S&E/RRT/sh

Mailed: 9/26/96

Decision 96-09-088 September 20, 1996

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of SOUTHERN CALIFORNIA REGIONAL RAIL AUTHORITY for authority to construct a pedestrian grade crossing within the new San Bernardino Metrolink Station, at railroad milepost 56.3 on its San Gabriel subdivision, in the City of Bernardino, County of San Bernardino.	ORIGINAL Application 95-10-032 (Filed October 25, 1995)

OPINION

Southern California Regional Rail Authority (SCRRA) requests authority to construct a pedestrian - railroad grade crossing within the new San Bernardino Metrolink Station across the tracks of SCRRA's San Gabriel subdivision in San Bernardino, San Bernardino County.

SCRRA is the five-county joint powers authority created under Public Utilities (PU) Code Section 130255. In this matter, it is also acting on behalf of San Bernardino Associated Governments (SANBAG), the railroad property owner (San Bernardino County) and SCRRA member agency.

SCRRA commuter trains operate from Union Station in downtown Los Angeles to Oxnard (Ventura County), Lancaster (north Los Angeles County), Oceanside (San Diego County) via Orange County, City of San Bernardino (San Bernardino County), and City of Riverside (Riverside County). SCRRA calls its commuter rail system "Metrolink". Metrolink provides an alternative for motorists dependent upon Southern California's freeways. Improved home-to-work travel times, reduced traffic, and reduced automatic air pollution are benefits. Metrolink is the regional rail program created in accordance with Senate Bill 1402 of 1990, PU Code Sections 130450 - 130455. The National Railroad Passenger Corporation (Amtrak) operates Metrolink for SCRRA.

Construction of the new San Bernardino Metrolink Station and pedestrian grade crossing is necessary to improve Los Angeles - San Bernardino Metrolink service and to improve pedestrian access to the station. Metrolink trains operate between Los Angeles and San Bernardino Counties with 12 round trips per day offered on weekdays and 4 round trips offered Saturdays. New stub tracks will provide additional layover capacity required for additional trains. Canopies at the new station will provide shelter for Metrolink passengers from rain and sun. Other new amenities and landscaping will be provided and additional parking also will be provided. Buses, taxi and paratransit services are available to Metrolink passengers, and Amtrak intercity trains serve the adjacent historic depot building. The new Metrolink station will make this important transportation center more attractive, useful and convenient for citizens of and visitors to the City of San Bernardino, San Bernardino County, and Southern California's "Inland Empire".

By timetable addition to Rule 5.8.1 of the General Code of Operating Rules, SCRRA requires ringing of the locomotive or cabcar bell while passing through passenger stations when persons are seen on or near station platforms. At an on-site diagnostic team review held July 13, 1995, representatives of SCRRA, San Bernardino Associated Governments (SANBAG), and the Commission's Safety and Enforcement Division analyzed the operation of trains in the station and the plans for the proposed crossing.

SCRRA is the lead agency for this project under California Environmental Quality Act of 1970 (CEQA), as amended, Public Resources (PR) Code Sections 21000, et seq. The SCRRA Metrolink projects, which institute passenger services on rail rights-of-way already in use, are statutorily exempt from the reporting requirements of CEQA under PR Code Section 21080(b)(11).

The Commission is a responsible agency for this project under CEQA, and has reviewed and considered the lead agency's exemption determination. The site of the proposed project has been inspected by the Commission's Safety and Enforcement Division - Traffic Engineering Section staff. After reviewing the need for and safety of the proposed pedestrian - railroad grade crossing, Staff recommends that SCRRA's request be granted.

SCRRA has met the filing requirements of the Commission's Rules of Practice and Procedure including Rule 38, which relates to the construction of a public road, highway, or street across a railroad. A site map and detailed drawings of the Metrolink Commuter Rail San Bernardino Station are included in Appendix A attached to this order.

Findings of Fact

1. Notice of the Application was published in the Commission's Daily Calendar on October 31, 1995. No protests have been received. A public hearing is not necessary.

2. SCRRA requests authority under Public Utilities Code Sections 1201-1205 to construct a pedestrian - railroad grade crossing across the tracks within the new San Bernardino Metrolink Station, in San Bernardino, San Bernardino County.

3. Construction of the new San Bernardino Metrolink Station and pedestrian grade crossing is necessary to improve Los Angeles - San Bernardino Metrolink service and also to improve pedestrian access to the station.

4. Public convenience and necessity require construction of the proposed pedestrian - railroad grade crossing.

5. Public safety requires that protection at the pedestrian - railroad grade crossing be two Standard No. 1-D pedestrian railroad grade crossing signs (General Order (GO) 75-C).

6. SCRRA is the lead agency for this project under CEQA, as amended.

7. The Commission is a responsible agency for this project, and has reviewed and considered the lead agency's

determination that the project is statutorily exempt from the environmental reporting requirements of CEQA.

Conclusions of Law

1. The Application should be granted as set forth in the following order.

2. The project is statutorily exempt from the environmental reporting requirements of CEQA.

O R D E R

IT IS ORDERED that:

1. Southern California Regional Rail Authority (SCRRA) is authorized to construct a pedestrian - railroad grade crossing within the new San Bernardino Metrolink Station across the tracks of SCRRA's San Gabriel Subdivision in San Bernardino, San Bernardino County, at the location and substantially as shown by the plans attached to the Application and Appendix A of this order, to be identified as Crossing 101SG-56.3-D.

2. Clearances shall be in accordance with General Order (GO) 26-D. Walkways shall conform to GO 118.

3. Protection at the crossing shall be two Standard No. 1-D pedestrian railroad grade crossing signs (GO 75-C).

4. Construction expense of the crossing and installation of the protection shall be borne by SCRRA.

5. Maintenance cost of the crossing and protection shall also be borne by SCRRA.

6. Construction plans of the pedestrian crossing, have been reviewed and approved by a diagnostic team composed of representatives of the Southern California Regional Rail Authority (SCRRA), San Bernardino Associated Governments (SANBAG), and the California Public Utilities Commission (CPUC).

7. Construction of the crossing shall be in accordance with GO 72-B. Maintenance of the crossing surfaces shall also be in accordance with GO 72-B.

8. Within 30 days after completion of the work under this order, SCRRA shall notify the Commission's Safety and Enforcement Division in writing that the authorized work has been completed.

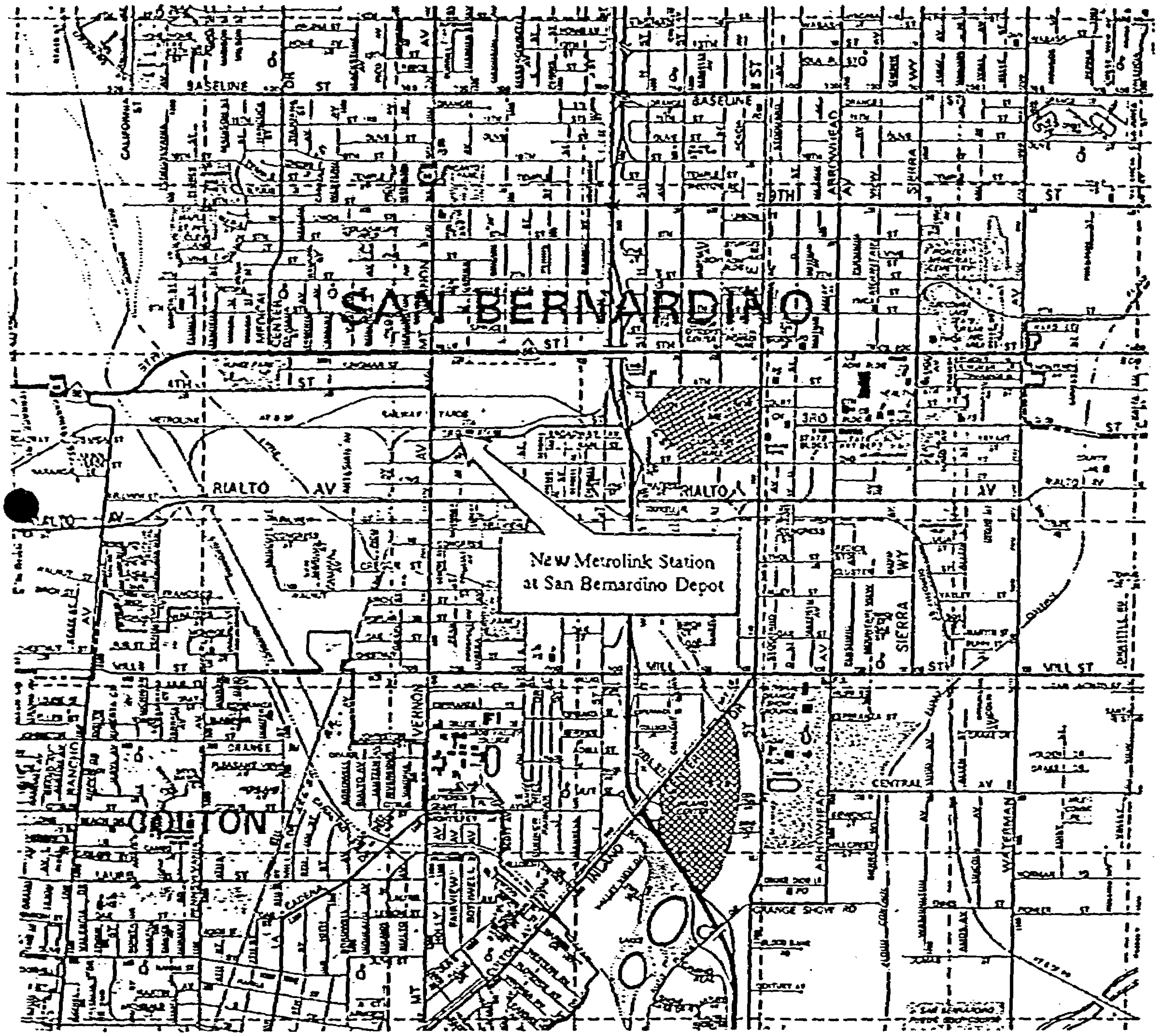
9. This authorization shall expire if not exercised within two years unless time is extended or if the above conditions are not complied with. Authorization may be revoked or modified if public convenience, necessity, or safety so require.

10. The Application is granted as set forth above.

This order becomes effective 30 days from today.

Dated SEPT 20 1996, at San Francisco, California.

P. GREGORY CONLON
President
DANIEL Wm. FESSLER
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners


SAN BERNARDINO
COLTON
New Metrolink Station
at San Bernardino Depot
BASELINE
RIALTO AV
SIERRA
WATERMAN
CENTRAL AV
ARROWHEAD
VERNON
VALLEY
MILL ST

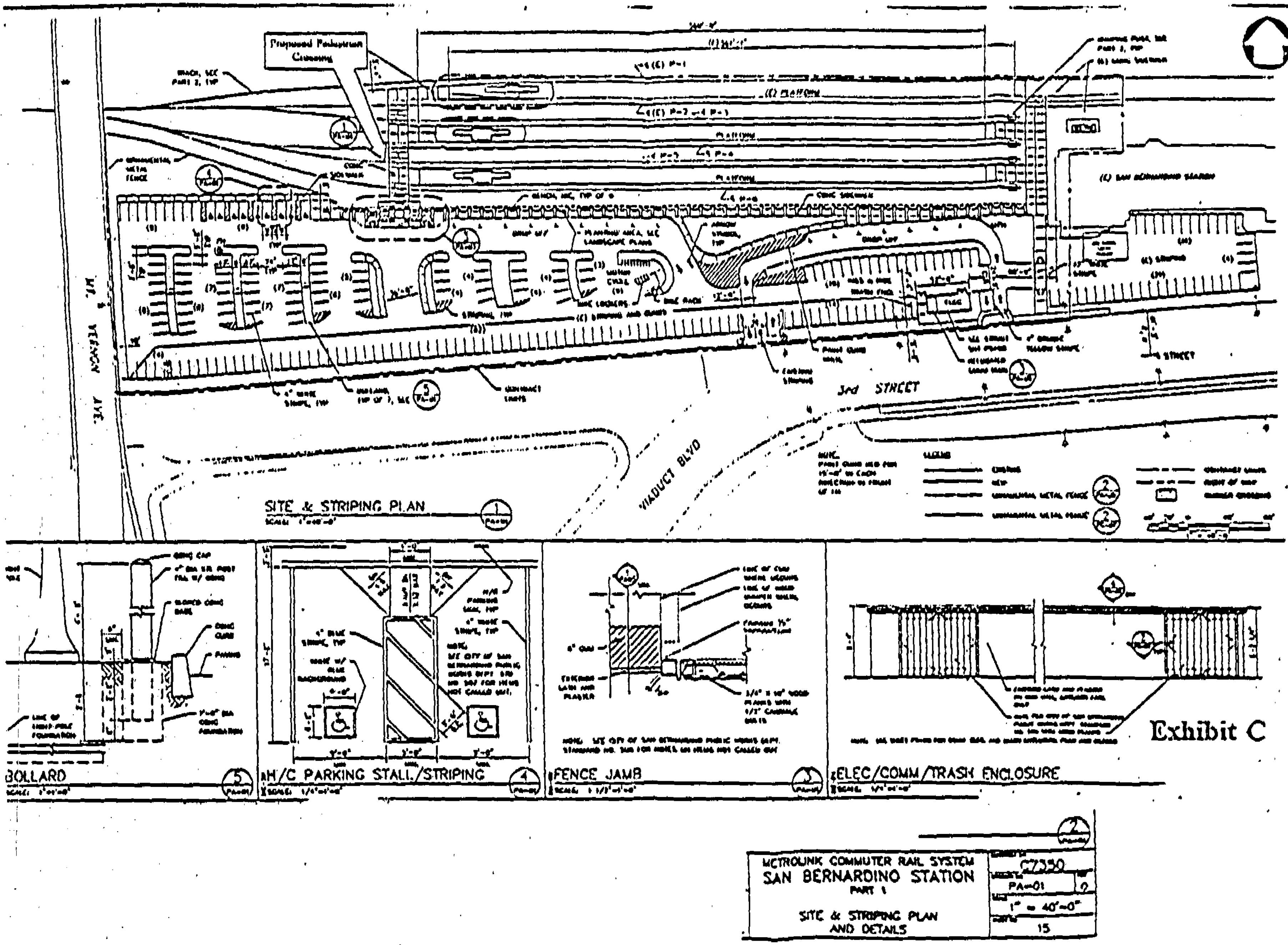

Proposed Pedestrian Crossing
PLATFORM
3rd STREET
VIADUCT BLVD
MT. VERNON AVE
SITE & STRIPING PLAN
BOLLARD
H/C PARKING STALL/STRIPING
FENCE JAMB
ELEC/COMM/TRASH ENCLOSURE
METROLINK COMMUTER RAIL SYSTEM
SAN BERNARDINO STATION
PART 1
SITE & STRIPING PLAN
AND DETAILS
C7350
PA-01
1" = 40'-0"
15

Exhibit C

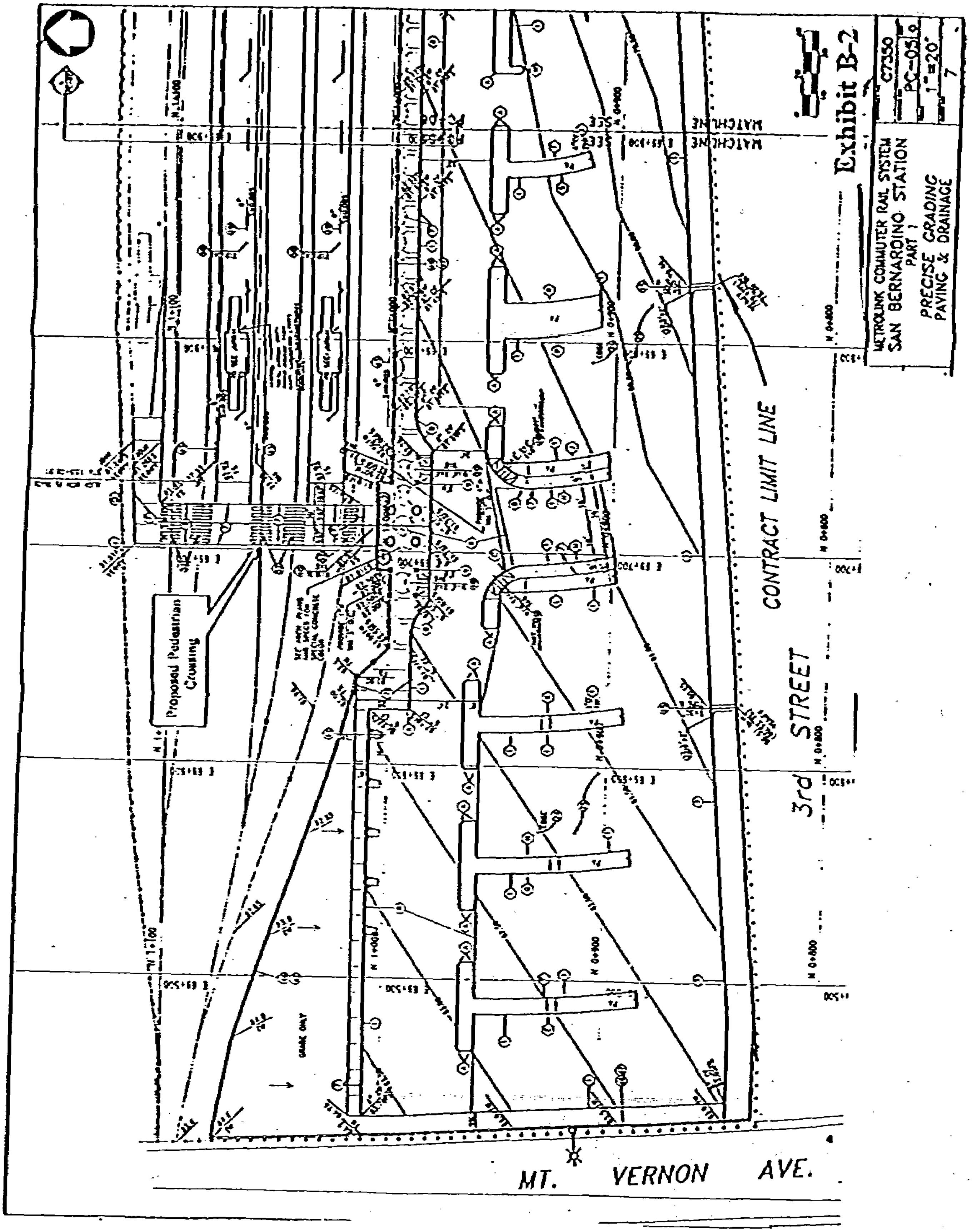


Exhibit B-2
METROLINK COMMUTER RAIL SYSTEM
SAN BERNARDINO STATION
PART 1
PRECISE GRADING
PAVING & DRAINAGE
C7350
PC-05.0
1"=20'
7
MATCHLINE
CONTRACT LIMIT LINE
3rd STREET
MT. VERNON AVE.
Proposed Pedestrian Crossing

COMMISSIONER JESSIE J. KNIGHT, JR., DISSENTING:

In my three years of experience as a Commissioner, never has a decision been so widely debated and analyzed within the California Public Utilities Commission. The issue before us regarding competitive franchise impacts on the incumbent telephone utilities, generated five proposed decisions, as many decisions as there are sitting Commissioners. With such focused, though varied positions, one would have hoped that this collegial body ultimately would be decisive and reach a sage result. Regrettably, this did not happen. In the end, compromise produced a decision which is neither decisive, nor wise in my opinion. Thus, I must strongly dissent from the vote of the majority.

After having dedicated nearly a year of this Commission's limited resources to the franchise impact issue, the decision resolves very little. The majority concludes that this phase of the Local Competition proceeding was premature and that sometime after January 1, 1997, at the behest of Pacific Bell (Pacific) or GTE California, Inc. (GTEC), the interested parties can re-visit the subject again. Additionally, the majority redefines the inquiry and greatly broadens the scope of the postponed Franchise Impact case unnecessarily.

Aside from being a waste of administrative resources, some might view the majority's decision as innocuous, or at least embrace the unfortunate belief that the decision does not deal a detrimental blow to this Commission's long term commitment to the promotion of competition in the telephone industry. I wish this decision truly promulgated so benign a circumstance. I believe that a close reading of the majority opinion will clearly reveal unforeseen and unintentional protection of the incumbent monopolies. The protection that the majority decision affords Pacific and GTEC is unwarranted, unnecessary and potentially destructive to our quest for full competition.

As a result of the majority's decision, Pacific and GTEC emerge as big winners, and perhaps the only winners. Since the utilities could not persuade the Commission to compensate them in any amount, let alone the several billion dollars requested, then the next best outcome for these entities would be an expressly sanctioned opportunity to try again. The majority has provided that opportunity.

Virtually every theory raised in support of the utilities' compensation request is preserved or expanded by the majority decision. Moreover, potential competitors in the local exchange market will find no comfort in the majority's positions. At best, the decision creates a discouraging atmosphere of uncertainty for new entrants into the market. At worst, the decision can be read as a foreboding message that higher economic risk is created because of an enhanced possibility of investment loss for new entrants into the local exchange market in California, as the incumbent monopolies seek to establish a treasure chest of future funds to bolster their economic standing in the emerging competitive world.

The Franchise Impact Claim

The issue before us was prescribed in D.95-07-054 as the examination of whether the rules which

> "permit local exchange competition alter our regulatory program so that it no longer affords Pacific and GTEC an opportunity to earn a fair return on invested capital. If we find that there is not such an opportunity to earn a fair return, then we shall consider what measures, if any, are appropriate to ensure the fairness of our regulatory policies....We shall also coordinate this hearing with the ... universal service docket(s)." (D.95-12-062, slip op. p.10, fn. 11 quoting from D.95-07-054, slip op. p. 33.)

In response to the franchise impacts inquiry, Pacific and GTEC claim that they have a constitutional right to be compensated for the adverse effects of local competition because such competition, developed pursuant to this Commission's rules, constitutes a taking under the Fifth Amendment (Takings Clause) and the Fourteenth Amendment (Due Process Clause) of the United States Constitution. The taking argument is framed as the confiscation of shareholder property, either because Pacific and GTEC will be unable to recover past capital investments, or because shareholders will be denied the opportunity to earn a fair return on those investments.

In the case of a claim of taking or confiscation of property, it is axiomatic that the party responsible for the alleged taking be the party to which the claim is directed. In this case, the utilities' claim that this Commission is the entity responsible for local exchange competition and therefore, the Commission is liable for the alleged taking of Pacific and GTEC's right to earn a fair return on invested capital. Prior to February 8, 1996, such a claim might have been credible, because the applicable law (The Telecommunications Act of 1934) gave the states primary jurisdiction over intrastate communication services (See Louisiana Public Service Commission v. F.C.C.) . However, on that date, the United States Congress passed the Telecommunications Act of 1996 (The Act), a statute which reasonably can be understood as effectively extinguishing the utilities' claims of this Commission's culpability in requiring local competition. The Act provides in relevant part:

> "No State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service." (emphasis added, Public Law 104-104, Section 253 (a).)

> "Nothing in this section shall affect the ability of a State to impose, on a competitively neutral basis and consistent with section 254, requirements

necessary to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services, and safeguard the rights of consumers." (Id. Section 253 (b).)

"If, after notice and an opportunity for public comment, the Commission determines that a State or local government has permitted or imposed any state, regulation, or legal requirement that violates subsection (a) or (b), the Commission shall preempt the enforcement of such statute, regulation, or legal requirement to the extent necessary to correct such violation or inconsistency." (Id. Section 253 (d).)

During this proceeding, several parties commented on the effect of the Act on the instant franchise impact inquiry. (See discussion of comments in the majority decision, D.96-09-089, slip op. pp. 9-12.). The Coalition and DRA assert that as a result of passage of the Act, the utilities' claims should be dismissed. DRA claims that pursuant to Article VI, clause 2 (the Supremacy Clause), of the United States Constitution, the Act preempts the Commission's regulation of local competition.

"The supremacy clause invalidates all state laws that conflict or interfere with an act of Congress.... DRA points out that both Pacific and GTEC have argued that even with the most favorable local competition rules, they will not have an opportunity to earn a fair return. Therefore, DRA concludes that it is the fact of local competition, and not specific rules, that GTEC and Pacific contend prevents them from earning a fair return. Since the Act preempts the Commission's regulation, DRA asserts that the carriers' claims before this Commission are moot and should be dismissed." (Id., p.10.)

The Coalition argues the principles of traditional fault doctrine, pointing out that "any franchise impacts complained of are caused by the Act and would occur if this Commission were to take no action. Therefore, the carriers have no claim against this Commission." (Id., p. 11.)

Commissioner Daniel Fessler and I reviewed the comments of DRA and the Coalition and found them impressive. We jointly authored an alternate decision in which we concluded the following:

"The Act mandates local exchange competition. The carriers' witnesses have testified that even under local competition rules that are viewed favorably by the carriers, they will experience a taking. In so stating, the local competition rules themselves are removed from the possible causes of the alleged taking. With passage of the Act, we no longer have the authority to 'remedy' takings by not allowing local competition. Therefore,

> we can not be the cause of claims that we have taken from Pacific and GTEC the opportunity to earn a fair return by authorizing local competition consistent with the Act. With the passage of the Act, the taking claims asserted by Pacific and GTEC are moot and should therefore be dismissed."
>
> "Having arrived at this conclusion, this decision need not address further the evidence presented in support of the takings claims or the arguments on any legal obligations this Commission holds to compensate the carriers." (Knight/Fessler Alternate, R.95-04-043, Local Exchange Franchise Impacts, Item H-3c 6/19/96 Agenda, pp.11-12)

I continue to believe that the Knight/Fessler conclusion is legally correct, pragmatically sound and that its adoption by this Commission would have served the best interests of Californians. It would have provided the kind of expeditious, final result that affirmatively facilitates progress toward the types of competition evidenced in non-regulated industries. It would have been a decisive result that could only serve to promote the accomplishment of our competition goals. It would have been an economical preservation of our scarce resources. It would have provided an invaluable measure of certainty for potential entrants to the local exchange market. This inquiry would have ended without financial or competitive harm to Pacific and GTEC, since the utilities could still have obtained remedy from the federal government, upon proof that the local competition mandate contained in the Act would deprive them of the right to earn a reasonable return on capital investment and that such deprivation was a compensable taking. And last but far from being least, it would have obliterated a future round of government scrutiny from the eventual court disputes over this issue which surely will be forthcoming.

Regrettably, the Commission did not adopt the Knight/Fessler position. The majority does not explain why they did not find the arguments of DRA and the Coalition more compelling, especially since they "agree with the Coalition and DRA that were we to take no action, the takings claim asserted by Pacific and GTEC would still occur." (D.96-09-089, slip op. p.12.)

It is appropriate for us to consider how the majority dismisses the applicability of the Act to the franchise impact inquiry: "whether our local exchange competition rules alters our regulatory program so that Pacific and GTEC are not afforded an opportunity to earn a fair return on invested capital. The majority dismisses, without explanation, the applicability of the Act to the instant franchise impact inquiry and states:

> "In comments on the proposed decision, the carriers argue that the Commission must take the effect of the Act into account. The act mandates local exchange competition. The carriers' witnesses have

testified that even under local competition rules that are viewed favorably by the carriers, they will experience a taking. As discussed in Section 4.1.1., the impact of competition cannot constitute a taking. Therefore, <u>we will consider the evidence and arguments to determine the impact of our local competition rules together with our depreciation policy on GTEC's and Pacific's opportunity to earn a fair return on their respective investments, including their opportunity to recover the depreciation expense in the emerging competitive telecommunications market</u>." (D.96-09-089, p.13.)

It is my firm conclusion that the recently enacted (February 8,1996) Telecommunications Act of 1996 (the Act) prohibits states from constraining local competition. The taking claims asserted by the utilities now must derive from the Act and not from any local competition rules which this Commission is obliged to develop consistent with the Act. The test for this is simple. May the commission rescind its decision to open the local market to competition? The answer is no. Therefore, local competition is not the result of this Commission's actions.

The taking assertion is further augmented by the claims that by introducing local competition, the Commission abrogates the utilities' "exclusive franchise" and/or the Commission breaches the "regulatory compact" which protects the utilities from competition. Finally, cloaking themselves in the Constitution's Equal Protection Clause, utilities claims that the Commission must provide phone companies with transition cost relief analogous to the non-bypassable. Competitive Transition Charge (CTC) provided in our Electric Services Restructuring Decision (D.95-12-063, as modified by D.96-01-009). Pivotal to the utilities' quantification of the taking claims is the accounting mechanism which identifies the companies' impaired assets, described by Pacific as depreciation reserve deficiency or as uneconomic assets by GTEC.

A taking argument is difficult to prove and the courts would tend to give deference to the government agency charged with acting in the public interest. The majority decision provides an apt picture of the taking law, but does not emphasize how difficult a burden the proponent has in such a case. Constitutional taking is not easy to prove, as the following summary of "taking" law suggests. Generally, an unlawful taking or confiscation does not occur unless a regulation or rate is unjust and unreasonable (<u>Duquesne Light Co. v. Barash</u> (1988) 488 U.S. 299, 307; <u>20th Century Ins. Co. v. Garamendi</u> (1994) 8 Cal.4th 216, 292.) Whether a regulation or rate is just and reasonable depends on the balancing of the interests of the regulated entity providing the services and the interests of the consumers of such services. (<u>Federal Power Com. v. Hope Nat. Gas Co.</u> (1943) 320 U.S. 591, 603; see also, <u>20th Century Ins. Co. v. Garamendi</u>, <u>supra</u>, 8 Cal.4th at p. 293.) " 'The just and reasonable" principle does not require "that the cost of each company be ascertained and its rates fixed with respect to its own costs." ' " (<u>Id</u>. citing <u>Giles Lowery Stockyards v. Dept. of Agriculture</u> (5th Cir. 1977) 565 F.2d 321, 327.) "[A] regulated industry is not entitled, as a matter of right, to realize a particular rate of return, and the interests of the consuming public are also to be considered in establishing rates." (Id. at p. 324.) "That a particular rate may not cover the cost of a particular good or service does not work confiscation in and of itself." (20th Century Ins. Co. v. Garamendi, supra, 8 Cal.4th at p. 293.) Further, a regulated entity neither has a constitutional right to a profit nor a constitutional right against a loss. (Id. at p. 294) "The fixing of prices, like other applications of the police power, may reduce the value of the property which is being regulated. But the fact that the value is reduced does not mean that the regulation is invalid." (Federal Power Com. v. Hope Nat. Gas Co., supra, 320 U.S.at p. 601). Competition alone cannot constitute adequate grounds for an unconstitutional taking, because the Constitution does not shield a utility from such business hazards (Public Service Commission of Montana v. Great Northern Utilities Co., (1933) 289 U.S. 130, 135). Finally, it appears that an unconstitutional taking will not lie if there is an adequate method for obtaining individualized relief. "Recognizing that virtually any law which sets prices may prove confiscatory in practice, courts have carefully scrutinized such provisions to ensure that the sellers will have an adequate remedy for relief from confiscatory rates." (Calfarm Ins. Co. v. Deukmejian (1989) 48 Cal. 3d 805, 817.)

The majority decision correctly orders denial of the utilities taking claims related to the introduction of competition in their local exchange markets (D.96-09-089, Ordering Paragraph 3). Because the recently enacted (February 8,1996) Telecommunications Act of 1996 (the Act) prohibits states from constraining local competition, the taking claims asserted by the utilities now must derive from the Act and not from any local competition rules which this Commission is obliged to develop consistent with the Act. Accordingly, the taking claims related to local competition rules are moot and should be dismissed.

I find the evidence clear and convincing that a takings has not occurred, nor does it appear that a taking of utility property is likely to occur. I find nothing in the analysis of stock price data that indicates the opening of the local telecommunications market to competition constitutes a taking. Even if one assumes a reduction in the value of the stock price of a utility, that is not, in and of itself, evidence of a taking. The stock price simply reflects the investors expectations of the value of the company at a point in time. Simply a reduction in these expectations does not constitute a taking. In reviewing the financial projections of the telephone companies, I am not convinced that a takings is ever likely to occur. The Commission is only responsible for the effects of its regulatory actions. The government is not responsible for shortfalls in earnings due to competitive losses, for shortfalls that occur as the result of poor managerial decisions, for shortfalls that result because of economic conditions, nor for shortfalls that result from technological change. Rather, it is the obligation of government as regulator, to allow for utilities to have a fair opportunity to earn a fair return on their investments dedicated to public service. In my mind, Pacific still has this opportunity.

The Second Bite at the Apple

The majority decision concludes that, based on the evidence presented, Pacific and GTEC failed to persuade this Commission that the implementation of local exchange competition would adversely impact the utilities' opportunity to earn a fair return on capital investment. That decision should have signaled the end of this case. As a matter of law, decisions made by this Commission are limited by and reflective of the underlying record (Camp Meeker Water System, Inc. v. Public Utilities Com. (1990) 51 Cal.3d 845, 864; see also, California Manufacturers Assn. v. Public Utilities Com. (1979) 24 Cal.3d 263, 265; see also Rule 1.2 of the Commission's Rules of Practice and Procedure, Cal. Code of Regs. tit. 20, paragraph 1.2 which states: "the Commission shall render its decision based on the evidence of record."). If the party seeking a remedy does not carry its burden, then the answer to its inquiries is negative! (Aetna Ins. Co. v. Hyde (1928) 275 U.S. 440, 447-448).

In this case, Pacific and GTEC did not carry their burden. In fact, according to the majority, the utilities' quantitative evidence of adverse impact on future earnings is so speculative that "it should be given no weight." (D.96-09-089, slip op. p. 59). Despite this clear rejection of the quantitative evidence, it is curious that the majority excuses the utilities' unpersuasive presentations:

> "This speculation was necessary due to the timing of this proceeding. Testimony was submitted before our local exchange competition rules were adopted." (D.96-09-089, slip op. p. 59.)

Inexplicably, the majority perceives prematureness as a relevant concern, even though the applicant utilities did not. The utilities chose the evidence and made their showing knowing full well that the franchise impact issues would be heard before resolution of the Commission's local competition interim rules. Furthermore, the utilities' testimony apparently anticipates the question of prematureness and deems it irrelevant. Both Pacific and GTEC conclude that their respective positions on the franchise impact issue will be unaffected by the outcome of the Commission's local competition rules.

> "Pacific's witness Darbee testified that Pacific will not have an opportunity to earn a fair return even if all the then-pending local exchange competition rules were resolved in Pacific's favor. GTEC's witness MacAvoy presented testimony which arrived at the same conclusion." (D.96-09-089, Finding of Fact 1, p.67.)

The majority's express invitation to the utilities to renew their request for franchise impact compensation "after January 1, 1997" was neither a legal nor a pragmatic necessity. Pacific and

GTEC management are quite familiar with Commission procedures and are fully cognizant of all the routes to gain Commission reconsideration of any matter they may have concern. Furthermore, the cornerstone of the utilities' compensation request, the constitutional taking argument, always can be renewed, particularly when changed circumstances or new facts form the basis for the renewed request. Therefore, it seems clear that the majority's reapplication invitation was not necessary. Moreover, when one considers the utilities' evidentiary decisions in the instant proceeding, it appears that the invitation also was undeserved. When one considers the utilities' "excused" speculative testimony and the reapplication invitation together, the following statement from the majority decision seems to have special importance:

> "We reemphasize the important distinction we made ... between protecting the carriers from competition -- which the Commission will not do -- and mitigating any deprivation of the carriers' opportunity to earn a fair return on their investment resulting from our (sic) adopted new regulatory program and on-going NRF regulation. The carriers should be careful to reflect this distinction in any presentation of evidence that our regulatory program deprives them of the opportunity to earn a fair return. We note that though the concept of losses due to competition was debated, <u>the parties did not debate the local competition assumptions Pacific applied in the scenarios it presented. These scenarios, although speculative, provide us with a sense of the possible impact of regulatory and market outcomes which we would like to further consider once our new regulatory programs have been completed.</u>" (D.96-09-089, p. 61.)

It is unclear whether the majority was positively impressed by the speculative quantitative evidence or simply wanted to see if the speculation became fact once the "new regulatory programs" become effective. It is unclear whether the majority felt that only the "debate" on Pacific's local competition assumptions were missing. As intimated by the above citation, it appears that the utility scenarios serve as the basis for the revised franchise impact inquiry which the majority adopts. A more troubling reading is whether the utility "scenarios" have become the blue print for the majority's revision of the franchise impact inquiry. Knowing and respecting the view of each of my colleagues in the majority regarding to their individual beliefs on competition, I am not persuaded that the latter is true. Each Commissioner is thoroughly dedicated to the rapid evolution of competition. I only highlight the possible misinterpretation by less informed parties who may become involved in some future inquiry of the Commission.

The New Franchise Impact Issue - A Big Target

Certainly the majority's reapplication invitation says more than "come back". Instead of considering the utilities' opportunities to earn a fair return in the context of local exchange competition rules, the inquiry we enunciated in D.95-07-054, the majority redefines and broadens the franchise impact issue. The new franchise impact inquiry as embodied in the Order is as follows:

> "whether our adopted new regulatory program embodied in the roadmap proceedings combined with the NRF-established depreciation methods will deprive them of the opportunity to earn a fair return on their 'regulated assets'." (d.96-09-089, Ordering Paragraph 7, p. 72.)

Before concluding the Order, the majority adds this guidance:

> "The carriers may concurrently recommend recovery mechanisms to mitigate any adverse effects of our regulatory policies. The carriers should specify who will be charged for the recovery. In their applications, the carriers should also specify what portion of their 'regulated assets' subject to our revised regulatory program should be considered in determining the impact of our policies." (D.96-09-089, Ordering Paragraph 7, p. 73.)

By adopting an expansive approach to the franchise impact inquiry, the majority introduces the high risk of creating a real, though unintended, barrier to the advent of full competition. The majority invites the proliferation of proceedings and extensive reargument of well-settled Commission positions, decided as long as seven years ago when the Commission adopted the New Regulatory Framework (NRF) (D89-10-031, 33 CPUC 2nd 43)

While the majority decision apparently provides the express opportunity for Pacific and GTEC to re-argue issues that were decided in 1995 and 1996, out of economic self interest and with nothing to lose, the carriers may attempt to re-argue all issues and decisions in which they did not originally prevail before the Commission. Most likely, they will seek to reverse our determination in D.96-03-020, (i.e. resale decision), that no taking had occurred. Literally, hundreds of calls were made within the 1994 Implementation Rate Design (IRD) decision that will be vulnerable to new claims of franchise loss and assertions of negative impact on the incumbent carriers. Conversely, some interveners might employ this opportunity to re-litigate the Airtouch decision and the 1995 NRF Review decision. The Southwestern Bell Corporation/Pacific Telesis merger application may also be implicated. In essence, the majority's broad reapplication invitation will serve as the unintended excuse for relitigation of ANY issue that has even a modicum of connection to local competition issues. NO issue will be safe or settled. The yoke of regulation will continue to be the albatross around the neck of the industry.

The present franchise impact case has been a time intensive inquiry and has taken nearly a year. It is not a pleasant thought to forecast how long it will take to complete the majority's new mega-proceeding, and how the sheer size and length of such a proceeding might adversely impact the evolution of competition.

This Commission, under Public Utilities Code section 1708, always retains the right to change previous Commission decisions. However, this broad inquiry sets a dangerous precedent that appears to subject all that was established in the march to competition to wholesale reevaluation. Such a belated assessment, or even the appearance thereof, could seriously undermine the entire enterprise to de-regulate, if not by actual changes in policies and rules, at least by the chilling effect such an inquiry will likely have on potential entrants to the newly opened market.

Electric Industry Framework Not Applicable

The majority concludes that ":[t]he fundamental similarity between the electric and telecommunications industries is their transition from monopoly to competitive environments and the role the commission plays in directing that transition. However, this similarity is far outweighed by the looming differences. The majority's decision spends a few scant lines stating that the situation between these industries is comparable. The majority's conclusionary statements are unpersuasive. The majority reaches the conclusion that the showing Pacific and GTEC made are not entirely inconsistent with the criteria the Commission laid out in its electric restructuring decision.[1] They cannot be more incorrect. In the electric restructuring decision, the Commission did allow the electric utilities to recover costs associated with uneconomic assets. However, the Commission refused to do so on the basis of the kind of speculative information offered by the Pacific Bell and GTEC. Rather the Commission simply stated that the utilities would be allowed to recover the difference between the market value of their assets and the book value of those same assets. There are three ways a utility may seek to establish a market value for these assets: 1) sell the asset, 2) spin the asset off to shareholders, or 3) seek a market valuation by an independent valuation expert. Each of these options are based upon the economic value of the asset and compares that to the book value of the asset. In addition, any assets with book values greater than their market value are netted out against those assets with a market value that exceeds the book value. **Neither Pacific nor GTEC calculated their "stranded assets" in a similar fashion.** Here it is important to note that the electric utilities had a market to book ratio much closer to 1:1 than was the case for either Pacific Bell or GTEC.

A second difference between the situation in the electric industry and the telecommunications

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[1]I note that the language of the decision implies that in the majority's own minds, the showings are not entirely consistent with criteria established in our electric restructuring decision either.

industry is that the Commission has fundamentally altered the pricing of the utilities service offering in the electric industry. The electric utilities are directed to pass along to consumers only the cost of purchasing power in the Power Exchange to consumers. If this price is not sufficient for the utility to recover both its going-forward operating costs and its sunk costs, the electric utility is allowed to recover the difference. However the electric utility may do so only to the extent that rates do not raise above current levels. In the telecommunications industry, Pacific seeks to recover its "compensation" thorough an increase in rates above today's levels or through a surcharge on existing rates. **Hence, the electric utilities were seeking only to continue to recover those costs already in rates while Pacific is arguing for recovery of new, higher costs.** In essence, the electric utilities seek to unbundle their uneconomic stranded cost recovery from existing rates and seek recovery through a surcharge on those that continue to use its distribution system.

A third difference between the stranded cost issue for electric utilities and the circumstances facing the Commission in the telecommunication industry is that in the electric industry, the utilities are only provided an opportunity to recover these "stranded costs". The utilities are allowed to recover those costs that the market will allow recovery. The electric utilities are allowed to recover stranded investment only until December 31, 2001. There is no guarantee that the utility will fully recover these stranded costs.

In the electric industry, the California Legislature has spelled out very specific guidelines regarding how and when the utilities are allowed to recover uneconomic costs. Rates are frozen at 1996 levels and the utilities are able to forego future rate decreases that would otherwise occur, and use this amount to recover stranded costs. The utility is allowed to forgo these rate reductions and retain the revenues, only until the year 2002 or until the uneconomic costs are fully recovered. In addition, the utility is allowed a reduced rate of return because of the reduced risk of recovery of these uneconomic sunk costs. The utility is not guaranteed a fair rate of return, only a fair opportunity to earn a fair return. Furthermore, the utility explicitly described what costs are recoverable as uneconomic costs. This bears no resemblance to the scheme that the incumbent local telephone companies have in mind.

And finally, the majority overlooks the most fundamental difference between the electric utilities and the incumbent local exchange carriers. The electric companies were regulated under rigorous traditional cost of service regulation and each of the major investments for which the utility would be eligible for recovery were expressly approved by the Commission, which found their construction to be in the public interest. The local telephone companies have been regulated under the New Regulatory Framework (NRF) since 1990 and since then have been at risk for any and all uneconomic investments. In addition, the telecommunications industry was not subject to the same degree of review for the specific investments they now claim are uneconomic. The Commission has allowed the telecommunications business the flexibility to manage their own affairs, while it has retained cost of service regulation and reasonableness reviews for the regulation of the electric utilities. In essence, the electric utilities investment decisions were much more subject to specific commission oversight and hence, the responsibility of the Commission to assure recovery is heightened. This is not, and should not, be the case in telecommunications.

No Evidence of Impaired Ability to Earn Fair Return

As I reviewed the financial projections of Pacific and GTEC, they appeared to be overly pessimistic and to overstate the impact of regulatory changes on the present and prospective fortunes of the company. In fact, it could be argued that the constant pessimistic outlook that permeated Pacific's projections led the market to under value Pacific Telesis's stock, producing lackluster stock results and resulting in Southwestern Bell Corporation viewing the stock price favorably and hence spurring their proposed acquisition of Pacific Telesis.

Even the majority concludes that Pacific and GTEC did not adequately prove that the Commission's regulatory program would impair the carriers opportunity to earn. The evidence in this caseas put forth by Pacific and GTEC is not only speculative, it is utterly unpersuasive.

As I prepared for the vote on this case, I made a special effort to review Pacific's financial and business conditions. According to publicly available data regarding Pacific's stock price, as of September of 1996, Pacific Bell had outperformed all other companies in its stock price performance since July of 1995. In fact, it outperformed the S&P 500 over that same time period.

Pacific Bell is experiencing tremendous growth in its market. Pacific is coming off a record 2nd quarter, well on its way to a very good year. Pacific Telesis operating income for the first six months of 1996 increased a staggering 18%, $182 million, over the operating income for the first six moths of 1995. This increase in operating income resulted from a surge in revenues of 5.4% combined with a modest increase in expenses, including depreciation, of just 1.7 %. Net income increased by 6.8% reflecting a 5 cent gain, to 66 cents in earnings per share for the 2nd quarter of 1996 over 2nd quarter 1995.

> " Total access lines in service increased by a record 726,000 lines in 1996 or 4.7 percent year over year, as business access lines grew even faster than the record-setting pace of the first quarter, rising to 5.7 percent. Residential lines grew 4.2 percent year over year, up from a 3.1 percent annual growth rate

through the first quarter."[2]

The fact of the matter is that Pacific Bell is selling more access lines now than it did prior to the Commission opening the market. In fact, revenues for local service for the first six months of 1996 is up $99 million dollars over the same six months in 1995 an increase in local service revenues of 5.2%.

> "Toll market share loss of 6 percent was less than we expected, while the overall toll market grew at a strong rate -- 13 percent at year-end." Phil Quigley February 23, 1996 discussing 1995 results of operations.[3]

Pacific Bell reported revenues of $639 million in intrastate Toll revenues for the first six months of 1996. This represents an increase of 3.9% over the revenues for the first six months of 1995. Over the past 12 months Pacific Bell's revenues for intraLATA service has increased even in the face of competition. In fact, for the 2nd quarter of 1996, Pacific's IntraLATA toll revenues increased by 7.7% over the same period in 1995. Clearly, the growth of the toll markets is outstripping the losses to competition Pacific has faced. Despite a market share loss of about 6%, Pacific has seen tremendous growth in its toll revenues. For the first year of competition in the intraLATA toll market the rate of increase in the size of the market more than offset, by a factor of two, the loss of market share by Pacific..

> "Estimated access minutes-of-use for the second quarter continued to be strong, up a substantial 10.0 percent from the same period last year: 8.4 percent interstate; 11.9 percent intrastate."[4]

It is an undisputed fact that the access market is booming in California and Pacific Bell is well positioned in this competitive market. It can be argued that Pacific's low access rates are a competitive advantage because its access rates are the lowest in the country and could serve as a competitive deterrent compared to rates in other parts of the country.[5] Intrastate access revenues are up 6.1% for the first half of this year as compared to the first six months of 1995. This is true despite the Commission opening the transport market to competition in 1995 and the existence of several viable facilities-based carriers in this high capacity market. On the interstate side, revenues are also up increasing 5.6% over last year. Despite competition, Pacific has seen its access minutes and its access revenues increase.

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[2] Pacific Telesis Press Release *Pacific Telesis Reports Record Setting Increases IN New Customer Lines in Second Quarter*, July 18, 1996.

[3] Phil Quigley Letter to Shareowners, February 23, 1996

[4] Ibid

[5] UBS Securities Analysis and Buy Recommendation of Pacific Telesis, July 9, 1996

" Accelerated demand for data services continued in the second quarter, as intensified marketing efforts drew more customers to Pacific Bell's FasTrak service family, including Integrated Services Digital Network (ISDN), Frame Relay, Switched Multi-megabit Digital Service and Asynchronous Transfer Mode. New lines placed in service for ISDN, ideal for high-speed telecommuting and Internet access, grew 129.4 percent year over year. Demand for high-capacity DS1 and DS3 lines is skyrocketing. DS1 lines grew three times as fast, and DS3 lines grew twice as fast, as the growth of both facilities at this time last year."[6]

Pacific's market in these high value services is booming. These are the type of high volume, high value services that should face the first impact from the Commission competitive policies.

Targeted promotions to consumers increased sales of custom calling services beyond the 7.5 million mark, an increase of 23.4 percent. Call Return, for example, which Pacific Bell introduced on a "pay-per-use" basis in April, is producing more than $5 million of revenue per month. Voice mailboxes in service reached 1.6 million as of the end of the second quarter 1996, generating year over year growth of 24.0 percent. In July, Pacific Bell also launched its Caller ID service, which has experienced tremendous success in other regions and which Pacific anticipates to be a $50 million market in two years. Because of the strong growth in these and other service Pacific faced an increase in Other Service Revenues of 6.4%.[7]

Revenues for Pacific increased for the first half of 1996 by $242 million over the same period last year. Revenues for the first half of 1996 exceed 51% of the revenues the company received in 1994 prior to IRD and IntraLATA toll competition. Given the rate of growth in so many areas of the services offered by Pacific Bell, it is very likely that Pacific Bell revenues will be stronger than prior to the introduction of competition.

After reviewing this publicly available information, I can find no reason to conclude that Pacific's financial integrity is at risk because of our local competition rules, nor can I find that given these earnings and revenue figures that Pacific's opportunity to earn has been impaired. In my view, the financial condition of Pacific is healthy and growing.

The constitution of the United States, as amended by the bill of rights protects against the confiscation of property by government has come to mean that regulators must not regulate in a fashion that denies an individual or a corporation a fair return on capital dedicated to public service and subject to regulation. I have taken a solemn oath to up-hold this constitutional

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[6] Pacific Telesis July 18, 1996 Press Release
[7] Ibid

protection. This commission has an obligation to regulate in a manner that prevents such a taking of public property. I believe we have. The rules we have adopted for local competition and the rules governing our regulation of the incumbent local exchange carrier provide the utility with a fair opportunity to earn. If I believed otherwise, I would be obligated to revise those rules so as to allow for such an opportunity.

If Pacific or GTEC felt that the Commission's decisions regarding depreciation had deprived it of an opportunity to earn a fair return, Pacific should have filed for a rehearing of those decisions which established the depreciation schedules currently in place. However, Pacific did not file such an appeal. Hence, they should not be allowed to argue that that past decision resulted in a taking. In fact, this Commission clearly stated its intention to open all markets to competition by January 1, 1997 in November and December of 1993. Since that time, the LECs have had two opportunities to file represcription applications. The Commission has acted on both of those, granting the requests of the utilities. Yet, the incumbent LEC's have not sought to appeal these decisions.

The Commission explicitly outlined the parameters under which conditions Pacific and GTEC could apply to increase their rates. GTEC and Pacific would be allowed in increase their rates if their earnings fell below a certain benchmark for two consecutive years. This framework was not found to be unreasonable or unfair.

On the issue of which earnings should be counted in determining the "total picture" of the change wrought by the recent changes in the regulation of the telecommunications industry, the decision of the majority concludes that we look exclusively to those lines of business subject to Commission rate- setting. This approach excludes revenues from those services which have been moved to category III under NRF, as well as those which were not part of the historical scope of the regulated business. I am concerned that included within this excluded category are the revenues that the LEC anticipates earning as a long-distance carrier. If this is the case, the majority would have us ignore the prize which Pacific sought as the animating goal of the very changes it confronts. In reaching this conclusion, the majority relies upon *Calfarm Insurance Co. v. Deukmejian*, 48 Cal3d 805(1989). Reliance on this decision is misplaced. In *Calfarm*, the insurance companies subject to proposition 103 sought to exclude from the affects, test lines of insurance which they had historically offered, but which fell outside the terms of the approved initiative. The majority decision seeks to exclude from the consideration of whether our evolving regulatory scheme allows the utility a fair opportunity to earn benefits which accrued to Pacific as a result of the change. Parties that present us with a claim for compensation for the pain caused by local competition but also ask us to ignore the gain that was explicitly part of the "deal" seek to draw a veil of fiction over the face of fact. Such an approach is anti-factual and ignores the symmetrical *quid pro quo* of the opening ALL markets to competition which was and is the commission's policy.

Balancing the Interests of All

I feel that is my obligation, and the obligation of this commission to review the claims made by the incumbents with the greatest of care. Just as we are obligated to allow these carriers an opportunity to earn a fair rate of return, we are also obligated to protect the public interest and to insure that the rates for telecommunications services offered by these LECs and others remain "just and reasonable".

There is only one way that Pacific Bell can recover costs associated with "franchise impacts" and that is by raising the cost of telecommunications services in California. Either Pacific Bell is allowed to raise its own rates, or the Commission will allow recovery via a All End-User Surcharge (AEUS). Either way, the cost of telecommunications services in California will increase. Allowing Pacific to recover so called impaired investments will have the same impact on the state's economy as a tax and an increased hurdle for new entrants into the market.

Such recovery will raise the cost of telecommunications in California. This will negatively impact those California businesses that are in telecommunications intensive businesses, including the rapidly growing but nascent multi-media and Internet services businesses, the most promising sectors of our economy. Not only will higher telecommunications prices negatively impact the information age industries upon which California's future rests, inflated prices adversely impacts this sector disproportionately relative to other industry sectors.

Moreover, the increased price of telecommunications that would result by granting the LEC request for franchise impacts would have the result of lowering the disposable income of California. This will have a secondary effect of lowering the demand for other goods and services in California and reducing the profitability of California companies.

There can be no doubt that the higher rates that result from compensation will result in fewer jobs and will hinder economic growth and investment in California. The only debate is by how much. We do not know the magnitude of the impact granting compensation for local competition will be. However, we do know, with certainty that it will dampen economic growth, and job creation.

The decision of the majority creates a great deal of uncertainty in the marketplace. This level of uncertainty will serve as a barrier to entry in California. Potential entrants need to know, with some certainty the regulatory structure in the marketplace. The decision of the majority leaves the question of franchise impacts hanging over the marketplace for a period of time that feeds investment uncertainty.

If compensation is granted, the competitiveness of the market may be compromised, if other entrants are forced to bear the cost of recovery. For example, if compensation is granted and the funds are raised via a end-user surcharge, rather than recovery through the rates of the LEC, new entrants will face this cost. Hence this cost would be a barrier to entry.

For this plethora of reasons, I believe that the Commission must carefully weigh the claims of the incumbent LEC's claiming compensation for our regulatory program. We, as a Commission, have an obligation to balance the interest of the public with that of the carriers we regulate. We, as a Commission, have an obligation to promulgate rules for local competition that are fair to all competitors, not just the incumbents. We, as a Commission, have an obligation to ensure we set rates at levels that are just and reasonable yet provide an opportunity to earn a fair return. Unlike the majority, I believe that we have done so. I am convinced that our current regulatory structure provides the incumbent monopolies the opportunity to earn a fair return on their investment as required by the Constitution of the United States. If I believed otherwise, I would not have voted for our rules governing the opening of local markets to competition.

In conclusion, the scope of this proceeding was limited to "the issue of whether the rules that permit local exchange competition alter our regulatory program so that it no longer affords pacific and GTEC an opportunity to earn a fair return on invested capital." (D.95-07-054, slip op., pp 33.) In addition, the objective of the case was not to determine the extent of any takings, rather simply to determine if our regulatory program affords Pacific and GTEC and opportunity to earn a fair rate of return.

The majority reaches the conclusion that "We cannot find at this time that our local competition rules have changed our regulatory structure so drastically as to have violated our obligation to ensure an opportunity to earn a fair return on investment and a fair opportunity to recovers invested capital for either GTEC or Pacific." (Conclusion of Law 71.) I also reach that conclusion. However, I differ from my colleagues who voted in the majority, allowing the incumbent monopolies another chance to reassert their claims, claims that may produce results that may chill the growth of competition in the telecommunications sector and its allied sectors throughout the California economy.

Dated September 20, 1996 in San Francisco, California.

Jessie J. Knight, Jr.
Commissioner

To the degree that the incumbent local exchange companies argue that they deserve the compensation envisioned by the majority because they made investment choices predicated on a mandate to provide universal service,[37] I believe that ¶ 713 of the FCC's *First Report and Order* in CC Docket 96-98 is on point. There the FCC rejects New York state's "pay or play" system, wherein competitors were required to contribute toward an universal-service obligation through the rates contained in interconnection agreements. Therefore, any type of compensation scheme that would have the competitors paying for the incumbent local-exchange companies' past investments would easily be vacated by this FCC order.

Daniel Wm. Fessler
Commissioner

San Francisco, California
September 20, 1996

[37] I fail to see any other justification for this kind of compensation.