introduce exhibits showing the actual recorded earnings of Pacific during the period in question, but this evidence was excluded by ruling from the ALJ. The ALJ correctly recognized the difference between adopted estimated test year results of operations, used for ratesetting, and recorded experience. Oral argument was heard on July 11,1980 in San Francisco. The Cities, Toward Utility Rate Normalization (TURN), California Retailers Association (CRA), Commission staff (staff), Mr. Webb and Pacific participated in the argument. The matter is now ready for decision.

Issues

The key issues in this rehearing are:

1. Did the 90-day delay in ZUM imposed by Decision No. 90642 or the additional 90-day delay granted by Decision No. 90919, or both, result in excessive revenues flowing to Pacific?

2. If the Commission agrees that there were overcollections, who should get the refunds?

Cities' Position

The Cities argue that it was very clear that the delay in the implementation of the ZUM plan resulted in unsupported excessive revenues. The Cities argue that Decision No. 90919 found that the additional revenue requirement for Pacific was $1.3 million. It then referred to page 22 of Decision No. 90919 which shows the rate design on how the $1.3 million increase was to be implemented. The Cities state that the rate design showed numerous rate increases and some rate decreases providing a net increase of $1.3 million. In implementing the ZUM plan which would result in a revenue loss of $105 million, the Commission found it necessary to increase other rates by $106.3 million to provide the $1.3 million increase in revenues necessary for Pacific.

Had these increases and decreases been implemented simultaneously, the Cities argue, there would have been no problem. However, in postponing the implementation of ZUM for 90 days in Decision No. 90642 and an additional 90 days in Decision No. 90919, Pacific was permitted to collect additional revenue at a rate of $106.3 million annually instead of the $1.3 million the Commission intended. The Cities argue that the Commission erred in not requiring ZUM to be implemented immediately with the other rate increases or in the alternative to delay the rate increases that were supposed to offset ZUM until the time ZUM was to go into effect.

The Cities further argue that in the case of General Telephone Company of California (General), the Commission recognized that General was going to have some revenue shortfall because of ZUM, and properly did not permit General to make up the shortfall until ZUM became effective.

The Cities claim that the period of the overcollection was approximately 144 days or approximately 40 percent of a year. Applying 40 percent to the $105 million of rate increases without the commensurate rate decreases the Cities arrive at a $42 million dollar overcollection figure. The Cities offset 40 percent of the $2.8 million settlement figure from General's rate increases which the Commission had used in its computation, as a legitimate deduction to arrive at a total overcharge for the period, of approximately $40 million. The Cities also argue that interest on such overcollection should be computed using the methodologies adopted in Decision No. 91337 (the Federal Reserve Board Commercial Paper Rate, 3-Month Prime with monthly compounding).

The Cities take the position that the most logical theory for refunding the overcollection is to return the money to those whose rate increases were not deferred pending the implementation of ZUM. On the other hand the Cities admit that there is some merit to the staff proposal that refunds should go to those customers who were supposed to benefit from the implementation of ZUM since ZUM would have resulted in a $105 million revenue reduction to the people affected by ZUM, and the authorized delay resulted in such customers' not receiving the benefits of ZUM revenue decreases until 144 days later. The Cities stated however that their proposal was the preferable methodology. In closing, the Cities emphasized that it was the Commission's statutory duty to reach a decision within 20 days after final submission on rehearing.

TURN's Position

TURN agrees with the Cities' position and also agrees that there are merits to both the Cities and staff refund proposals. TURN however, pointed out that one negative point in the Cities position with respect to the refund methodology was that the rate increases granted by the Commission were on competitive equipment that has been underpriced for a subtantial period of time.

CRA's Position

CRA agrees with Cities that there has been a mismatch of rate increases with rate decreases that has been effectuated by Decisions Nos. 90642 and 90919. CRA believes that the Commission intended to lower revenues derived from multimessage unit calling by adoption of the ZUM plan. CRA therefore recommends that the overcollection be refunded based on what Pacific's customers have spent for ZUM or multimessage unit calling using actual usage or usage for a representative month. CRA believes this method will result in the least administrative burden for the company. CRA also agrees that the Commission did appear to make a determination that the increases in rates for other services had an independent basis for increase and that it does not make sense to attempt to refund monies to those customers.

Staff Position

The staff in its argument refers to Finding of Fact 1(d) on page 29 of Decision No. 90919 which states that "Pacific's jurisdictional revenue requirements should be increased by approximately $1.3 million annually." The staff further points out that Conclusion of Law 1 in Decision No. 90919 states that "Pacific's gross revenue requirements should be increased by $1.3 million pursuant to OII No. 21 and based upon the test year 1979." The staff further argues that the reason for extending the ZUM implementation for 180 days was for operational purposes, that is to preserve service on the system. The staff argues that the effect of increasing certain rates and delaying ZUM implementation resulted in a revenue overcollection of $43.6 million. It believes that, by accident, the rates were put into effect in such a way that Pacific collected approximately $43 million more than the Commission intended.

While the staff agrees that the method recommended by the Cities for refunding the overcollection is based on sound regulatory principles, the staff argues that from a philosophical point the Commission should realize that the ones who really suffered the overcollection were the customers who did not get ZUM on time rather than some other customers.

Mr. Webb's Position

Mr. Webb argues that before ordering any reduction in Pacific's rates because of the delayed implementation of ZUM, the Commission should consider the effect of such action in investment circles. Webb points out the importance of improving Pacific's single A debt ratings to the triple A ratings held by most other Bell subsidiaries, especially since this Commission continues to grant further debt authorizations. Webb concludes by stating that Pacific's earnings have not been excessive in spite of delays in implementing ZUM.

Pacific's Position

Pacific argues that the Commission intended the consequence which flowed from Decisions Nos. 90642 and 90919. Pacific's argument quoted from page 2 of Decision No. 90919 is as follows:

> "Our goal in rate-making is to determine a utility's revenue requirement--or rate level--based on a normal year of operation, intended to be reflective of conditions it will operate under during the future period for which rates are set."

Pacific then argues that the Commission on page 36 concluded that the newly adjusted rates in Decision No. 90919 are just and reasonable.

In response to the Cities' contention that there was a windfall to Pacific resulting from the deferral of the ZUM plan, Pacific states that such deferral and the impact of such deferral was proper and in accordance with traditional ratemaking principles.

In support of its position Pacific quoted the following from Pacific Telephone rate case Decision No. 87827:

> "We employ a test year to determine whether, for a normal year of operation, the utility has an additional revenue requirement to be satisfied by increasing rates.
>
> "It is usually the case that the rates increased to satisfy an additional revenue requirement will not be collected during the calendar confines of the particular test year used to determine the revenue requirement.
>
> "The result is that when we issue our decision in a rate case, the revenues from the increased rates are, in effect, recognized in the test year retrospectively on a pro forma basis.
>
> "We decide what the revenue requirement is and authorize increases in rates to satisfy that requirement for the test year, knowing that, in fact, the increased revenues will be collected prospectively."

Pacific then argues that this principle was followed in Decision No. 83162, dated July 1974 in which $7.3 million for the timing of local message units (SMRT) was included in Pacific's test year revenues, even though the increased revenues would not be received in the 1973 test year. In fact, Pacific argues that such revenues were not received until after March 1976, or almost two years after the issuance of Decision No. 83162. Since the loss of revenues due to the delayed implementation of SMRT was not considered as unreasonable revenue loss, likewise, the delayed implementation of ZUM should not be considered an unreasonable or unsupported revenue increase.

Pacific also argues that the Commission's treatment of the delayed implementation of Centrex rate increases in Decisions Nos. 90642 and 90919 in which the total authorized increase of $14.6 million in Centrex revenues was used in determining Pacific's revenue requirement even though the actual revenue impact in test year 1979 was $2.6 million and only $10 million in 1980 was consistent with the Commission's long-standing principle and that delayed implementation of rate decreases should be treated similarly to delayed implementation of rate increases.

Pacific further argues that the Commission obviously recognized that there is no exact standard for accurately computing rates relating to a new and untried rate spread which may have unforeseen effects (e.g. ZUM). Because of this uncertainty, Pacific reasons that the Commission ordered Pacific to report all pertinent data gained from the actual experience from ZUM, and ordered only limited implementation of ZUM to evaluate the feasibility of the future expansion of ZUM statewide.

In conclusion, Pacific argues that the challenging parties have failed to prove that the rates authorized are unreasonable; that the Commission intended Pacific to keep the revenues resulting from the deferrals, since such revenues would still leave Pacific below its authorized rate of return; and, finally, that should the Commission order refunds, such refunds should go to existing customers as a negative surcharge on exchange service.

Discussion

The Cities, supported by TURN, CRA and staff, allege that the delay in implementation of ZUM authorized by Decisions Nos. 90642 and 90919 has resulted in unsupported revenues flowing to Pacific. Specifically, the Cities allege that our deferral of the ZUM plan for 180 days pursuant to Decisions Nos. 90642 and 90919 has a rather significant revenue impact which, except as a consequence of this delay in ZUM, has no justification. It is our opinion that the original delay occasioned by Decision No. 90642, with a potential revenue impact of approximately $26 million, is not unreasonable. It is fully substantiated on the record that the ZUM plan could not be implemented immediately; it is also substantiated that Pacific needed immediate rate relief. The Cities, being frequent and sophisticated participants in our rate proceedings, are fully aware that rate increases or decreases are not always wholly synchronized, and that there may be lag periods where an increase is operating without an offsetting decrease or vice versa. Decision No. 90642 created one of those situations. Since the Cities did not protest this aspect of Decision No. 90642 in their petition for rehearing of that decision, it can be assumed that they considered the first 90 days to be reasonable, as did the Commission.

However, the Commission is of a different mind regarding the approximately $26 million in revenues created by the second delay ordered by Decision No. 90919. That delay increases the magnitude of potential revenues significantly and, we think, beyond the bounds of reasonableness. It is our opinion that any revenues collected because of this delay should be returned to the ratepayers subject to ZUM.

Pacific argues that this type of pro forma adjustment is regularly made by the Commission in its rate decisions and that in all fairness the Commission should treat delayed implementation of rate decreases in the same manner as it has treated delayed implementation of rate increases. While it is true that the Commission has frequently included in test year revenues rate increases that may not be collected in the test year or even in a 12-month period after the effective date of a rate decision, the significant difference in this proceeding is the magnitude of the revenues in question.

When we authorize rate changes after determining test year revenue requirement, we authorize rate changes (decreases or increases) that net out to producing the authorized revenue requirement increase. This should, as a regulatory principle, result in the authorized revised rates starting to produce the increased annual revenue requirement from the day they go into effect. In reality, of course, hypothetical test year results will vary from actual recorded experience for the comparable calendar year. Where it is not feasible for all rate changes to go into effect simultaneously, any minor temporary revenue deficiency or excess may properly be characterized as an inevitable consequence of test year ratemaking.

If, however, the magnitude of windfall occurring because some rate changes will be delayed is substantial, we should formulate a mechanism of stepped reductions and simultaneous increases following issuance of a general rate decision. Otherwise we will end up setting rates that are unreasonable because the authorized test year revenue requirement will be exceeded. We consider the approximate $26 million revenue excess occasioned by the additional 90-day delay specified in Decision No. 90919 to be substantial. Because we had not formulated the type of mechanism described above to offset this increase, it should now be offset through customer refunds.

H-3

As indicated in Exhibit ZUM-1, all parties agree that non-ZUM rates authorized in Decision No. 90919 became effective on October 30, 1979 and that the average ZUM rate reductions became effective halfway between March 8 and April 7, or about March 22. However, we must also consider Rate Design Finding 14 in Decision No. 90919 which reads, "it is practical for Pacific and General to convert MMU routes to the ZUM plan within 180 days of the effective date of this order...." in calculating the period of overcollection. The effective date of the order is the date of signature or October 10, 1979. The initial 90 days would run from October 10, 1979 (effective date of D. 90919) to January 7, 1980 and the second 90 days from January 8, 1980 to April 7, 1980. The period of overcollection would then begin on January 8, 1980 to March 22, 1980 or 75 days.

$\frac{75}{365}$ x $105 million = $21.6 million overcollection ✓

Less net settlement effect with General

$\frac{90}{365}$ x $2.8 million = .7

Net overcollection subject to refund = $20.9 million.

We also concur that interest on such overcollection should be computed on the methodologies adopted in Decision No. 91337; that is, using Prime Commercial Paper Rate, compounded monthly as the overcollection was collected until the date of refund.

The issue as to who should receive refunds is controversial, as would be expected. The Cities' position is that the refunds should go to those customers whose rates were increased. The staff position that the customers who really suffered the overcollection were those customers who did not get the lower ZUM rates on time also has merit. This position coincides with CRA's belief that the Commission intended to implement a new means of pricing what had been multimessage unit calls in certain rate zones. Since this would result in a reduction in revenues from such service CRA recommends that refunds should go to customers based on actual usage or on a representative month usage basis under ZUM or multi-message unit calling.

Staff, TURN, and CRA all point out that the Commission found that the rate increases authorized in Decision No. 90919 were appropriate and should go into effect and are final rates. Moreover, TURN points out that the increases were on competitive equipment that has been underpriced for a substantial period of time.

Refunds should be made to those customers who paid the excess revenue Pacific collected because of the delay in implementing ZUM. Had ZUM not been delayed, those customers participating in ZUM service would have benefitted by reduced ZUM rates. Customers with competitive services would have paid the same increased charges they have paid. This suggests that the intended beneficiaries of ZUM paid the excess revenue through rates which should have been reduced as we originally intended on October 30, 1979 but which were not reduced until March 23, 1980.

Cities argue, however, that refunds should be made to customers who paid increased charges for competitive services. Since ZUM was in fact delayed, it can be argued that there was no necessity to increase competitive charges to offset the revenue consequences of ZUM. Under this assumption it would seem that customers with competitive services paid the excess revenue Pacific collected through rates which should not have been increased until ZUM was implemented March 23, 1980.

The excess revenue was collected as a simple result of our failure to implement the intended increases and decreases concurrently. If we had increased rates for competitive services solely to offset the revenue consequences of ZUM we would order refunds to customers with competitive services as well as those intended to benefit from ZUM. The increases for competitive services were, however, independently justifiable. These services were previously underpriced and should have been increased even if ZUM had not been adopted. Refunds should accordingly be made to all customers subject to ZUM rates. Based on our experience in prior telephone refunds we believe that allocating such refunds on the basis of recurring exchange charges will be the easiest and least costly method to administer. We therefore will require that refunds be made to all current customers (customers who are receiving service as of the date of this order) subject to ZUM, by means of bill credits to be based on recurring exchange charges.

Findings of Fact

1. In Decision No. 90919, the Commission found that Pacific was entitled to additional revenue requirements of $1.3 million for test year 1979.

2. In the adopted rate design we authorized the implementation of the ZUM plan having a negative revenue requirement effect of $105 million, and also authorized increases in certain rates having a $106.3 million increase in test year revenues.

3. In Decision No. 90642 we authorized a 90-day delay in the implementation of the ZUM plan and an additional 90-day delay in Decision No. 90919 for a total of 180 days.

4. The record fully substantiates the necessity for the first 90-day delay of implementation of the ZUM plan.

5. Rate increases and decreases authorized in the same rate order are frequently not completely in synchrony regarding their revenue impact.

6. The revenue impact of the approximately 90-day delay in the implementation of the ZUM plan occasioned by Decision No. 90642, consisting of approximately $26 million, was not protested in the Cities' petition for rehearing of Decision No. 90642.

7. The additional 90-day delay provided by Decision No. 90919 resulted in substantial excess revenues of approximately $21 million being retained by Pacific.

8. The rates authorized by Decisions Nos. 90642 and 90919 went into effect on October 30, 1979 and the ZUM rates went into effect between March 8 and April 7, 1980 or, on an average, on March 23, 1980 resulting in an overall deferral period of 145 days, offset in part by delayed revenue increases from route conversions.

9. Based on our computation shown on page 11a of this decision, the amount of the overcollection is $ 20.9 million for the additional 90-day delay occasioned by Decision No. 90919.

10. Interest on refunds should be calculated using the Federal Reserve Board Commercial Paper Rate 3-Month Prime, published in the Federal Reserve Board Statistical Release G-13, to be applied with monthly compounding to the overcollection.

11. Section 453.5 of the Public Utilities Code sets forth the legal requirements for refunds ordered by this Commission.

12. Refunds to customers based on recurring exchange billings represent an equitable pro rata basis for allocating the refunds.

13. It is reasonable to make refunds to all current customers (those who are customers on the effective date of this order) subject to ZUM.

14. It is reasonable to make the refunds in the form of bill credits to current customers subject to ZUM and by check to current customers subject to ZUM who have left the system after the effective date of this order and prior to the date of refund.

15. It is reasonable to require Pacific to submit a refund plan within 30 days after the effective date of this order.

Conclusions of Law

1. The revenue impact created by the 90-day delay in ZUM ordered by Decision No. 90642 is not unreasonable.

2. The further revenue impact created by the additional 90-day delay in ZUM ordered by Decision No. 90919 is unreasonable and resulted in an unreasonable overcollection of revenues.

3. Such overcollection, plus appropriate interest should be refunded to current customers subject to ZUM based on recurring exchange charges for a typical month.

IT IS ORDERED that:

1. Within 30 days after the effective date of this order, The Pacific Telephone and Telegraph Company shall file, subject to Commission approval, a plan to refund to current customers subject to ZUM the overcollection in rates resulting from the delay authorized in implementing the ZUM plan of $20.9 million, plus interest for the period of overcollection to payment date.

2. Interest on amounts subject to refund shall be computed using the Federal Reserve Board Commercial Paper Rate 3-Month Prime, published in Federal Reserve Board Statistical Release G-13, compounded monthly.

3. Pacific shall file a report showing the refunds distributed within 90 days after the distribution date and as to any unrefunded balances for further distribution at some future time.

4. The Pacific Telephone and Telegraph Company shall inform each recipient of a refund either by transmittal letter or notation on the bill or check reflecting the refund that: "This refund is due to delay in applying the Zone Usage Measurement plan rate reductions and pursuant to an order of the California Public Utilities Commission."

The effective date of this order shall be thirty days after the date hereof.

Dated FEB 18 1981, at San Francisco, California.

John E. Bryson
President

Richard D. Gravelle

Leonard M. Grimes, Jr.

Commissioners