ALJ/BAR/gab*

Mailed

APR 30 1997

ORIGINAL

Decision 97-04-086 April 23, 1997

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion Into Competition for Local Exchange Service.	R.95-04-043 (Filed April 26, 1995)
Order Instituting Investigation on the Commission's Own Motion Into Competition for Local Exchange Service.	I.95-04-044 (Filed April 26, 1995)

OPINION ON MOTION OF GTEC TO ESTABLISH A MEMORANDUM ACCOUNT AND MAKE RATES SUBJECT TO CHANGE

In Decision (D.) 96-09-089, *Opinion on the Franchise Impacts on Pacific Bell and GTE California, Inc. Resulting from the Authorization of Local Exchange Competition* (Franchise Impacts Decision), the Commission concluded that it could not find, at that time, that the local competition rules have changed California's regulatory structure so drastically as to have violated the Commission's obligation to ensure Pacific Bell and GTE California Incorporated (GTEC) an opportunity to earn a fair return on investment. Therefore, these carriers' requests for compensation were denied. However, the Commission ordered that it would permit the two carriers to each file an application "...to show 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, slip. op., ordering paragraph 7.) The Commission also stated that in these applications, the carriers may recommend recovery mechanisms to compensate them going forward from January 1, 1997. These applications are to be filed no earlier than January 1, 1997.

GTEC's Motion

By motion, GTEC requests the establishment of a memorandum account to track the dollars it will ask to recover in the application permitted by the Commission in the

Franchise Impacts Decision. It also requests an order making rates subject to change as of January 1, 1997. GTEC proposes initially to accrue $727 million in the account, subject to later true-up based on the outcome of its application.[1]

GTEC asserts that its motion should be granted to avoid the irreparable financial harm that could occur if the Commission were to find, as a result of its application, that although compensation should be granted, relief could not be granted back to January 1, 1997, because of the rule against retroactive ratemaking.

GTEC also filed a motion pursuant to Rule 45(g) of the Commission's Rules of Practice and Procedure for permission to file a reply to the responses. The Coalition's response to the motion to file a reply mirrors its response to the primary motion. We address the two motions together.

Responses to GTEC's Motion

Two parties responded to GTEC's motion: the Commission's Office of Ratepayer Advocates (ORA) and the California Telecommunications Coalition (Coalition).[2] Both of them argue that the motion should be denied.

ORA does not address the substance of the motion in its response because it believes the motion is procedurally improper. Specifically, ORA asserts that the docket is closed with respect to issues concerning franchise impacts. ORA argues that the Commission identified the application process described above as the proper forum for considering future issues concerning the impact of the Commission's regulatory program on GTEC's opportunity to earn a fair return.

---

[1] It is important to note that the Commission has stated an interest in whether its actions will deprive the carriers of the *opportunity* to earn a fair return. In its motion, GTEC repeatedly refers to the adverse impact the Commission's revised regulatory program will have on the company's *ability* to earn a fair return. The "ability to earn" and the "opportunity to earn" are not equivalent standards. It is evidence on whether the latter standard is met that GTEC and Pacific Bell are permitted to present through applications.

[2] Coalition members sponsoring this response include AT&T Communications of California, Inc.; California Cable Television Association; ICG Telecom Group, Inc.; MCI Telecommunications Corp.; Teleport Communications Group; Time Warner AxS of California, L.P.; and The Utility Reform Network.

The Coalition lays out five arguments. First, it argues that the request is premature since the Commission ordered the carriers to propose recovery mechanisms concurrent with the permitted applications. By disregarding that aspect of the Franchise Impacts Decision, and requesting different treatment by motion (rather than seeking a rehearing or modification of the decision), the Coalition asserts the motion is a collateral attack on the Commission's order. The premature nature of the filing is also demonstrated, the Coalition argues, by the lack of information provided by GTEC regarding when and how the accruals to the requested account will be calculated. Second, the Coalition argues the request is not appropriate since the asserted impacts have not yet occurred and are acknowledged by GTEC to be speculative. Third, the Coalition asserts that GTEC's claims of irreparable harm are unfounded, since GTEC has failed to show that the Commission would be precluded from fashioning a prospective rate change, and ignored the Commission's decision. Fourth, the Coalition asserts that GTEC's takings claims are meritless, making any "remedy" unnecessary. Finally, the Coalition asserts that GTEC's motion is a disguised request for an enormous rate increase and is procedurally flawed.

Discussion

Is The Motion Procedurally Improper?

GTEC's motion is not procedurally improper. Rule 45 of the Commission's Rules of Practice and Procedure provides for the filing of a motion "...at any time during the pendency of a proceeding..." The Coalition's claim that the motion is procedurally flawed because it is a rate increase, and therefore subject to Articles 4 and 6 of our Rules, is also without merit. As GTEC acknowledges in its reply to the responses, the account is "a device... for tracking amounts that the Commission may subsequently allow to be collected." (Reply of GTEC, p. 6.)

Is A Memorandum Account Appropriate?

Memorandum accounts have been authorized in the past so that costs which are accruing from the date of the account's establishment may, after further consideration by the Commission, be recovered from customers through adjustments in rates. In this motion, GTEC identifies $727 million as the amount it would like authority to accrue in

the account. GTEC presented this figure in the hearings which resulted in the Franchise Impacts Decision. It was presented in support of GTEC's primary argument that the Commission is legally obligated, under the Takings Clause of the Constitution, to compensate it for what it claimed were the impacts of local entry and the Commission's local exchange competition rules. That is, GTEC asserted that local entry and the Commission's local exchange competition rules resulted in a "taking" of $727 million in the value of GTEC's assets.

It is unclear from GTEC's motion how the traditional application of a memorandum account would be applied here. Assume that in the application GTEC intends to file pursuant to the Franchise Impacts Decision, it argues that the new regulatory program embodied in the roadmap proceedings combined with the depreciation methods established in the New Regulatory Framework resulted in a "taking" of $727 million. Assume also that the Commission finds GTEC's arguments compelling, and determines GTEC should be compensated $727 million for the unlawful "taking." It is unclear how a memorandum account would be appropriate if the amount at issue in this taking argument is a lump sum of historically incurred costs, rather than a tracking of costs as they are incurred from the date of establishment of the account.

In the Franchise Impacts Decision the Commission already found GTEC's claim of approximately $727 million in harm to be speculative, and necessarily so given the fact that the policies and rules being developed in the pending roadmap proceedings were unresolved. The Coalition is correct in questioning the appropriateness of memorandum account treatment for expenses which may not be recoverable. In considering this motion, the Commission is not concluding that GTEC's claim of $727 million in harm has merit, in whole or in part, nor is the Commission concluding that if the claim is meritorious, it is recoverable through rates. GTEC's request would preserve the option of recovery of the dollars booked into the account through adjustments in rates. Whether compensation is warranted, and if so, the mechanism for recovery, the actual amount to be recovered, and any associated rate increase, are subjects to be addressed in the application GTEC states it intends to file.

Does D.96-09-089 Bar Authorization of A Memorandum Account?

The Coalition is correct that the Franchise Impacts Decision clearly states in ordering paragraph 7 that the "...carriers may *concurrently* recommend recovery mechanisms..." (D.96-09-089, slip op. at 73 (emphasis added).). However, the decision also states that the Commission "...may establish a special recovery mechanism to compensate Pacific and GTEC *going forward from January 1, 1997...*" (Id. at 64 (emphasis added).) Granting GTEC's motion would make it clear that, in the event the Commission regards compensation through a ratemaking adjustment warranted, that adjustment may be made from the date the account is authorized, an outcome closer to the intent expressed on page 64. In the ordering paragraph which indicates the recovery mechanism recommendations be presented concurrent with the application, the Commission uses the permissive "may." The Coalition's argument asks the Commission to read this order as a requirement that recovery mechanisms be presented concurrent with the application. Such a reading would not be accurate. The Franchise Impacts Decision does not bar GTEC from requesting a memorandum account.

Is it Necessary and Prudent to Make Rates Subject to Change?

The Franchise Impacts Decision, as noted above, clearly states that recovery mechanisms are to be addressed in the application allowed for in that decision. Establishing a memorandum account today would make it possible for costs which are accruing from today, after further consideration by the Commission, to be recovered from customers through adjustments in rates. Recovery of any dollars would begin from the date of the decision granting recovery, or a date thereafter determined by the Commission. It is not necessary, therefore, for the Commission to make rates subject to change as of January 1, 1997, or even today.

Conclusion

Though we are troubled by whether a memorandum account is appropriate in the context of a takings argument, we are convinced that it is nonetheless appropriate to preserve GTEC's opportunity for recovery for the time period going forward from the date of this decision. GTEC's request for authority to establish a memorandum account to track for possible future recovery the dollars it will ask to recover in the application

permitted by the Commission in the Franchise Impacts Decision is granted. In granting GTEC's request, however, we emphasize that we are merely preserving this option, not prejudging the necessity or wisdom of exercising it. GTEC's motion to file a reply was properly filed and should also be granted.

Findings of Fact

1. The Commission stated in Decision (D.) 96-09-089, *Opinion on the Franchise Impacts on Pacific Bell and GTE California, Inc. Resulting from the Authorization of Local Exchange Competition* (Franchise Impacts Decision), that Pacific Bell and GTEC may each recommend, through applications, recovery mechanisms to compensate them going forward from January 1, 1997.

2. By motion filed November 15, 1996, GTEC requests the establishment of a memorandum account to track the dollars it will ask to recover in the application permitted by the Commission in the Franchise Impacts Decision. It also requests an order making rates subject to change as of January 1, 1997. GTEC proposes initially to accrue $727 million in the account, subject to later true-up based on the outcome of its application.

3. By motion filed December 18, 1996, GTEC requests the Commission accept for filing its reply to responses to its November 15 motion.

4. It is appropriate to preserve GTEC's opportunity for recovery for time periods going forward from the date of this decision.

Conclusions of Law

1. GTEC's motion to file a reply was properly filed and should be granted.

2. Memorandum accounts have been authorized in the past so that costs which are accruing from the date of the account's establishment may, after further consideration by the Commission, be recovered from customers through adjustments in rates.

3. In considering this motion, the Commission is not concluding that GTEC's claim of $727 million in harm has merit, in whole or in part, nor is the Commission concluding that if the claim is meritorious, it is recoverable through rates. Whether

compensation of any amount is warranted, and if so, the mechanism for recovery, and any associated rate increase are subjects to be addressed in the application GTEC states it intends to file at which time interested parties will have an opportunity to be heard.

ORDER

IT IS ORDERED that:

1. The motion of GTE California Incorporated (GTEC) to file a reply is granted.

2. GTEC's request for authority to establish a memorandum account to track for possible future recovery the dollars it will ask to recover in the application permitted by the Commission in Decision 96-09-089 is granted.

3. GTEC may accrue in the memorandum account an amount not to exceed $727 million.

This order is effective today.

Dated April 23, 1997, at San Francisco, California.

P. GREGORY CONLON
President
HENRY M. DUQUE
JOSIAH L. NEEPER
RICHARD A. BILAS
Commissioners

I will file a dissent.

/s/ JESSIE J. KNIGHT, JR.
Commissioner

State of California

Public Utilities Commission
San Francisco

R. 95-04-043 / I. 95-04-044
D. 97-04-086

Commissioner Jessie J. Knight Jr., Dissenting:

GTE of California (GTEC) has requested the establishment of a memorandum account to tract the dollars it will ask to recover when it files an application for Franchise Impacts. My views on the general lack of merit of the LEC's claims to franchise impacts are well known and I will not belabor that point here. Rather, I will focus my attention on this specific motion by GTEC. In my mind, this motion by GTEC is another action in what is clearly a feeble effort to gain regulatory relief in order to grab the last few dollars of the old regulatory regime with old world certainty; that is, if you consider $726 million as a few dollars. In my view, this motion, like the LEC's entire franchise impact showing to-date, is illogical and one of this Commission's biggest and unnecessary headaches.

Basically, I have five problems with this proposal by GTEC.

1. As argued by ORA, this request is premature. If GTEC is actually facing the inability to earn a fair return on its investment, presently it should immediately file an application seeking recovery of the alleged franchise impact and propose the means of recovery.

2. GTEC's request to book the dollars to a memorandum account is inappropriate because the so-called losses GTEC seeks to book are, by GTEC's own admission speculative. Generally, only actual incurred expenses are booked to memorandum accounts, not costs that might or might not have been incurred.

3. There is no evidence that GTEC would be in anyway irreparably harmed by our denial of this motion. As far as I am concerned, the harm is planting the seed of thinking that this money is due. There is no guarantee that this same Commission will be here when this decision is eventually made. A future Commission may not be as well informed as these five Commissioners as to the intricacies and trade-offs involved in the initial phases of this debate.

4. The parameters of what can be booked to this memorandum account are overly vague. Generally, past regulatory practice dictates that the types of costs booked to a memorandum account are carefully described. The debate that usually surrounds a memorandum account is whether the recovery of the costs booked to the account should be allowed, not whether the costs in question were actually recovered by the utility.

5. Even if one accepts their arguments for recovery, GTEC does not explain why a memorandum account is necessary. GTEC seems to place some special importance on memorandum account treatment. Just because an accounting entry is made in a memorandum account should have no weight as to whether that dollar figure is justifiable for recovery.

Memorandum accounts are anachronisms of traditional-cost-of-service regulation. From all appearances, GTEC would like a quasi-return to the days of general rate cases and reasonableness reviews, which are the brothers and sisters in the regulatory world to memorandum accounts. It appears that GTEC enjoyed the benefits of an incentive-based framework but now is seeking protections that make sense only in a cost-of-service world. In my mind, they have to choose. The question for GTEC is, do they want cost-of-service regulation, with the micromanagement and regulatory burdens that are part and parcel to it, or do they truly want incentive based regulation? If the company chooses the former, then they must accept the other parts of the regime that they claim to deplore, such as the reviews by Commission's cost accountants, cost engineers, and regulatory economists to determine

whether the firm is earning fair returns. It has been my experience from observing regulation up-close and personal for over three and a half years that when firms try for the best of both worlds, they generally end-up with the worst of both.

Dated April 23, 1997 in San Francisco, California.

/s/ Jessie J. Knight, Jr.
Jessie J. Knight, Jr.
Commissioner

State of California

Public Utilities Commission
San Francisco

R. 95-04-043 / I. 95-04-044
D. 97-04-086

Commissioner Jessie J. Knight Jr., Dissenting:

GTE of California (GTEC) has requested the establishment of a memorandum account to tract the dollars it will ask to recover when it files an application for Franchise Impacts. My views on the general lack of merit of the LEC's claims to franchise impacts are well known and I will not belabor that point here. Rather, I will focus my attention on this specific motion by GTEC. In my mind, this motion by GTEC is another action in what is clearly a feeble effort to gain regulatory relief in order to grab the last few dollars of the old regulatory regime with old world certainty; that is, if you consider $726 million as a few dollars. In my view, this motion, like the LEC's entire franchise impact showing to-date, is illogical and one of this Commission's biggest and unnecessary headaches.

Basically, I have five problems with this proposal by GTEC.

1. As argued by ORA, this request is premature. If GTEC is actually facing the inability to earn a fair return on its investment, presently it should immediately file an application seeking recovery of the alleged franchise impact and propose the means of recovery.

2. GTEC's request to book the dollars to a memorandum account is inappropriate because the so-called losses GTEC seeks to book are, by GTEC's own admission speculative. Generally, only actual incurred expenses are booked to memorandum accounts, not costs that might or might not have been incurred.

3. There is no evidence that GTEC would be in anyway irreparably harmed by our denial of this motion. As far as I am concerned, the harm is planting the seed of thinking that this money is due. There is no guarantee that this same Commission will be here when this decision is eventually made. A future Commission may not be as well informed as these five Commissioners as to the intricacies and trade-offs involved in the initial phases of this debate.

4. The parameters of what can be booked to this memorandum account are overly vague. Generally, past regulatory practice dictates that the types of costs booked to a memorandum account are carefully described. The debate that usually surrounds a memorandum account is whether the recovery of the costs booked to the account should be allowed, not whether the costs in question were actually recovered by the utility.

5. Even if one accepts their arguments for recovery, GTEC does not explain why a memorandum account is necessary. GTEC seems to place some special importance on memorandum account treatment. Just because an accounting entry is made in a memorandum account should have no weight as to whether that dollar figure is justifiable for recovery.

Memorandum accounts are anachronisms of traditional-cost-of-service regulation. From all appearances, GTEC would like a quasi-return to the days of general rate cases and reasonableness reviews, which are the brothers and sisters in the regulatory world to memorandum accounts. It appears that GTEC enjoyed the benefits of an incentive-based framework but now is seeking protections that make sense only in a cost-of-service world. In my mind, they have to choose. The question for GTEC is, do they want cost-of-service regulation, with the micromanagement and regulatory burdens that are part and parcel to it, or do they truly want incentive based regulation? If the company chooses the former, then they must accept the other parts of the regime that they claim to deplore, such as the reviews by Commission's cost accountants, cost engineers, and regulatory economists to determine

whether the firm is earning fair returns. It has been my experience from observing regulation up-close and personal for over three and a half years that when firms try for the best of both worlds, they generally end-up with the worst of both.

Dated April 23, 1997 in San Francisco, California.

Jessie J. Knight, Jr.
Commissioner