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Decision 97-07-066

July 16, 1997

MAIL DATE
7/21/97 ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's Own
Motion Into the Second Triennial
Review of the Operations and
Safeguards of the Incentive-Based
Regulatory Framework for Local
Exchange Carriers.

1.95-05-047
(Filed May 24, 1995)

ORDER DENYING REHEARING OF DECISION 95-12-052

I. INTRODUCTION

An application for rehearing of Decision (D.) 95-12-052 was filed by Toward Utility Rate Normalization (TURN) on January 25, 1996. D.95-12-052 is the decision issued following the Commission's "Second Triennial Review of the Operations and Safeguards of the Incentive-Based Regulatory Framework for Local Exchange Carriers." The purpose of the proceeding was to review and, if necessary, reform the New Regulatory Framework (NRF) initially adopted in D.89-10-031. The primary question was whether a 5% productivity factor should continue to be imputed in the NRF price cap formula. In D.95-12-052 we found that the 5% productivity factor for Pacific Bell (PacBell) was inappropriate for the next 3 years primarily because the underlying assumptions and data on which the 5% was based were obsolete. Similarly we found that the 5% factor for GTEC California Incorporated (GTEC) was inappropriate for the time period following the expiration of a settlement entered into by GTEC. We found that a productivity factor lower than the prevailing rate of inflation would lead to rate increases and was inappropriate. Accordingly, we set the productivity factor equal to the

prevailing rate of inflation by suspending the application of the GDPPI minus productivity formula until completion of a future review. (D.95-12-052, pp. 1-2)

The application filed by TURN raises a number of arguments in support of the claim that we committed legal error in D.95-12-052. Responses to the Application for Rehearing were filed by GTEC California Incorporated, Pacific Bell, and Division of Ratepayer Advocates. We have reviewed the arguments raised in the application and in the responses.

TURN argues that the decision is unlawful because it is barred by D.93-11-011. That decision concerns the spin-off of PacTel and its wireless subsidiaries. TURN claims that the decision violates Public Utilities Code section 1705 because it does not include separately stated findings of fact on the material issues of the effect of the spin-off on this proceeding. We reject Turn's argument because the decision is not based upon the effect of the spin-off on Pacific's financial picture. We concluded that productivity factors lower than the prevailing rate of inflation would lead to rate increases and were inappropriate. (D.95-12-052, pp. 1-2)

Findings of fact and conclusions of law regarding the effect of the spinoff are not required under section 1705 because the effect of the spinoff was not a material issue to our decision. TURN overlooks the fact that D.95-12-052 applies to GTEC as well as Pacific, and GTEC was not a party to the spinoff decision. We also reject TURN's argument that we improperly failed to address the effect of the spinoff due to time constraints. While we did observe in Finding of Fact 30 that time constraints prevented a full exploration of the issue, there was no necessity of fully exploring this issue because the issue was not material to our decision. Similarly, TURN is incorrect in its contention that the decision violates section 1708 of the Public Utilities Code because it effectively rescinds an essential provision of D.93-11-011. We did not modify the NRF formula because of effects of the spinoff and the decision does not rescind any requirement of D.93-

11-011. We reject TURN's claim that changes to the NRF framework should not have been made without reference to the financial plan that we ordered Pacific to file in the spinoff decision. The plan would not have been material to our decision because we did not base our decision to modify the NRF formula upon any aspect of the consequences of the spinoff decision.

TURN argues that the decision is unlawful and erroneous because it is barred by D.89-10-031, the original NRF decision. We reject this argument for the reasons expressed below. TURN is incorrect when it implies that current or future Commissions are precluded from modifying the NRF formula. (See Re Pacific Gas and Electric Company [D.88-12-083] (1988) 30 Cal.P.U.C. 2d 189, 224.) As we explained in D.95-12-052 at page 49, our action in suspending the application of the GDPPI minus productivity factor formula results in a reduction of the 5% productivity by an amount that will set productivity equal to the inflation factor. This action is consistent with an update of the productivity target which D.89-10-031 explicitly contemplated. (See Alternative Regulatory Frameworks for Local Exchange Carriers [D.89-10-031] (1989) 33 Cal. P.U.C.2d 43, 150-151.) TURN is incorrect in stating that we have rescinded part of the NRF decision. The record in this proceeding supports the conclusion that the productivity factor of 5% is outdated and no longer reflects today's market and prices. Based upon this record it was appropriate to set the productivity factor equal to the prevailing rate of inflation by suspending of the GDPPI minus productivity factor formula. We find TURN's reliance on the case of Popowsky v. Pennsylvania Public Utility Commission, 1995 Pa. Commw. Lexis 589 (Dec. 1995), misplaced. In this case, unlike Popowsky, we did not conclude that the record was insufficient to reach a determination regarding productivity numbers and input price differential numbers.

We reject TURN's claim that D.95-12-052 deprives customers of cost savings. Customers continue to benefit from cost savings because the LEC's

bear the risk of inflation. We expect the real prices of services will fall at the rate of inflation. We also disagree with TURN's claim that inadequate notice and opportunity to be heard were provided. The record shows that all parties, including TURN, were given an opportunity to present testimony, cross-examine witnesses and to present evidence on issues at hearing including the issue of whether to modify or eliminate GDPPI-X as a Phase I issue. We find the rates to be just and reasonable pursuant to the decision. Pursuant to the Decision the LEC's rates are frozen through 1998. The LEC investors have the opportunity to earn a reasonable rate of return but must bear the burden of inflationary cost increases.

TURN maintains that the decision is erroneous and unlawful because it is barred by the "IRD Decision" (D.94-09-065). TURN claims that the decision grants the LEC's relief in the form of compensation for losses due to competition. TURN is incorrect that in D.95-12-052 we have reversed our earlier holding in D.94-09-065. In D.95-12-052, we observed that competition is increasing in the LEC's intraLATA market. However, we did not base our action on a finding that the LECs should be compensated for losses due to competition. We entered no finding to that effect. We disagree with TURN's allegation that P.U. Code Section 1708 requires that the Commission hold hearings on the issue of compensating the LECs for competitive losses. This issue was not material to our decision.

We also disagree with TURN's claim that we erred in relying on evidence of labor force reductions as support for suspending application of the price cap. While we noted that there is evidence in the record regarding reductions in labor force following the beginning of incentive regulation, this is not the basis of our suspension of the application of the GDPPI minus productivity factor formula. Similarly, while we noted that financing for infrastructure can be hindered when regulation creates an automatically declining revenue stream,

TURN is incorrect in its argument that we relied upon this finding in reaching our decision. We made no finding of fact to that effect.

We find that we did not commit error in failing to adopt an input price differential, as alleged by TURN. TURN claims that the input price differential has won "overwhelming acceptance" where it has been considered. There is no evidence in the record to support this claim. We note that there is conflicting evidence in the record on this point, and that Dr. Duncan testified that the concept of an input price differential is contrary to well established economic theory. (Duncan, Exh. 37, p. 8) We do find that TURN is correct that the decision omits a discussion of the testimony of Dr. Reneghan, the witness for Division of Ratepayer Advocates. The Decision should be clarified to include a summary of Dr. Reneghan's position, to reflect the fact that we considered the DRA testimony at the time that we considered the positions of the other parties that are summarized in the Decision. We do not find Dr. Reneghan's testimony dispositive on this point. In weighing the evidence we conclude that the testimony of witnesses Christensen, Schmalensee and Duncan are more persuasive on this point. As stated in Finding of Fact 37, the record on LEC input prices shows that the difference between the input price growth for the U.S. economy and input price growth for the LEC industry is not statistically different from zero.

We reject TURN's assertion that the rates established under the decision place ratepayers in a "dramatically worse position" than they would have been under traditional rate of return regulation. TURN's assertion is not supported by any citation to the record and provides no basis for a finding of legal error.

No further discussion is required of applicant's allegations of error. Accordingly, upon reviewing each and every allegation of error raised by applicant we conclude that sufficient grounds for rehearing of D.95-12-052 have not been shown. Therefore, **IT IS ORDERED:**

1. Decision 95-12-052 is modified to include the following language after the last sentence ending "... or that it exists today." on page 67:

"We have also reviewed the testimony of Dr. Reneghan for DRA. (Exh. 58, pp. 5-3 to 5-7.) While we find Dr. Reneghan's testimony provides support for the notion that aggregate input price growth for the telecommunications industry differs from economywide input price growth, we do not find it conclusive."

2. That the application for rehearing of D.95-12-052 filed by TURN, as modified, is denied.

This order is effective today.

Dated July 16, 1997 at San Francisco, California.

P. GREGORY CONLON

President

JESSIE J. KNIGHT, JR.

HENRY M. DUQUE

JOSIAH L. NEEPER

RICHARD A. BILAS

Commissioners