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MAIL DATE
7/22/97

Decision 97-07-024

July 16, 1997

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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

)
)
) I.87-11-033
) (Filed November 25, 1987)
)

And Related Matters.

)
)
) Application 85-01-034
) Application 87-01-002
) I.85-03-078
) Case 86-11-028
) I.87-02-025
) Case 87-07-024
)

ORDER DENYING REHEARING OF DECISION 97-02-049

Today we deny the application of Pacific Bell (Pacific) for rehearing of Decision (D.) 97-02-049.¹ In D.97-02-049 we exercised our discretion to deny the joint petition of Pacific and GTE California (GTEC) to reopen and to modify D.94-09-065, the Implementation Rate Design (IRD) component of the New Regulatory Framework (NRF). GTEC did not join Pacific's application, nor did GTEC separately file an application for rehearing of D.97-02-049.

Pacific's application was timely filed as was the opposition to the application jointly filed by the following parties: the Commission's Office of Ratepayer Advocates (ORA), formerly the Division of Ratepayer Advocates (DRA), AT&T Communications of California, Inc. (AT&T), MCI

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Telecommunications, Inc. (MCI), and The Utility Reform Network (TURN). In addition, TURN timely filed a separate response in opposition to Pacific's rehearing application.

I. INTRODUCTION

To provide a context for our discussion of Pacific's allegations of error in D.97-02-049, it is helpful first to consider the substance of the underlying petition for modification. The utilities' explanation of why IRD should be modified is simple and straightforward. They claim: (1) The Commission intended that IRD be revenue neutral; (2) The Commission selected faulty estimates for the elasticity of demand² for toll and switched access services; (3) Since implementation of IRD, the result of the faulty estimates is that the utilities actually have received considerably less revenue from these services than was estimated; (4) IRD has fallen short of its revenue neutrality intent to the extent that the revenues actually received from toll and switched access services are less than the revenue estimated for those services; (5) The Commission should correct the failure of these estimates to produce revenue neutrality. The revenues for toll and switched access services should be recalculated using new elasticity estimates that reflect actual results, and the corresponding revenue decline in those services should be offset by rate increases in other utility services.

In their petition, the utilities suggest specific rate and surcharge changes to cure the perceived shortfall in toll and

2. Elasticity of demand is an economic term which describes the degree to which the demand for a product will rise or fall in response to a change in the product's price. In the IRD rate design, the calculation of the anticipated volume of some services was derived by taking the actual volume of that service in the base year (1989 for Pacific and 1990 for GTEC) and applying the elasticity estimate.

switched access revenues resulting from the elasticities adopted in IRD. We note that some of these proposals are the same ones which these utilities made, and which the Commission rejected, in the IRD Decision. For example, Pacific's proposed changes in directory assistance mirror the utility's original request in IRD. GTEC's proposals on Foreign Exchange service, returned check charge, and directory assistance are all identical to those originally proposed in IRD.

The petition for modification claims that the discrepancy between IRD's estimates and the actual revenues received from toll and switched access services has contributed significantly to a "dramatic deterioration" in the utilities' financial condition. However, the petition does not claim that IRD rates are confiscatory, that the utilities have been deprived of the opportunity to earn a reasonable return on their investments, or even that the utilities have actually failed to recover the start-up revenue requirement authorized by the IRD Decision.³

Despite the utilities' suggestion of a generally "deteriorated" financial condition, no insight into this fiscal malady is provided. The financial analysis submitted with the petition, as amended, is confined to the targeted toll and switched access services where calculations of the allegedly overestimated, missed revenues show what the utilities contend

3. In IRD, we explained the revenue requirement was predicated on a rate design employing a base year of 1989 (as modified by later decisions) for Pacific. We said:

"Rates adopted in this rate design proceeding are to yield the LECs' authorized start-up revenue requirement as of January 1, 1990, adjusted to reflect certain subsequent Commission actions. The resulting rates will be applied to actual post-IRD sales, however." (D.94-09-065, page 162.)

would have, or should have, been available through rate increases in other utility services if revenue neutrality had been maintained. Thus, the gravamen of the petition is the utilities' premise that IRD's revenue neutrality fails when the estimate for a given service or product is not replicated in real life revenue receipts. In D.97-02-049, we correctly rejected this proposition and denied the petition.

The essence of Pacific's grounds for rehearing D.97-02-049 is contained in the introduction to its application:

"The Commission intended its Implementation Rate Design ('IRD') to be 'revenue neutral' (footnote omitted). In ordering certain price decreases, the IRD Decision used an estimate of elasticity of demand for toll and switched access services offered by us. In fact, the estimates of elasticity used for IRD were much too high, as proven by actual, subsequent experience. In summarily denying the Petition for Modification of IRD to use accurate elasticity figures reflecting actual increases in calling, the Commission has failed to regularly pursue its authority and deprived us of due process of law."
(Pacific's Application for Rehearing of D.97-02-049, pp. 1-2)

Pacific claims that rehearing should be granted to correct errors in D.97-02-049. Pacific alleges that the Commission erred because it failed to regularly pursue its authority: (1) by concluding, wrongly, that the elasticity figures for toll and switched access services in IRD could not be reconsidered without reexamination of all other rate components; (2) by erroneously assuming that Pacific was seeking compensation for economic conditions or competitive losses; (3) by arbitrarily and capriciously rejecting Pacific's evidence without explanation or further proceedings; and (4) by violating Pacific's due process by refusing to give Pacific a chance to prove that the utility's actual experience demonstrates that the estimates relied upon in IRD are substantially incorrect.

We have carefully considered Pacific's allegations of error and the responses in opposition thereto. For the reasons explained more fully below, we conclude that rehearing on the grounds asserted by Pacific is not warranted. We also take this opportunity to underscore the rationale for our decision to deny the Pacific/GTEC petition to modify IRD and we further clarify our analysis, our intent and the impact of that decision.

Apparently, Pacific misunderstands the meaning of D.97-02-049 because it mistakenly attributes to that decision conclusions that we do not reach and errors that we do not believe exist. In D.97-02-049 we exercised our discretion to reject the utilities' request that we reconsider, revisit or redo the painstakingly developed, complex rate design of the IRD Decision - a decision that is final as a matter of law.

The following summary of what D.97-02-049 does and does not do is instructive. D.97-02-049 does not dismiss as untrue the utilities' claim that IRD's estimates of the volume of toll and switched access services has not, in fact, been realized. D.97-02-049 does not decide or assume the factors that may have caused a deficiency between those estimates and actual experience. D.97-02-049 makes no finding about whether the utilities are seeking compensation for economic conditions or competitive losses. D.97-02-049 does identify factors, other than erroneous elasticity estimates, which may have caused a difference between IRD's forecast of toll and switched access volumes and actual experience. The discussion of "other factors" portrays the complexity of the investigation that would have been required if the petition's premise of revenue neutrality merited further consideration.

D.97-02-049 does conclude that the utilities' perception of the role of revenue neutrality in the IRD rate design is wrong, and therefore, that the utilities' basis for modification of IRD is flawed. Most certainly, D.97-02-049 does emphasize that, contrary to the utilities' claim, the IRD Decision neither states nor implies that the intent of revenue neutrality can be

measured by whether the estimated revenue for a given service is replicated in real life revenue receipts. D.97-02-049 references the IRD Decision's rejection of the true-up proposal to adjust discrepancies between estimates and actual experience as it similarly rejects the utilities' true-up or balancing account premise for recovery of missed revenues. In that discussion, D.97-02-049 demonstrates that although revenue neutrality was a significant component of the IRD rate design, it was never promised. There was no guarantee, even with respect to the utility's recovery of the base year's revenue requirement. As we said in the IRD Decision, the rate design provided only the fair opportunity for such recovery:

"Today,s decision will permit each company to have a fair opportunity to recover its authorized revenue requirement based on its own array of services." (Emphasis added D.94-09-065, page 4)

II. PROCEDURAL BACKGROUND

The instant proceeding is an investigation which was instituted in 1987 by the Commission to reconsider the regulatory framework for California local exchange carriers (LECs), the largest of which are Pacific and GTEC. The proceeding was divided into three phases: Phase I addressed price flexibility for services subject to competition; Phase II considered alternative approaches to ratemaking for basic rates and culminated in an incentive-based new regulatory framework (NRF) for GTEC and Pacific; and, Phase III focused on pricing flexibility and competition for intraLATA message toll and related services. Phase III was IRD.

The IRD phase began in 1991. It was a mammoth undertaking. The issues, which were complex and of great significance, produced tremendous activity, strong advocacy and an abundance of written briefs and commentary on draft decisions. By July, 1993, when the proposed decision of the administrative law judges was mailed, IRD had comprised 120 days of evidentiary

hearings, generating 17,450 pages of transcript, 438 of the 458 exhibits marked had been received in evidence, and twenty-nine opening briefs and 28 reply briefs producing a total of over 2600 and 1600 pages, respectively, had been filed. After a round of comments and reply comments on the proposed decision, in September, 1993, the Commission adopted D.93-09-076 as its IRD Decision. About three weeks later, the Commission rescinded that decision and reopened the proceedings for a new round of opening and reply briefs. In July, 1994, a new draft decision was distributed and a final round of opening and reply comments began. On September 15, 1994, the Commission unanimously adopted D.94-09-065, the IRD decision.

The following is a brief summary of the IRD decision:

"The IRD Decision adopts a revenue neutral rate design which expands authorized intraLATA competition in the telephone industry by extending competition to various services; establishes a cost-based pricing rate design which will permit each local exchange carrier (LEC) to have a fair opportunity to recover its authorized revenue requirement based on its own array of services; and clarifies the appropriate standards for imputation of price floors for the LECs' bundled competitive services using monopoly building blocks. (D.96-02-023, page 1.)

Six applications for rehearing of the IRD Decision were filed by fourteen parties alleging more than forty errors as grounds for rehearing various components of the decision. Although Pacific did not file an application for rehearing, GTEC did. All applications were resolved in D.96-02-023, our Order

Denying Rehearing And Modifying D.94-09-065.⁴ No party appealed our order denying rehearing to the California Supreme Court. Therefore, the IRD Decision became final as a matter of law thirty days after the rehearing decision was issued.

As discussed in D.97-02-049, it is worth reiterating that GTEC's application for rehearing included many of the same issues which are the subject of the Pacific/GTEC petition for modification of IRD.⁵ Specifically, GTEC alleged that because there is no evidentiary support for the specific elasticity estimates which were adopted in D.94-09-065 (-0.5 toll elasticity and -0.44 switched access elasticity), the Commission failed to regularly pursue its authority and therefore denied GTEC due process (D.96-02-023, mimeo, page 7.) GTEC's application also requested the "true-up" proposed in the Pacific/GTEC petition for modification of IRD:

"If the Commission does not correct its error in selecting a -.5 elasticity, then at the very least it should allow for a true-up. Even though GTEC has opposed the concept of a true-up as inconsistent with the purpose and policy of NRE, a true-up based upon the actual stimulation which will occur under intraLATA competition would be fair and proper, given the Decision's unsupported choice of a -.5 elasticity estimate." (Emphasis added, GTEC's "Application For Rehearing Of Decision 94-09-065", pp. 7-8.)

Although we did not discuss the true-up proposal in our order denying rehearing of the IRD Decision, we provided for its

4. D.94-09-065 also was later modified by D.96-06-023 on an issue unrelated to the present inquiry.

5. Due to procedural time requirements, the application for rehearing was filed before January 1, 1995, when the IRD Decision was implemented. Therefore GTEC's application did not include the allegations of discrepancies between the estimated and actual revenues received from toll and switched access services.

disposition.⁶ GTEC's allegations of error related to the selection of the elasticity estimates for toll and switched access services were expressly rejected in the decision. Before D.96-02-023 was issued, Pacific and GTEC filed the petition to modify which subsequently was denied in D.97-02-049 (the subject of the instant application for rehearing). That petition was a plea submitted pursuant to Rule 47 of the Commission's Rules of Practice and Procedure.

III. ALLEGATIONS OF ERROR IN D.97-02-049

A. Pacific's Claims That D.97-02-049 Erred In Concluding That The Commission Could Not Reconsider Elasticity Without Reexamining All Other Rate Components

The application for rehearing states: "[T]here is a logical and compelling basis for the Commission to reconsider elasticity without reexamining all other rate components." (Application, page 5.) Pacific bases this conclusion on the argument that the petition to modify sought reconsideration of the elasticity figures for toll and switched access because "those figures were merely estimates, and those estimates proved to be dramatically different from subsequent actual experience. In contrast, all other rate components in the IRD rate design were based on actual experience, not estimates" (Application, page 4). These assertions do not support a claim of error in D.97-02-049.

Pacific's claim that "all other rate components were based on actual experience not estimates" is clearly wrong.

6. In D.96-02-023, we stated: "Although we do not discuss each of the numerous allegations which applicants assert justify rehearing, all bona fide allegations (footnote omitted) have been considered. Herein we decide that applicants' allegations of error, whether or not discussed, do not show good cause for rehearing." (D.96-02-023, pp. 3-4.)

Elasticity estimates were used to estimate anticipated demand for services other than toll and switched access⁷ as the following quote from the IRD Decision reveals:

"GTEC's estimate of demand elasticity for WATS usage is -1.105. Pacific offers an overall estimate of demand elasticity for MTS and WATS services of less than -1.0. DRA's revenue calculation used an implicit stimulation factor of 10%, but this factor was not based on an underlying elasticity estimate. Since Pacific's factor is not specific to WATS, we will use GTEC's demand elasticity factor to calculate usage-based WATS revenues.

For elasticity of demand for the WATS recurring monthly charge, and in the absence of any plausible WATS-specific recommendation (footnote deleted), we will adopt the -0.29 factor which GTEC proposed and we adopt for the monthly charge for 800 service. Because the nonrecurring WATS installation charge is so small relative to the recurring charges for WATS service, and because WATS usage rates are being lowered substantially, we conclude that demand elasticity for the nonrecurring installation charge may reasonably be estimated to be zero for purposes of revenue calculation.

Pacific estimated the demand for 800 services to be twice as elastic as the demand for residential MTS; DRA recommended a usage demand elasticity of -0.6, the same as its estimate for toll services in general; and GTEC proposed a usage elasticity factor for 800 services of -1.494. Pacific's estimate does not specify whether it applies to 800 usage only or to the combined usage, recurring, and nonrecurring charges for 800

7. See also D.94-09-065 at pages 305 through 306 for several findings of fact addressing elasticity estimates in the IRD Decision.

service. GTEC's figure of -1.494 is an industry-based figure and is the most reliable of the three estimates for usage we therefore will adopt it. GTEC's demand elasticity estimate for the monthly rate for 800 service, -0.29, will also be adopted. Finally, for the reasons cited above regarding elasticity for the WATS nonrecurring charge, an elasticity of zero is appropriate to apply to the installation charge for 800 service." (D.94-09-065, pp. 156-157.)

Pacific's characterization of elasticity figures as "merely estimates" is a non sequitur. It provides no support for a claim of error in the decision. According to the petition for modification, the problem with the elasticity figures is not that they were "merely estimates" but rather, that they were the wrong estimates as later proved by actual experience. In other words, the utilities' complaint is that, in retrospect, the elasticity estimates produced substantially incorrect forecasts of demand. Had those "estimates" produced a forecast of demand for toll and switched access services which proved more acceptable to the utilities, presumably there would have been no petition for modification.

In the face of Pacific's unclear position in support of its allegation that D.97-02-049 erred in concluding that the Commission could not reconsider elasticity without reexamining all other rate components, we will nevertheless further discuss our rationale. As stated, the allegation is misleading. D.97-02-049, Conclusion of Law No. 7 states:

"There is no reasonable basis to do a true-up of actual-to-forecasted revenues associated with any one component of the overall rate design adopted in D.94-09-065 without the opportunity for a reexamination of all of the components." (D.97-02-049, page 19.)

Conclusion of Law No. 7 is correct because any discreet or isolated rate adjustment of an individual service would damage,

if not destroy, the integrity of the IRD rate design.

The intent of revenue neutrality is a crucial component of the IRD rate design. It informed and guided the process of rate changes and revenue rebalancing so that the numerous rate changes or surcharge adjustments incorporated in the design ultimately added up to zero, or no change at all, in the authorized revenue requirement (as modified by Commission decisions) for the 1989 base year. Virtually no rate change could be considered discrete or be viewed in isolation.

Revenue neutrality was not the only rate design component. It interacted with other principles such as the Commission's express goals of cost-based rates and low rates for consumers. In addition, in the complex revenue rebalancing model used by the Commission, changes in rates for most services were passed through the model used to determine the revenue impacts on the small Local Exchange Companies. Those changes had direct impacts on the revenues of Pacific Bell, as well as on the revenues of the small companies.

In the context of the IRD rate design, it is unreasonable to apply the concept of revenue neutrality on a service-by-service basis. There is nothing in the IRD Decision, express or implied, that should lead one to believe that revenue neutrality could be measured on a service-by-service basis. Our decision in D.97-02-049 to reject the utilities' erroneous interpretation of IRD's revenue neutrality preserves the integrity of the IRD rate design. It is consistent with the description and application of the intent of revenue neutrality in the IRD Decision itself, and, with the interpretation of revenue neutrality contained in D.96-03-021, our decision denying the petition of California Association of Long Distance Telephone Companies to modify D.94-09-065. We are concerned that even our attempts to briefly describe or summarize the revenue neutrality intent as it functioned in the IRD rate design never quite conveys the high degree of complexity that was involved. Therefore, we hereby attach as Appendix A to this decision

several pages from the Executive Summary to the IRD Decision which better explains the role of revenue neutrality.

B. Pacific's Claim that In D.97-02-049, The Commission Erred In Relying On Assumptions Or Speculation As A Basis For Unfairly Rejecting The Utilities' Evidence Without Further Proceedings

Pacific contends that, because the rationale underlying D.97-02-049 is a series of unproved assumptions, the Commission committed legal error by not giving the utilities an opportunity to demonstrate the truth of their assertions.

"[T]he Commission has made factual assumptions rejecting our evidence, without record support, explanation or further proceedings. That is arbitrary and capricious." (Application, page 9)

"The Decision also erroneously assumed that we are asking for compensation for economic conditions or competitive losses." (Application, page 5.)

As we have explained, D.97-02-049 does not decide or assume the factors that may have caused a deficiency between the revenue estimates and actual receipts for toll and switched access services. No finding was made in D.97-02-049 about whether the utilities were seeking compensation for competitive loss or economic conditions.

Apparently, Pacific is persuaded that D.97-02-049 would have been decided differently if the Commission had believed Pacific's statement that:

"Based on its overestimate of elasticity, IRD estimated \$234 million more in annual toll calling revenue than we actually received. IRD also estimated \$53 million more in annual switched access revenue than we actually received." (Application, page 8.)

Because Pacific has misunderstood the meaning of our decision, it has missed the point that D.97-02-049 did not turn upon the accuracy of the above alleged facts but on the several factors which we have explained, not the least of which was the invalidity of the utilities' revenue neutrality theory. To be sure, we did have some concern about the petition's reference to the "dramatic deterioration" in the utilities' financial condition in the months following the IRD decision. Accordingly, we reviewed the petition carefully to assure ourselves that there were no allegations about confiscatory rates or the utilities' inability to earn a reasonable return on their investments. We found no such allegations. Furthermore, we are aware that in NRF we did provide utilities with a safety net in the event of significant reductions in their rate of return.⁸

In addition, we satisfied ourselves that despite the dollar amount of the "missed revenue" alleged, the utilities could very well have benefitted as much, or more, from the reverse situation. As we mentioned in D.97-02-049 at page 15, the IRD revenue requirement did not include the explosion in switched access lines which has occurred since the base year in 1989. We quoted the IRD Decision on that point but neglected to include the footnote from the IRD Decision which shows, for example, that as of 1993 Pacific was receiving revenue for 2.2 million access lines more than the company had in 1989. Because only the 1989 volume for access lines was included in the IRD revenue requirement, the revenue neutrality process did not cause any rates to be adjusted downward to offset the revenue already being received from the growth in access lines. Thus, the revenue

8. In 1989, the Commission adopted NRF which provided utilities the opportunity to petition the Commission for consideration of rate increases if the utility's earning fall 325 basis points below the market-based rate of return for two consecutive years. (See 33 CPUC2d 42, 184, [D.89-10-031].)

from access line growth was, in the IRD rate design sense, excess revenue for Pacific. In 1993, the rate charged for most basic access lines was \$8.35 per month meaning that as of 1993, Pacific received a minimum of \$220,444,000 in annual revenues in excess of the IRD revenue requirement. We note that IRD increased the rates for access lines which would yield higher annual revenues and that, in addition, the growth in access lines has continued.⁹

C. Pacific's Claim that In D.97-02-049, The Commission Failed To Regularly Pursue Its Authority And Deprived Pacific Of Due Process Of Law

Pacific contends that D.97-02-049 violates its right to due process by arbitrarily and capriciously rejecting Pacific's evidence without explanation or further proceedings or affording the utility the opportunity to prove the truth of its assertion that the elasticity estimates used for toll and switched access services were too high, thereby causing Pacific to receive less revenues from these services than estimated. Pacific is mistaken. Under the circumstances presented, the utilities were not entitled to a hearing or further proceedings or the opportunity to prove the validity of its allegations.

The petition was submitted pursuant to Rule 47 of the Commission's Rules of Practice and Procedure. Rule 47 (h) anticipates the Commission's exercise of its discretion to summarily dismiss petitions to modify. It provides:

9. We exercise our discretion to take official notice of the 1995 annual report for Pacific filed with this Commission April 1, 1996 in compliance with General Order No. 104-A which shows that for the year 1995, Pacific's switched access lines had grown to 15.5 million.

"In response to a petition for modification, the Commission may modify the decision as requested, modify the affected portion of the decision in some other way consistent with the requested modification, set the matter for further hearings or briefing, summarily deny the petition on the ground that the Commission is not persuaded to modify the decision or take other appropriate action." (Emphasis added.)

Statutory authority for our promulgation of Rule 47 is contained in Section 1708 of the Public Utilities Commission which provides:

"The commission may at any time, upon notice to the parties, and with opportunity to be heard as provided in the case of complaints, rescind, alter, or amend any order or decision made by it. Any order rescinding, altering, or amending a prior order or decision shall, when served upon the parties, have the same effect as an original order or decision." (Public Utility Code, Section 1708.)

In D.97-02-049, the Commission denied the utilities' petition to modify the IRD Decision because, based on the petition for modification presented to us, we were not persuaded that the reopening or modification of the IRD Decision would be reasonable or in the public interest.

There is no constitutional or statutory right to reopen a decision that is final. The Commission's authority pursuant to Section 1708 of the Public Utilities Code to modify a final decision is discretionary. Here we exercised our discretion not to modify D.97-02-049. Our decision will not be disturbed on appeal except for abuse of discretion which, we are confident, has not occurred in this case.

Even if the utilities' claim is true, that the elasticity figures used for toll and switched access services resulted in revenue estimates which were substantially higher than the revenues the utilities actually received from those

services, this Commission's action denying the petition was proper for the following reasons.

(1) Pacific's theory of revenue neutrality being capable of measurement on a single service basis is erroneous, entirely inconsistent with the IRD rate design and our interpretation of that design in previous decisions. Denial of the petition without further proceedings is warranted to preserve the integrity of the IRD rate design and our consistency in that regard belies claims of arbitrariness.

(2) This Commission has good reasons for the refusal, under the circumstances posed in the petition, to reopen and to modify the IRD Decision. Those reasons are discussed in D.97-02-049 and also are explained in this decision. Reasoned decisions are neither arbitrary nor capricious. We have been consistent in our refusal to allow for true-ups in the toll and toll-related services where intraLATA competition was so recently introduced. We have been consistent in our insistence that the integrity of the IRD rate design be preserved in that we have consistently insisted that revenue neutrality can not be determined on a single service basis.

THEREFORE, for good cause appearing,

IT IS HEREBY ORDERED that:

1. Decision 97-02-049 is affirmed as clarified herein.
2. Rehearing of Decision 97-02-049 is denied.
3. This order is effective today.

Dated July 16, 1997, at San Francisco, California.

P. GREGORY CONLON
President
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
RICHARD A. BILAS
Commissioners

I dissent.

/s/ JOSIAH L. NEEPER
Commissioner

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would have, or should have, been available through rate increases in other utility services if revenue neutrality had been maintained. Thus, the gravamen of the petition is the utilities' premise that IRD's revenue neutrality fails when the estimate for a given service or product is not replicated in real life revenue receipts. In D.97-02-049, we correctly rejected this proposition and denied the petition.

The essence of Pacific's grounds for rehearing D.97-02-049 is contained in the introduction to its application:

"The Commission intended its Implementation Rate Design ('IRD') to be 'revenue neutral' (footnote omitted). In ordering certain price decreases, the IRD Decision used an estimate of elasticity of demand for toll and switched access services offered by us. In fact, the estimates of elasticity used for IRD were much too high, as proven by actual, subsequent experience. In summarily denying the Petition for Modification of IRD to use accurate elasticity figures reflecting actual increases in calling, the Commission has failed to regularly pursue its authority and deprived us of due process of law."
(Pacific's Application for Rehearing of D.97-02-049, pp. 1-2)

Pacific claims that rehearing should be granted to correct errors in D.97-02-049. Pacific alleges that the Commission erred because it failed to regularly pursue its authority: (1) by concluding, wrongly, that the elasticity figures for toll and switched access services in IRD could not be reconsidered without reexamination of all other rate components; (2) by erroneously assuming that Pacific was seeking compensation for economic conditions or competitive losses; (3) by arbitrarily and capriciously rejecting Pacific's evidence without explanation or further proceedings; and (4) by violating Pacific's due process by refusing to give Pacific a chance to prove that the utility's actual experience demonstrates that the estimates relied upon in IRD are substantially incorrect.

We have carefully considered Pacific's allegations of error and the responses in opposition thereto. For the reasons explained more fully below, we conclude that rehearing on the grounds asserted by Pacific is not warranted. We also take this opportunity to underscore the rationale for our decision to deny the Pacific/GTEC petition to modify IRD and we further clarify our analysis, our intent and the impact of that decision.

Apparently, Pacific misunderstands the meaning of D.97-02-049 because it mistakenly attributes to that decision conclusions that we do not reach and errors that we do not believe exist. In D.97-02-049 we exercised our discretion to reject the utilities' request that we reconsider, revisit or redo the painstakingly developed, complex rate design of the IRD Decision - a decision that is final as a matter of law.

The following summary of what D.97-02-049 does and does not do is instructive. D.97-02-049 does not dismiss as untrue the utilities' claim that IRD's estimates of the volume of toll and switched access services has not, in fact, been realized. D.97-02-049 does not decide or assume the factors that may have caused a deficiency between those estimates and actual experience. D.97-02-049 makes no finding about whether the utilities are seeking compensation for economic conditions or competitive losses. D.97-02-049 does identify factors, other than erroneous elasticity estimates, which may have caused a difference between IRD's forecast of toll and switched access volumes and actual experience. The discussion of "other factors" portrays the complexity of the investigation that would have been required if the petition's premise of revenue neutrality merited further consideration.

D.97-02-049 does conclude that the utilities' perception of the role of revenue neutrality in the IRD rate design is wrong, and therefore, that the utilities' basis for modification of IRD is flawed. Most certainly, D.97-02-049 does emphasize that, contrary to the utilities' claim, the IRD Decision neither states nor implies that the intent of revenue neutrality can be

measured by whether the estimated revenue for a given service is replicated in real life revenue receipts. D.97-02-049 references the IRD Decision's rejection of the true-up proposal to adjust discrepancies between estimates and actual experience as it similarly rejects the utilities' true-up or balancing account premise for recovery of missed revenues. In that discussion, D.97-02-049 demonstrates that although revenue neutrality was a significant component of the IRD rate design, it was never promised. There was no guarantee, even with respect to the utility's recovery of the base year's revenue requirement. As we said in the IRD Decision, the rate design provided only the fair opportunity for such recovery:

"Today,s decision will permit each company to have a fair opportunity to recover its authorized revenue requirement based on its own array of services." (Emphasis added D.94-09-065, page 4)

II. PROCEDURAL BACKGROUND

The instant proceeding is an investigation which was instituted in 1987 by the Commission to reconsider the regulatory framework for California local exchange carriers (LECs), the largest of which are Pacific and GTEC. The proceeding was divided into three phases: Phase I addressed price flexibility for services subject to competition; Phase II considered alternative approaches to ratemaking for basic rates and culminated in an incentive-based new regulatory framework (NRF) for GTEC and Pacific; and, Phase III focused on pricing flexibility and competition for intraLATA message toll and related services. Phase III was IRD.

The IRD phase began in 1991. It was a mammoth undertaking. The issues, which were complex and of great significance, produced tremendous activity, strong advocacy and an abundance of written briefs and commentary on draft decisions. By July, 1993, when the proposed decision of the administrative law judges was mailed, IRD had comprised 120 days of evidentiary

hearings, generating 17,450 pages of transcript, 438 of the 458 exhibits marked had been received in evidence, and twenty-nine opening briefs and 28 reply briefs producing a total of over 2600 and 1600 pages, respectively, had been filed. After a round of comments and reply comments on the proposed decision, in September, 1993, the Commission adopted D.93-09-076 as its IRD Decision. About three weeks later, the Commission rescinded that decision and reopened the proceedings for a new round of opening and reply briefs. In July, 1994, a new draft decision was distributed and a final round of opening and reply comments began. On September 15, 1994, the Commission unanimously adopted D.94-09-065, the IRD decision.

The following is a brief summary of the IRD decision:

"The IRD Decision adopts a revenue neutral rate design which expands authorized intraLATA competition in the telephone industry by extending competition to various services; establishes a cost-based pricing rate design which will permit each local exchange carrier (LEC) to have a fair opportunity to recover its authorized revenue requirement based on its own array of services; and clarifies the appropriate standards for imputation of price floors for the LECs' bundled competitive services using monopoly building blocks. (D.96-02-023, page 1.)

Six applications for rehearing of the IRD Decision were filed by fourteen parties alleging more than forty errors as grounds for rehearing various components of the decision. Although Pacific did not file an application for rehearing, GTEC did. All applications were resolved in D.96-02-023, our Order

Denying Rehearing And Modifying D.94-09-065.⁴ No party appealed our order denying rehearing to the California Supreme Court. Therefore, the IRD Decision became final as a matter of law thirty days after the rehearing decision was issued.

As discussed in D.97-02-049, it is worth reiterating that GTEC's application for rehearing included many of the same issues which are the subject of the Pacific/GTEC petition for modification of IRD.⁵ Specifically, GTEC alleged that because there is no evidentiary support for the specific elasticity estimates which were adopted in D.94-09-065 (-0.5 toll elasticity and -0.44 switched access elasticity), the Commission failed to regularly pursue its authority and therefore denied GTEC due process (D.96-02-023, mimeo, page 7.) GTEC's application also requested the "true-up" proposed in the Pacific/GTEC petition for modification of IRD:

"If the Commission does not correct its error in selecting a -.5 elasticity, then at the very least it should allow for a true-up. Even though GTEC has opposed the concept of a true-up as inconsistent with the purpose and policy of NRF, a true-up based upon the actual stimulation which will occur under intraLATA competition would be fair and proper, given the Decision's unsupported choice of a -.5 elasticity estimate." (Emphasis added, GTEC's "Application For Rehearing Of Decision 94-09-065", pp. 7-8.)

Although we did not discuss the true-up proposal in our order denying rehearing of the IRD Decision, we provided for its

4. D.94-09-065 also was later modified by D.96-06-023 on an issue unrelated to the present inquiry.

5. Due to procedural time requirements, the application for rehearing was filed before January 1, 1995, when the IRD Decision was implemented. Therefore GTEC's application did not include the allegations of discrepancies between the estimated and actual revenues received from toll and switched access services.

disposition.⁶ GTEC's allegations of error related to the selection of the elasticity estimates for toll and switched access services were expressly rejected in the decision. Before D.96-02-023 was issued, Pacific and GTEC filed the petition to modify which subsequently was denied in D.97-02-049 (the subject of the instant application for rehearing). That petition was a plea submitted pursuant to Rule 47 of the Commission's Rules of Practice and Procedure.

III. ALLEGATIONS OF ERROR IN D.97-02-049

A. Pacific's Claims That D.97-02-049 Erred In Concluding That The Commission Could Not Reconsider Elasticity Without Reexamining All Other Rate Components

The application for rehearing states: "[T]here is a logical and compelling basis for the Commission to reconsider elasticity without reexamining all other rate components." (Application, page 5.) Pacific bases this conclusion on the argument that the petition to modify sought reconsideration of the elasticity figures for toll and switched access because "those figures were merely estimates, and those estimates proved to be dramatically different from subsequent actual experience. In contrast, all other rate components in the IRD rate design were based on actual experience, not estimates" (Application, page 4). These assertions do not support a claim of error in D.97-02-049.

Pacific's claim that "all other rate components were based on actual experience not estimates" is clearly wrong.

6. In D.96-02-023, we stated: "Although we do not discuss each of the numerous allegations which applicants assert justify rehearing, all bona fide allegations (footnote omitted) have been considered. Herein we decide that applicants' allegations of error, whether or not discussed, do not show good cause for rehearing." (D.96-02-023, pp. 3-4.)

Elasticity estimates were used to estimate anticipated demand for services other than toll and switched access⁷ as the following quote from the IRD Decision reveals:

"GTEC's estimate of demand elasticity for WATS usage is -1.105. Pacific offers an overall estimate of demand elasticity for MTS and WATS services of less than -1.0. DRA's revenue calculation used an implicit stimulation factor of 10%, but this factor was not based on an underlying elasticity estimate. Since Pacific's factor is not specific to WATS, we will use GTEC's demand elasticity factor to calculate usage-based WATS revenues.

For elasticity of demand for the WATS recurring monthly charge, and in the absence of any plausible WATS-specific recommendation (footnote deleted), we will adopt the -0.29 factor which GTEC proposed and we adopt for the monthly charge for 800 service. Because the nonrecurring WATS installation charge is so small relative to the recurring charges for WATS service, and because WATS usage rates are being lowered substantially, we conclude that demand elasticity for the nonrecurring installation charge may reasonably be estimated to be zero for purposes of revenue calculation.

Pacific estimated the demand for 800 services to be twice as elastic as the demand for residential MTS; DRA recommended a usage demand elasticity of -0.6, the same as its estimate for toll services in general; and GTEC proposed a usage elasticity factor for 800 services of -1.494. Pacific's estimate does not specify whether it applies to 800 usage only or to the combined usage, recurring, and nonrecurring charges for 800

7. See also D.94-09-065 at pages 305 through 306 for several findings of fact addressing elasticity estimates in the IRD Decision.

service. GTEC's figure of -1.494 is an industry-based figure and is the most reliable of the three estimates for usage we therefore will adopt it. GTEC's demand elasticity estimate for the monthly rate for 800 service, -0.29, will also be adopted. Finally, for the reasons cited above regarding elasticity for the WATS nonrecurring charge, an elasticity of zero is appropriate to apply to the installation charge for 800 service." (D.94-09-065, pp. 156-157.)

Pacific's characterization of elasticity figures as "merely estimates" is a non sequitur. It provides no support for a claim of error in the decision. According to the petition for modification, the problem with the elasticity figures is not that they were "merely estimates" but rather, that they were the wrong estimates as later proved by actual experience. In other words, the utilities' complaint is that, in retrospect, the elasticity estimates produced substantially incorrect forecasts of demand. Had those "estimates" produced a forecast of demand for toll and switched access services which proved more acceptable to the utilities, presumably there would have been no petition for modification.

In the face of Pacific's unclear position in support of its allegation that D.97-02-049 erred in concluding that the Commission could not reconsider elasticity without reexamining all other rate components, we will nevertheless further discuss our rationale. As stated, the allegation is misleading. D.97-02-049, Conclusion of Law No. 7 states:

"There is no reasonable basis to do a true-up of actual-to-forecasted revenues associated with any one component of the overall rate design adopted in D.94-09-065 without the opportunity for a reexamination of all of the components." (D.97-02-049, page 19.)

Conclusion of Law No. 7 is correct because any discreet or isolated rate adjustment of an individual service would damage,

if not destroy, the integrity of the IRD rate design.

The intent of revenue neutrality is a crucial component of the IRD rate design. It informed and guided the process of rate changes and revenue rebalancing so that the numerous rate changes or surcharge adjustments incorporated in the design ultimately added up to zero, or no change at all, in the authorized revenue requirement (as modified by Commission decisions) for the 1989 base year. Virtually no rate change could be considered discrete or be viewed in isolation.

Revenue neutrality was not the only rate design component. It interacted with other principles such as the Commission's express goals of cost-based rates and low rates for consumers. In addition, in the complex revenue rebalancing model used by the Commission, changes in rates for most services were passed through the model used to determine the revenue impacts on the small Local Exchange Companies. Those changes had direct impacts on the revenues of Pacific Bell, as well as on the revenues of the small companies.

In the context of the IRD rate design, it is unreasonable to apply the concept of revenue neutrality on a service-by-service basis. There is nothing in the IRD Decision, express or implied, that should lead one to believe that revenue neutrality could be measured on a service-by-service basis. Our decision in D.97-02-049 to reject the utilities' erroneous interpretation of IRD's revenue neutrality preserves the integrity of the IRD rate design. It is consistent with the description and application of the intent of revenue neutrality in the IRD Decision itself, and, with the interpretation of revenue neutrality contained in D.96-03-021, our decision denying the petition of California Association of Long Distance Telephone Companies to modify D.94-09-065. We are concerned that even our attempts to briefly describe or summarize the revenue neutrality intent as it functioned in the IRD rate design never quite conveys the high degree of complexity that was involved. Therefore, we hereby attach as Appendix A to this decision

several pages from the Executive Summary to the IRD Decision which better explains the role of revenue neutrality.

B. Pacific's Claim that In D.97-02-049, The Commission Erred In Relying On Assumptions Or Speculation As A Basis For Unfairly Rejecting The Utilities' Evidence Without Further Proceedings

Pacific contends that, because the rationale underlying D.97-02-049 is a series of unproved assumptions, the Commission committed legal error by not giving the utilities an opportunity to demonstrate the truth of their assertions.

"[T]he Commission has made factual assumptions rejecting our evidence, without record support, explanation or further proceedings. That is arbitrary and capricious." (Application, page 9)

"The Decision also erroneously assumed that we are asking for compensation for economic conditions or competitive losses." (Application, page 5.)

As we have explained, D.97-02-049 does not decide or assume the factors that may have caused a deficiency between the revenue estimates and actual receipts for toll and switched access services. No finding was made in D.97-02-049 about whether the utilities were seeking compensation for competitive loss or economic conditions.

Apparently, Pacific is persuaded that D.97-02-049 would have been decided differently if the Commission had believed Pacific's statement that:

"Based on its overestimate of elasticity, IRD estimated \$234 million more in annual toll calling revenue than we actually received. IRD also estimated \$53 million more in annual switched access revenue than we actually received." (Application, page 8.)

Because Pacific has misunderstood the meaning of our decision, it has missed the point that D.97-02-049 did not turn upon the accuracy of the above alleged facts but on the several factors which we have explained, not the least of which was the invalidity of the utilities' revenue neutrality theory. To be sure, we did have some concern about the petition's reference to the "dramatic deterioration" in the utilities' financial condition in the months following the IRD decision. Accordingly, we reviewed the petition carefully to assure ourselves that there were no allegations about confiscatory rates or the utilities' inability to earn a reasonable return on their investments. We found no such allegations. Furthermore, we are aware that in NRF we did provide utilities with a safety net in the event of significant reductions in their rate of return.⁸

In addition, we satisfied ourselves that despite the dollar amount of the "missed revenue" alleged, the utilities could very well have benefitted as much, or more, from the reverse situation. As we mentioned in D.97-02-049 at page 15, the IRD revenue requirement did not include the explosion in switched access lines which has occurred since the base year in 1989. We quoted the IRD Decision on that point but neglected to include the footnote from the IRD Decision which shows, for example, that as of 1993 Pacific was receiving revenue for 2.2 million access lines more than the company had in 1989. Because only the 1989 volume for access lines was included in the IRD revenue requirement, the revenue neutrality process did not cause any rates to be adjusted downward to offset the revenue already being received from the growth in access lines. Thus, the revenue

8. In 1989, the Commission adopted NRF which provided utilities the opportunity to petition the Commission for consideration of rate increases if the utility's earning fall 325 basis points below the market-based rate of return for two consecutive years. (See 33 CPUC2d 42, 184, [D.89-10-031].)

from access line growth was, in the IRD rate design sense, excess revenue for Pacific. In 1993, the rate charged for most basic access lines was \$8.35 per month meaning that as of 1993, Pacific received a minimum of \$220,444,000 in annual revenues in excess of the IRD revenue requirement. We note that IRD increased the rates for access lines which would yield higher annual revenues and that, in addition, the growth in access lines has continued.⁹

C. Pacific's Claim that In D.97-02-049, The Commission Failed To Regularly Pursue Its Authority And Deprived Pacific Of Due Process Of Law

Pacific contends that D.97-02-049 violates its right to due process by arbitrarily and capriciously rejecting Pacific's evidence without explanation or further proceedings or affording the utility the opportunity to prove the truth of its assertion that the elasticity estimates used for toll and switched access services were too high, thereby causing Pacific to receive less revenues from these services than estimated. Pacific is mistaken. Under the circumstances presented, the utilities were not entitled to a hearing or further proceedings or the opportunity to prove the validity of its allegations.

The petition was submitted pursuant to Rule 47 of the Commission's Rules of Practice and Procedure. Rule 47 (h) anticipates the Commission's exercise of its discretion to summarily dismiss petitions to modify. It provides:

9. We exercise our discretion to take official notice of the 1995 annual report for Pacific filed with this Commission April 1, 1996 in compliance with General Order No. 104-A which shows that for the year 1995, Pacific's switched access lines had grown to 15.5 million.

"In response to a petition for modification, the Commission may modify the decision as requested, modify the affected portion of the decision in some other way consistent with the requested modification, set the matter for further hearings or briefing, summarily deny the petition on the ground that the Commission is not persuaded to modify the decision or take other appropriate action." (Emphasis added.)

Statutory authority for our promulgation of Rule 47 is contained in Section 1708 of the Public Utilities Commission which provides:

"The commission may at any time, upon notice to the parties, and with opportunity to be heard as provided in the case of complaints, rescind, alter, or amend any order or decision made by it. Any order rescinding, altering, or amending a prior order or decision shall, when served upon the parties, have the same effect as an original order or decision." (Public Utility Code, Section 1708.)

In D.97-02-049, the Commission denied the utilities' petition to modify the IRD Decision because, based on the petition for modification presented to us, we were not persuaded that the reopening or modification of the IRD Decision would be reasonable or in the public interest.

There is no constitutional or statutory right to reopen a decision that is final. The Commission's authority pursuant to Section 1708 of the Public Utilities Code to modify a final decision is discretionary. Here we exercised our discretion not to modify D.97-02-049. Our decision will not be disturbed on appeal except for abuse of discretion which, we are confident, has not occurred in this case.

Even if the utilities' claim is true, that the elasticity figures used for toll and switched access services resulted in revenue estimates which were substantially higher than the revenues the utilities actually received from those

services, this Commission's action denying the petition was proper for the following reasons.

(1) Pacific's theory of revenue neutrality being capable of measurement on a single service basis is erroneous, entirely inconsistent with the IRD rate design and our interpretation of that design in previous decisions. Denial of the petition without further proceedings is warranted to preserve the integrity of the IRD rate design and our consistency in that regard belies claims of arbitrariness.

(2) This Commission has good reasons for the refusal, under the circumstances posed in the petition, to reopen and to modify the IRD Decision. Those reasons are discussed in D.97-02-049 and also are explained in this decision. Reasoned decisions are neither arbitrary nor capricious. We have been consistent in our refusal to allow for true-ups in the toll and toll-related services where intraLATA competition was so recently introduced. We have been consistent in our insistence that the integrity of the IRD rate design be preserved in that we have consistently insisted that revenue neutrality can not be determined on a single service basis.

THEREFORE, for good cause appearing,

IT IS HEREBY ORDERED that:

1. Decision 97-02-049 is affirmed as clarified herein.
2. Rehearing of Decision 97-02-049 is denied.
3. This order is effective today.

Dated July 16, 1997, at San Francisco, California.

P. GREGORY CONLON
President
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
RICHARD A. BILAS
Commissioners

I dissent.

/s/ JOSIAH L. NEEPER
Commissioner