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Decision 98-09-041 September 3, 1998

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of GTE California Incorporated (U 1002 C), pursuant to D.90-10-039, for modification of D.90-10-039, for modification of D.88-09-030 and D.89-12-048 to eliminate the requirement for annual rate adjustment filings to reflect the impact of the Uniform System of Accounts Rewrite and for modification of Resolution T-15696 to eliminate the Uniform System of Accounts adjustment required therein of $11.527 million for 1995.	ORIGINAL Application 95-02-011 (Filed February 17, 1995)
Application of Pacific Bell (U 1001 C) for modification of Decision 88-09-030, Decision 89-12-048, and Resolution T-15695, to eliminate Uniform System of Accounts turnaround adjustments.	Application 95-05-018 (Filed May 5, 1995)

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Glenn A. Stover, Attorney at Law, for AT&T Communications of California, interested party.
James S. Rood, Attorney at Law, for the Office of Ratepayer Advocates (formerly Division of Ratepayer Advocates).

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FINAL OPINION

Summary

By this final order, we authorize GTE California Incorporated (GTEC) and Pacific Bell to eliminate their Uniform System of Accounts (USOA) "Turnaround Adjustment" and to close out their 1996, 1997, and 1998 turnaround memorandum accounts. The turnaround adjustment is a step-down or reduced revenue requirement resulting from adoption of the Federal Communication Commission's (FCC) Part 32 USOA for telephone companies, pursuant to Decision (D.) 87-12-063 (26 CPUC2d 349 at 372 (1987)).

Background

Our adoption of the FCC's USOA required the telephone utilities to, among other matters, change their method of accounting and recovering certain indirect construction costs from being capitalized into rate base to being recorded into operating expense accounts. The affected indirect construction costs consisted of approximately 20 distinct cost components which included general office overheads, labor-related additives, property taxes, and losses of construction materials and supplies.

In recognition that the utilities' revenue requirement impacts would increase in the initial years of implementation because the utilities were allowed dollar-for-dollar recovery for reasonable expenses, the utilities were authorized to initiate balancing accounts to record their revenue-requirement impacts from adoption of the FCC's USOA, pursuant to D.87-12-063. These balancing accounts were subsequently closed through advice letter filings which became effective January 1, 1989. Concurrent with approval of the advice letter filings, the utilities were authorized revenue requirement increases associated with the capital-to-expense accounting change. GTEC was authorized a $69.162 million and Pacific Bell a $136.150 million revenue requirement increase.

By D.88-09-030 (29 CPUC2d 313 (1988)) GTEC and Pacific Bell were required to file USOA turnaround adjustments in their upcoming attrition filings or, absent such filings, by advice letters. The turnaround adjustments, scheduled to continue annually until the utilities' next general rate cases, were required so that ratepayers could benefit from the reduced revenue requirement impacts associated with the change from capital-to-expense accounting.

However, before GTEC and Pacific Bell filed their next general rate proceedings, those proceedings were replaced with a New Regulatory Framework (NRF), D.89-10-031 (33 CPUC2d 43 (1989)). Rates based on reasonable changes in the utility's costs under the traditional method were replaced with inflationary and productivity factors under NRF.

In December 1989, the Commission adopted D.89-12-048 (34 CPUC2d 155 at 178 (1982)) in which it set forth the NRF start-up revenue requirement for January 1, 1990 and beyond. In that order, the utilities were required to continue with the annual turnaround adjustments in their respective price cap filings as a "Z-factor," or exogenous cost change, adjustment. Consistent with that order, annual turnaround adjustments were included in GTEC's and Pacific Bell's price cap filings for the years 1991 through 1994.

Neither GTEC nor Pacific Bell proposed a turnaround adjustment in their respective 1995 price cap filings. However, pursuant to Resolution T-15695 in Pacific Bell's 1995 price cap filing, dated December 21, 1994, we concluded that the price cap filing was not the appropriate procedural mechanism to seek the discontinuance of the USOA turnaround adjustment. The resolution required the turnaround adjustment to continue for 1995 and concluded that the appropriate procedure for Pacific Bell to seek discontinuance of its turnaround adjustment would be through the application process. A similar conclusion and recommendation was made for GTEC. (Resolution T-15696, December 21, 1994.)

GTEC and Pacific Bell filed applications for rehearing of Resolution T-15696 on December 30, 1994 and Resolution T-15695 on January 26, 1995, respectively. The utilities sought authorization to recover their 1995 turnaround adjustment based on their ability to demonstrate, through subsequent applications, that the ratepayers' benefit obligation had been fully satisfied without implementing the 1995 USOA turnaround adjustments. These applications for rehearing were denied by the

Commission approximately two years later on September 20, 1996, pursuant to D.96-09-100 and D.96-09-101. These decisions resolved the treatment of the 1995 turnaround adjustment for GTEC and Pacific Bell. Because GTEC and Pacific Bell did not file for judicial review of the decisions, D.96-09-100 and D.96-09-101 are final decisions. Any reconsideration of the 1995 turnaround adjustment at this time could be construed to be retroactive ratemaking. These final decisions make GTEC's and Pacific Bell's requests for recovery of their 1995 turnaround adjustments in this proceeding moot and need not be discussed further in this order.

The utilities have complied with Resolutions T-15695 and T-15696 through their filing of separate applications being addressed in this order. The utilities have requested authority to eliminate their turnaround adjustment effective January 1, 1995. Protests to these applications were filed by the Division of Ratepayer Advocates (DRA)[1] and AT&T Communications of California, Inc. (AT&T).

Prehearing Conference

A prehearing conference (PHC) was held on July 7, 1995, before Administrative Law Judge (ALJ) Michael Galvin in San Francisco. Discussed at the PHC was consolidation of the applications, establishment of a memorandum account to track revenue requirement impacts, and the scheduling of testimony and hearings. At this time, the applications were consolidated pursuant to Rule 55 of the Commission's Rules of Practice and Procedure. Evidentiary hearings were scheduled to begin on October 17, 1995.

Memorandum Account Motion

On August 1, 1995, GTEC, Pacific Bell and the DRA filed a joint motion in this consolidated proceeding to stay GTEC's and Pacific Bell's 1996 rate reductions

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[1] By action of the Executive Director, the Commission's Division of Ratepayer Advocates ceased to exist as a staff unit on September 10, 1996. The functions it performed as a participant in this proceeding now reside with the Commission's Office of Ratepayer Advocates (ORA).

associated with the turnaround adjustment and to authorize GTEC and Pacific Bell to establish interest bearing memorandum accounts for the amounts that otherwise would flow through to their ratepayers, until a final order is issued in this proceeding. This joint motion was filed because the procedural schedule adopted in this proceeding made it extremely unlikely that a final order addressing the merits of the applications would be issued prior to January 1, 1996, when the next step-down adjustment would be made.

There was no opposition to the joint motion. Hence, to avoid any prejudice to the utilities or to the ratepayers, the joint motion was granted pending a final order in this consolidated proceeding, pursuant to D.95-11-061.

Subsequently, by D.96-11-006 and D.97-11-023, GTEC and Pacific Bell were ordered to include their 1997 and 1998 USOA turnaround adjustment in their respective memorandum accounts instead of their price cap filing, pending a final order in this proceeding.

Evidentiary Hearings

Evidentiary hearings were held on October 17 and 18, 1995 in San Francisco. Testimony was received from GTEC, Pacific Bell, AT&T and DRA. Controller Frederick K. Hesse, Director of Regulatory Financial Proceedings Emery G. Borsodi, District Manager of State Government Affairs Daniel P. Rhinehart, and Public Utilities Regulatory Analyst III Linda J., Woods testified for GTEC, Pacific Bell, AT&T, and DRA, respectively. Briefs were filed on November 17, 1995, and the proceeding was submitted upon the filing of reply briefs on December 8, 1995.

GTEC's Basis to Discontinue its Step-Down Adjustment

GTEC contends that it has provided its ratepayers with more than a sufficient amount of USOA benefits through its annual turnaround adjustment, NRF start-up rate base, and NRF shareable earnings.

Turnaround Adjustment

GTEC envisioned its annual turnaround adjustment to be a means to provide its ratepayers with the benefits of the amortization of the increased revenue requirement which GTEC was authorized due to the capital-to-expense shift. Since GTEC had just received a rate order with respect to its 1988 test year rate case and was scheduled to file a 1991 test year rate case in 1990, GTEC concluded that the turnaround adjustment would be discontinued at the time GTEC filed its next general rate case, as provided for by D.88-09-030.

However, after the adoption of the NRF in 1989, GTEC was removed from traditional cost-of-service regulation and from its obligation to file general rate cases and attrition filings. In addition, the start-up revenue requirement set by D.89-12-048 required GTEC to adjust its rates to reflect a 11.50% rate of return for the 1990 calendar year based on eight months of 1989 earnings data annualized.

GTEC expected the initial USOA turnaround adjustment after the implementation of NRF to be its last turnaround adjustment because the NRF start-up revenue requirement replaced the general rate case proceeding for GTEC contemplated by D.88-09-030. However, as part of the NRF Start-up order (D.89-12-048, 34 CPUC2d 155), the Commission required GTEC to continue the turnaround adjustment. Through 1995, GTEC made seven turnaround adjustments annually of $11.5 million, which the utility believes have fully reversed GTEC's $69 million capital-to-expense rate increase. GTEC estimates the cumulative effect of ratepayer turnaround benefits through 1995 was $242 million in rate reductions.

GTEC also contends that its ratepayers received positive USOA benefits on an accelerated basis prior to the seven-year time period contemplated in D.87-12-063 due to the amortization of the income-tax component included in the $69 million revenue requirement increase it was granted to compensate for the capital-to-expense shift in D.87-12-063. GTEC explained that its revenue requirement increase consisted of two components, a $42 million capital-to-expense shift on GTEC's operating expenses and a $27 million tax effect caused by the Internal Revenue Service (IRS) not recognizing the capital-to-expense shift for income tax purposes. GTEC now contends that the tax effect should not have been amortized as part of its annual step down adjustment, because it is an ongoing cost. If GTEC's tax position is correct, its $11.5 million annual step down adjustment should have been reduced by $4.5 million

($27 million divided by six years) to $7 million. However, DRA points out that the tax effect is merely a timing difference which occurred because the capitalized items were depreciated for tax purposes and expensed for accounting purposes. This timing difference will reverse itself when depreciation on the capitalized items has been taken for tax purposes and accounting income is higher than tax income.

Irrespective of GTEC's new position, because these rate-increase benefits and turnaround adjustments were made permanent, and not subject to refund or adjustment as the result of any application for rehearing, the 1988 rate increases and subsequent yearly turnaround adjustments through year-end 1995 cannot now be adjusted, due to the prohibition on retroactive ratemaking, (*Pacific Telephone and Telegraph Co. V. Public Utility Commission* (1965) 62 CPUC2d 634, 650).

NRF Start-Up Rate Base

GTEC's Hesse contends that GTEC ratepayers received additional USOA benefits from its 1989 NRF start-up rate base. This is because D.89-10-031 required GTEC to use eight months of 1989 actual data, normalized, to arrive at its 1989 NRF start-up rate base. Had GTEC continued to capitalize its indirect construction costs beyond adoption of the USOA capital-to-expense change on January 1, 1988, GTEC's NRF start-up rate base would have increased by the amount of indirect construction costs expensed in 1988 and 1989. Since a utility's revenue requirement is directly dependent on the amount of its rate base, GTEC's ratepayers benefited from the incremental amount of reduced rate base caused by indirect construction costs being expensed. Hesse calculates that this lower rate base provided its ratepayers with a cumulative USOA benefit of $76 million through year-end 1995.

NRF Shareable Earnings

GTEC further contends that its ratepayers received USOA benefits through the sharing of GTEC's 1990 through 1993 earnings with its ratepayers. The original NRF order required GTEC to share 50% of any earnings on rate base in excess of 13%, up to a predetermined earnings cap. Since GTEC exceeded its NRF rate of return benchmark level for the years 1990 through 1993, GTEC shared a portion of its earnings with its ratepayers, resulting in a $48 million ratepayer benefit as confirmed by DRA's interests.

Had GTEC continued to capitalize its indirect construction costs, similar to the above discussion of the NRF start-up rate base, its NRF rate base would have been higher. Assuming the same net income level, a lower rate base yields a higher rate of return, causing GTEC's earnings to exceed the sharing benchmark by more than what it would have experienced if the indirect construction costs were included in rate base. Hesse calculates that the USOA impacts on GTEC's NRF rate base provided its ratepayers with a cumulative USOA benefit of $48 million through the form of shareable earnings for the years 1990 through 1993.

GTEC's Summary of its Ratepayer Benefits

GTEC believes that the cumulative USOA benefits it flowed back to its ratepayers through the annual turnaround adjustment, NRF start-up rate base, and NRF shareable earnings exceed $366 million. This is in contrast to the additional revenues of $146 million[2] it received to offset the revenue requirement increase associated with the USOA capital-to-expense shift, excluding the continuing income tax liability as summarized in the following GTEC tabulation.

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[2] 1995 cumulative sum of revenue requirement GTEC received for the $41.739 million capital-to-expense shift in 1989.

Category	Amount (Millions)
Ratepayer Benefits:	
Turnaround Adjustments	$242
NRF Start-Up Rate Base	76
NRF Shareable Earnings	48
TOTAL RATEPAYER BENEFITS	366
Less	
GTEC Cumulative Part 32 Revenues (Capital-to-expense impact only)	146
Cumulative Net Ratepayer Benefits	$220

Pacific Bell's Basis to Discontinue its Turnaround Adjustment

Pacific Bell also believes that its ratepayers have received sufficient benefits from the several years of USOA turnaround adjustments to justify the elimination of the turnaround adjustment effective January 1, 1995. Pacific Bell contends that the economic benefits its ratepayers received from the capital-to-expense step down adjustments, through year end 1994, are greater than the ratepayers would have received from all past and future revenue-requirement savings resulting from the USOA capital-to-expense change under traditional ratemaking policy. This is discussed below.

Turnaround Adjustment

Similar to GTEC, Pacific Bell represented that the primary source of USOA ratepayer benefits was provided through its annual turnaround adjustment. In 1988, Pacific Bell was granted a rate increase of approximately $136 million to cover its USOA start-up revenue requirement. This start-up revenue requirement consisted of a

$105 million actual capital-to-expense shift, a $43 million tax effect caused by the IRS not recognizing the capital-to-expense shift for income tax purposes, and a $12 million first-year turnaround adjustment caused by decreases in Pacific Bell's depreciation expense and return on rate base during the USOA implementation year.

Consistent with GTEC and D.88-09-030, Pacific Bell filed annual turnaround adjustments to reflect its reduced revenue requirement impacts from the capital-to-expense change. Pacific Bell used a simple mathematical formula to calculate its annual step down adjustment, so that the initial $136 million USOA revenue requirement increase would be fully and permanently reversed in equal increments. Therefore, the sum of all USOA turnaround adjustments made by Pacific Bell would total $136 million by year-end 1994. However, because Commission Resolution T-15696 required Pacific Bell to continue its annual turnaround adjustment Pacific Bell implemented an additional $23 million annual turnaround adjustment in 1995. Pacific Bell believes that without reversal of its 1995 turnaround adjustment, it will have provided its ratepayers with an excess of $23 million in USOA benefits.

Pacific Bell constructed two independent financial models to test its conclusion that ratepayers have been adequately compensated for the capital-to-expense change in 1988. These financial models were the Embedded Base Amortization Analysis (EBA) and the Rate Base Avoidance Analysis (RBA).

Embedded Base Amortization Model

Pacific Bell's EBA model examined the revenue requirement effect of the indirect construction costs embedded in rate base January 1, 1988, the implementation date of the capital-to-expense shift. This analysis recognized that embedded indirect construction costs automatically decline over time through depreciation and retirements due to the discontinuance of capitalizing future indirect construction costs. The EBA model calculated the declining revenue requirement by using Pacific Bell's 12.5 year average remaining life of embedded intrastate rate base with prevailing rates of return and tax rates in effect for the time periods used in the model. The year-over-year decline in revenue requirement was assumed by Pacific Bell to be the Commission-envisioned ratepayer benefit. The net present value (NPV) of these yearly declines in revenue requirement were then compared to the NPV of benefits that ratepayers actually received as a result of the USOA turnaround adjustments.

This EBA model shows that, as of December 31, 1994, Pacific Bell's ratepayers had received a cumulative net benefit of approximately $27 million more than they would have received under traditional rate of return regulation. This net ratepayer benefit increases to approximately $50 million with the inclusion of the 1995 step down adjustment.

Rate Base Avoidance Model

Pacific Bell's RBA model examined the revenue requirement effect of the capital-to-expense change on a going-forward basis. Similar to the EBA model, the underlying principle of the RBA was that rate base declines incrementally, leading to the incremental reduction in rate of return on rate base and depreciation expenses. The assumptions used by Pacific Bell in this model consisted of known and Commission adopted variables such as: changes for rate of return on ratebase, depreciation expense, and deferred taxes that would have been generated if these costs had been capitalized.

The RBA model calculated the revenue requirement benefits Pacific Bell's ratepayers would have received under pre-NRF regulation through an analysis of revenue requirement savings that would have resulted from avoiding rate base additions subsequent to adoption of the USOA capital-to-expense shift. The NPV of these yearly declines in revenue requirement were then compared to the NPV of the annual step-down adjustments.

Under this RBA model, Pacific Bell's ratepayers have received approximately $3 million in step down adjustments less than if the indirect construction cost continued to be capitalized under traditional rate of return regulation as of December 31, 1994. However, this negative benefit changes to a positive $20 million benefit upon inclusion of Pacific Bell's $23 million 1995 step-down adjustment.

Summary of Pacific Bell Ratepayers' USOA Benefits

Pacific Bell concludes that there is no mandate that ratepayers must receive rate reductions that equal or exceed the amount of the initial USOA revenue requirement increase. In support of its position, Pacific Bell relies on the Commission intent to keep the turnaround adjustment in existence only until Pacific Bell filed its next scheduled test year general rate proceeding. Pacific Bell believed that upon the filing of its next general rate proceeding, which never took place, its rates would be adjusted to reflect the effect of the USOA accounting changes in test-year estimated rate base, revenues and expenses. This is the time that the Commission would exercise its broad authority on an on-going basis in allowing expenses, judging the appropriateness of depreciation rates and capital expenditures, and setting rates of return.

Pacific Bell believes that its $136 million cumulative turnaround adjustments, passed through to its ratepayers through year end 1994, which fully reverse its $136 million USOA start-up revenue requirement granted in 1988, provide Pacific Bell's ratepayers with sufficient long-term benefits. Pacific Bell uses the results of its EBA and RBA models as a reality check on its belief that ratepayers have received sufficient long-term benefits. Although the models produced slightly different cumulative excess benefits to ratepayers on an individual basis, the models taken as a whole support Pacific Bell's contention that it has provided more than all of the benefits that would have accrued to ratepayers under traditional ratemaking.

Pacific Bell also concluded that any further continuation of the turnaround adjustments would unfairly harm Pacific Bell financially because each additional turnaround adjustment past 1994 will create an even wider discrepancy between the benefits ratepayers would have received under traditional rate of return ratemaking and the benefits ratepayers have actually received.

AT&T Communications' Opposition

AT&T opposes GTEC's and Pacific Bell's request for authority to discontinue their respective USOA turnaround adjustments until the utilities provide significant additional benefits to their respective ratepayers. AT&T's opposition is based on its understanding of expected ratepayer benefits and its analyses of: historical embedded revenue requirements model (HEIRMM); NPV analyses; perceived flaws in GTEC's and Pacific Bell's models; and the utilities' double recovery of tax allowances.

Expected Ratepayer Benefits

AT&T asserts that the USOA case history demonstrates that the Commission was led to expect that long-term and substantial ratepayer benefits would be gained from adopting the capital-to-expense change. Although an initial rate increase would be needed, ratepayers would realize annual rate reductions for many years. AT&T supports its assertion by reference to the (1) Wilson (GTEC) and Cancilla (2) Pacific Bell testimonies provided in the initial USOA investigation. According to AT&T, these testimonies indicated that revenue requirements would decrease annually until the cross-over point is reached in 1994. From that time forward the capital-to-expense change would produce revenue requirements lower than those which would have existed if the change were not adopted.

AT&T also cites various Commission findings of fact, conclusions of law, and ordering paragraphs related to adoption of the capital-to-expense shift to support the need for long-term and substantial ratepayer benefits. For example, D.88-09-030's Finding of Fact 13 reaffirmed the Commission's previous finding that revenue-requirement impacts associated with the capital-to-expense change would result in yearly revenue-requirement reductions. D.88-09-030's Ordering Paragraph 3 required the utilities to file annual advice letters to reflect reduced revenue requirement needs. This requirement was subsequently reaffirmed in the start-up NRF revenue requirement proceeding, D.89-12-048, which required the utilities to continue their respective turnaround adjustments as a Z-factor adjustment.

AT&T asserts that, regardless of whether GTEC and Pacific Bell had filed another general rate case prior to the implementation of NRF, the turnaround adjustment would have continued to ensure long-term and substantial ratepayer benefits. This is because the Commission has, on at least two other occasions, adopted long-term capital-to-expense type rate reductions that crossed multiple rate case periods and the current incentive regulatory environment.

The first instance related to the change of inside wire being expensed instead of capitalized. Pursuant to Resolutions T-14235 and T-14236, the Commission required GTEC and Pacific Bell to continue revenue requirement reductions from a memorandum account attributable to the accounting change that resulted in a declining rate base through the Z-factor adjustment until the amortization time period ended.

The second instance related to a change from capitalizing to expensing certain telephone plant costing less than $500 and more than $200. Again, this change ended the capitalization of certain costs, leaving an embedded investment base. Pursuant to D.90-08-029, 37 CPUC2d 129 (1990), Pacific Bell was authorized to recover its revenue requirement increase caused by the capital-to-expense change and to implement yearly step-down revenue reductions reflecting future rate reductions attributable to the accounting change that resulted in a declining rate base through the Z-factor adjustment, until the amortization time period ended.

Both instances provided immediate rate increases followed by a finite number of required step-down adjustments providing long-term savings to ratepayers. However, we already considered and rejected such a procedure through the use of a deferred account in D.87-12-063, the initial order adopting the capital-to-expense change. We concluded that the utilities should not be committed by a long-term recovery of cost that a deferred account or balancing account should not be implemented for the revenue requirements associated with the capital-to-expense change because such mechanisms assume a guaranteed recovery of costs. No party sought a modification or rehearing on our rejection of establishing such a deferred amount or balancing account.

Historical Embedded Revenue Requirements Model

AT&T utilized its HEIRMM model to determine how long the step-down revenue reductions should continue.

AT&T contends that the single most important factor to consider in determining GTEC's and Pacific Bell's ultimate ratepayer obligation is the amount of the utilities' embedded revenue requirements at the time the capital-to-expense shift was adopted. To do so, AT&T utilized its HEIRRM model which was based on historical rather than projected future construction activity. Excluded from the model was the impact of rate base being avoided from the expensing of indirect construction costs subsequent to the adoption of the capital-to-expense change.

AT&T concluded from its HEIRRM model that, as of 1987, the embedded revenue requirement for previously capitalized amounts now expensed under the capital-to-expense change was approximately $72 million for GTEC and $285 million for Pacific Bell. The model also estimated that both GTEC's and Pacific Bell's revenue requirements would decline on an annual basis until fully extinguished in the year 2005. Such impact was due to declining rate bases and associated returns, taxes, depreciation and retirements. AT&T offset the benefits that GTEC and Pacific Bell have already flowed back to their ratepayers from its benefit estimate.

AT&T concluded that GTEC refunded approximately $8 million more to ratepayers than it should have and that Pacific Bell still needs to refund $112 million to ratepayers, as shown in the following tabulation. However, AT&T further adjusted its GTEC estimate to reflect ratepayer funding benefits which AT&T believes GTEC received from implementation of the capital-to-expense change. No such further adjustment was applied to its Pacific Bell estimate. This adjustment changed AT&T's estimated GTEC $8 million overpayment to a $47 million underpayment.

	GTEC	Bell
Estimated Benefit	$ 72	$285
Approved Rate Reductions	80	173
Balance to be Refunded	$ (8)	$112
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Net Present Value Analyses

AT&T believes that the embedded revenue requirement at the time the capital-to-expense change was adopted is the appropriate bench mark to determine whether ratepayers have received benefits. However, as an alternative to its own and the utilities' historical analyses, AT&T conducted a net present value (NPV) analysis to further determine whether ratepayers could actually expect to see a net benefit from the capital-to-expense change. It believes that a NPV analysis provides insight as to when ratepayers should expect to begin seeing a net benefit from the capital-to-expense change. AT&T acknowledges that a NPV analysis, traditionally used to calculate the amount of payments needed to pay off a loan, is completely divorced from the concept of embedded revenue requirements, traditionally used to calculate the amount revenue a utility has an opportunity to earn.

The components of this NPV analysis included GTEC's and Pacific Bell's authorized revenue requirement increases, subsequent rate reductions through 1996, and start-up NRF revenue changes adopted in 1990. Similar to its HEIRRM model, AT&T excluded the impact of rate base avoided from the indirect construction costs being expensed subsequent to the adoption of the capital-to-expense change. Revenue increases and decreases were assumed to have been received on December 31st of each year with a 11.50% discount factor, consistent with the NRF start-up revenue requirement.

AT&T concluded from its alternative NPV analysis that ratepayers have not yet broken even. As an extreme example of a long-term pay back, the NPV analysis shows that it would take ratepayers 100 years to recoup all the Payments they have made to GTEC and Pacific Bell if the utilities permanently reduced their rates by approximately $47 million and $70 million, respectively on January 1, 1996.

Double Recovery of Income Taxes

AT&T also contends that the utilities are double recovering the tax component of their respective 1988 approved USOA start-up revenue requirements. Although the IRS has not recognized the capital-to-expense change for federal income tax purposes, AT&T contends that the utilities should be required to reduce their rates by the tax component of the start up revenue requirement because the utilities will recapture all of the taxes previously paid over all expected normalized time periods. AT&T demonstrates through a theoretical model that, over time, the normalization of tax timing differences will drive the utilities' net revenue requirement capital-to-expense tax allowance to zero. Because both GTEC and Pacific Bell depreciate their expenses capitalized for tax purposes on an accelerated basis, the acceleration of tax depreciation has the effect of quickly reducing the embedded base for tax purposes. Thus, AT&T concludes that the utilities have been recovering the full start-up tax effect in rates annually even though actual tax requirements have been lower.

Absent its proposed tax normalization in rates, AT&T asserts that the utilities have and will continue to double recover their start-up USOA tax allowances. To eliminate this perceived double recovery, AT&T recommends that GTEC and Pacific Bell flow back the $27 million and $43 million, respectively, of tax effects caused by the start-up capital-to-expense change not being immediately deductible for federal and state income tax purposes. However, this argument is moot because the issue of tax normalization applicable to the capital-to-expense change was considered and rejected in D.87-12-063, a proceeding in which AT&T also promoted the use of tax normalization. Neither AT&T nor any other party to the proceeding filed a petition for modification or application for rehearing on the tax normalization issue. Although AT&T had ample opportunity to readdress this issue, it has not. We will not now readdress this issue.

AT&T's Recommendation

AT&T does not oppose the utilities' request to discontinue their turnaround adjustments as long as the ratepayers are adequately compensated. Based on its HEIRMM model and NPV analysis, AT&T believes that an adequate compensation for GTEC's ratepayers would be a permanent rate reduction of at least $47 million and elimination of the double recovery of tax allowance through an additional $27 million rate reduction, effective January 1, 1996. Adequate compensation for Pacific Bell's ratepayers under AT&T's HEIRMM analysis would require Pacific Bell to implement a $112 million rate reduction over a 10-year time period and eliminate the double recovery of a tax allowance through an additional $43 million rate reduction effective January 1, 1996. However, should the Commission choose a NPV method, AT&T proposes that Pacific Bell's rates be reduced by $118 million, effective January 1, 1996.

DRA's Opposition

Similar to AT&T, DRA opposes GTEC's and Pacific Bell's request for authority to discontinue their USOA turnaround adjustments. However, DRA would not oppose the utilities' request if the utilities provide significant additional benefits to their ratepayers. The DRA's opposition to the utilities request is based on its analysis of the USOA regulatory history and of the utilities' NPV revenue requirement impacts.

Regulatory History

All parties to this proceeding recognize that adoption of the capital-to-expense change results in a significant revenue requirement increase during the first few years of implementation with decreasing revenue requirements thereafter due to smaller ratebases. DRA points out, as it did at the time we evaluated the merits of adopting the capital-to-expense change, that such increased revenue requirement did not reflect an increase in the utilities' costs. It resulted from a change in the way such costs are recovered through rate-of-return regulation. Under traditional rate-of-return regulation, utilities are allowed dollar-for-dollar recovery for reasonable expenses and allowed a return on the reasonable costs capitalized plus a yearly recovery for the amount of capitalized costs being depreciated over a number of years.

Although the capital-to-expense change reflects the utilities' willingness to accept short-term benefits through increased revenue requirements, DRA sees a consistently stubborn refusal of the utilities to share any of the later benefits with ratepayers. This is demonstrated by Pacific Bell's failure to propose a turnaround adjustment in its NRF start-up revenue requirement and by the utilities' filing of petitions to discontinue the annual Z-factor adjustment.

DRA compares the utilities' testimony presented in the initial USOA investigation with Commission orders to reach DRA's position that substantial additional benefits are due the utilities' ratepayers. For example, the utilities previously testified that once the cross-over point is reached in 1994 the revenue requirements will become, and remain, less than they would if indirect construction costs had continued to be capitalized. Also, GTEC's witness previously testified that the most obvious benefit to the California ratepayer is the tremendous decrease in revenue requirement beginning in 1994.

DRA also points to the Commission order which required the utilities to file reduced revenue requirement impacts from the adopted USOA in their annual attrition filing, until their next rate case. Absent an attrition filing, on or before October 1 of each year, the utilities were required to submit advice letters to reflect their reduced revenue requirement needs. In the NRF start-up revenue-requirement order the Commission stated that the USOA accounting changes leading to the turnaround adjustments are the type of regulatory changes the Commission contemplated in allowing for recognition of exogenous factors in the price cap indexing mechanism. It was also recognized that ratepayers should receive the benefits of cost reductions through revenue requirement reductions arising from the change in the USOA through yearly revenue adjustments. D.89-12-048 concluded that, contrary to Pacific's and GTEC's assertions, basing the start-up revenue adjustment on 1989 recorded rate base failed to capture the fact that 1990 rate base would be lower than 1989 rate base, due to the capital-to-expense shift. D.88-09-030 found (Finding 13), that the USOA capital-to-expense shift would result in a yearly revenue requirement reduction and concluded (Conclusion 3) that ratepayers should realize the benefit of reduced revenue requirement impacts that would occur in future years. Thus, per DRA, the USOA turnaround adjustments should continue under the new regulatory framework as an exogenous factor.

DRA concludes from its regulatory history analysis that the Commission intended ratepayers to receive long-term benefits from the capital-to-expense change. Therefore, DRA does not believe that the mere returning of rates to pre-USOA levels will provide any benefits to the utilities' ratepayers. It simply means that the ratepayers no longer have to pay for the capital-to-expense change.

Long-Term Revenue Requirement NPV Analysis

The DRA conducted two analyses to determine the amount of USOA long-term ratepayer benefits it perceives to be required by the USOA case history and whether ratepayers have received such benefits. The first analysis compared the cumulative USOA start-up revenue requirement benefiting the utilities to the cumulative turnaround adjustments benefiting ratepayers as of December 31, 1995. DRA concludes from this analysis that the USOA change has provided benefits only to GTEC and Pacific Bell. This is because the analysis shows that ratepayers have paid approximately $231 million and $458 million more to GTEC and Pacific Bell, respectively, in cumulative start-up rates than cumulative turnaround benefits they received from implementation in 1988 to December 31, 1995. (See Attachment B to Exhibit 19 (DRA).)

The second analysis calculates the NPV of the amounts which ratepayers have paid in excess of the step-down benefits they received through year-end 1995, adjusted to reflect the sharing of 1990 through 1993 profits from GTEC to its ratepayers. This result of approximately $336 million and $795 million for GTEC and Pacific Bell, respectively, is then applied to the authorized NRF market base rate of return over a 10-year time period. The 10-year time period was selected by the DRA to approximate the remaining composite plant lives of the items being expensed instead of capitalized. DRA concludes from its NPV analysis that ratepayers are entitled to a one-time $47 million and $106 million benefit from GTEC and Pacific Bell, respectively.

DRA's Recommendation

DRA recommends that the USOA Z-factor adjustment not be eliminated from the utilities' annual price cap index filing until GTEC and Pacific Bell make an additional one-time permanent reduction of approximately $47 million and $106 million, respectively, through a billing surcredit applicable to the utilities' intraLATA exchange, intraLATA toll, and intrastate access charges. The surcredit should be calculated using the utilities' billing bases contained in their individual 1995 price cap advice letter filings.

Discussion

The issue in this consolidated proceeding is whether GTEC and Pacific Bell have provided ratepayers with sufficient benefits from adoption of the capital-to-expense change. To resolve this issue it is necessary to identify the benefits provided to the utilities, the benefits that were expected to be provided to ratepayers at the time the capital-to-expense change was adopted, and benefits actually provided to the ratepayers.

Utilities' Benefits

Pursuant to D.87-12-063, the utilities were provided an opportunity, not a "guarantee," to recover their revenue requirement deficiencies associated with the capital-to-expense change. In exchange for this recovery opportunity, the utilities gave up any rights to recover a return on their future indirect construction costs.

As addressed in our earlier background discussion, GTEC and Pacific Bell filed advice letter requests for revenue requirement increases of $69.162 million and $136.150 million, respectively, for their opportunity to recover revenue requirement deficiencies applicable to the capital-to-expense change in 1988. The utilities' calculations and supporting workpapers were reviewed and found to be reasonable by DRA. Subsequently, the utilities' advice letters were approved. Hence, GTEC and Pacific Bell received a benefit in the form of a $69.162 million and $136.150 million rate increase, respectively, in 1988 related to the capital-to-expense shift.

We recognized in D.88-09-030 that the utilities' recovery of revenue requirement deficiencies could result in excessive recovery if turnaround adjustments were not implemented to account for the yearly amortization of rate base. Hence, to balance the utilities' and ratepayers' interests, we adopted DRA's recommendation that the utilities annually file reduced revenue requirement impacts (annual turnaround adjustments) until their next general rate case proceeding. Although parties disputed the intent of the annual turnaround adjustment, Ordering Paragraph 3 of D.88-09-030 specifically stated that the annual turnaround adjustment was to remain in existence until the utilities filed their next general rate case proceeding. This meant that the turnaround adjustment would continue only until the utilities' next general rate case proceeding where a final adjustment, if necessary, would be made. The general rate case proceeding, an event expected to occur in 1990 for GTEC and a few years later for Pacific Bell, never occurred because the implementation of NRF made general rate cases obsolete. However, ratepayers have continued to receive benefits from the turnaround adjustment through year end 1995. The 1996 and subsequent annual turnaround adjustments are pending resolution of this proceeding.

The utilities calculated their annual turnaround adjustments so that their approved capital-to-expense revenue requirement increases would be fully and permanently reversed by year-end 1994, the date that their capital-to-expense revenue requirement savings were to start, consistent with the initial USOA order. In other words, the cumulative sum of all step-down adjustments at year end 1994 would equal the utilities' 1988 authorized revenue requirement increase. This is not in dispute by the parties, what is in dispute is the amount of benefits ratepayers should receive before the turnaround adjustment is eliminated.

Similar to the 1988 revenue requirement increases approved for the impact of the utilities capital-to-expense change, the annual turnaround adjustments were permanent, and not subject to refund or adjusted as the result of any application for rehearing. Hence, the utilities continued to receive benefits on a reduced basis while ratepayers began to benefit on an increasing basis from the yearly turnaround adjustments authorized through year-end 1995. The cumulative benefits, net of annual turnaround adjustments, received by GTEC and Pacific Bell by year-end 1995 were $230.540 million and $457.743 million, respectively.

Turnaround adjustments for 1996, 1997, 1998, and the future are subject to our decision on whether ratepayers have realized a sufficient amount of reduced revenue requirement benefits from the capital-to-expense change as of year-end 1995.

Expected Ratepayer Benefits

All parties concurred that ratepayers would benefit from revenue requirement savings in the long-term through lower recorded rate bases, as set forth in D.87-12-063, and from the turnaround adjustments required by D.88-09-030. Hence, the expected benefits to ratepayers should be measured in terms of revenue requirement savings. However, the utilities and interested parties do not agree on what constitutes lower recorded rate bases or on the level of revenue requirement savings that should flow back to the ratepayers.

The utilities believe that reduced rate bases should be derived from both the amortization of existing capital-to-expense indirect construction costs and from the avoidance of capitalizing future indirect construction costs into rate base. Irrespective of the reduced rate-base source, Pacific Bell contends that there is no Commission mandate for ratepayers to receive a specific amount of benefits, let alone rate reduction benefits that equal or exceed the utilities short-term revenue requirement benefits.

On the other side of this expected-ratepayer-benefit issue, AT&T and DRA believe that the Commission intended and implied that ratepayers would receive significant long-term benefits solely from the elimination of indirect construction costs embedded in rate base at the time the capital-to-expense change was adopted. Neither AT&T nor DRA defined what they meant by significant long-term benefits. However, DRA does not believe that ratepayers received any benefit solely from the returning of utilities' rates to pre-USOA levels through the turnaround adjustments. Rather, it believes that such action merely means that ratepayers are no longer required to pay for the capital-to-expense change.

Similarly, AT&T believes that ratepayers should receive benefits in excess of the cumulative rate increases granted to the utilities for their capital-to-expense change. Hence, we are left to conclude that AT&T and DRA define significant long-term benefits to be an unspecified amount of revenue requirement reductions that exceed the cumulative amount of revenue requirement increases which the utilities received for their capital-to-expense change.

DRA's witness acknowledged that lower recorded rate base results from both the amortization of indirect construction costs previously capitalized and from the discontinuance, or avoidance, of recording future indirect construction costs into rate base. This was the precise reason the capital-to-expense change was adopted.

Under traditional ratemaking procedures, the capital-to-expense change results in perpetual ratepayer benefits through lower recorded rate base. This is because expensing indirect construction costs, instead of capitalizing them, results in the least revenue requirement cost to ratepayers, as confirmed by AT&T and DRA. For example, if a utility chose to expense a $1 million cost, the utility would be entitled to recover only that amount. However, if the $1 million was placed into rate base and the utility was provided the opportunity to earn a 10% rate of return over a ten year useful life, the utility would be entitled to recover 150% of its cost, or $0.5 million more than if the cost was expensed.

AT&T believes that avoided rate base should not be considered a ratepayer benefit because current rates include payments for direct expenses for the opportunity to avoid having the capital base grow. However, our adoption of the capital-to-expense change for indirect construction costs does provide ratepayers with cost savings. These costs savings occur because the utilities are no longer provided with an opportunity to recover a return on such future costs over the useful life of the construction activity. To ignore avoided rate-base impacts camouflages the true benefit provided to ratepayers.

The appropriate assessment of ratepayer benefits from the capital-to-expense change should be dependent on the cumulative amount of turnaround adjustments and on whether the change has reduced rate base. This would reflect both actual amortization of embedded indirect construction costs and avoidance of capitalizing indirect construction costs into rate base subsequent to adoption of the capital-to-expense change in 1988.

Realized Ratepayer Benefits

Although the parties disputed the amount of benefits derived from the embedded turnaround adjustments, there is no dispute that the annual turnaround adjustments, on a cumulative basis through year-end 1995, have eliminated the utilities' 1988 rate increases applicable to their capital-to-expense revenue requirement deficiencies. Hence, GTEC's and Pacific Bell's ratepayers have benefited from the annual turnaround adjustments through year-end 1995 to the extent that the utilities no longer recover capital-to-expense revenue requirement deficiencies in rates.

AT&T's and DRA's financial models and analyses were based on a comparison between the utilities' increased revenue requirement to recover deficiencies from the capital-to-expense change, and benefits the ratepayers received from the turnaround adjustments. Except for DRA's inclusion of shareable earnings for GTEC's ratepayers, neither AT&T nor DRA reflected any benefits that ratepayers received from avoided ratebase in their models or analyses. Therefore, these financial models and analyses can only be used as a reality check on the benefits utility ratepayers have received from embedded indirect construction cost.

With regard to benefits derived from avoided rate base, AT&T disputed GTEC's use of certain factors in GTEC's avoided-rate-base financial models (such as its selection of historical construction activities, depreciation lives, and exclusion of deferred taxes) for being inconsistent with AT&T's HEIRRM analysis. However, even AT&T's HEIRRM analysis, with the exclusion of any impact of avoided rate base and independent of its NPV adjustment, corroborates that GTEC's ratepayers have received at least $8 million in benefit from the capital-to-expense change in nominal dollars. The inclusion of cost savings from avoided rate base into AT&T's analyses can only increase the amount of benefits shown to have accrued to GTEC's ratepayers.

AT&T also disputed GTEC's use of its NRF shareable earnings model as demonstrating benefits to ratepayers.

DRA also ignored avoided-rate-base benefits in its analyses. However, DRA's witness confirmed that GTEC's ratepayers benefited from $48 million in shareable earnings due to the capital-to-expense change, and reflected such benefit in its benefit analysis for GTEC's ratepayers. Hence, GTEC's ratepayers have also received a benefit through shareable earnings.

In summary, GTEC's ratepayers benefited in three ways: from discontinuance of the $69 million rate increase applicable to capital-to-expense revenue requirement deficiency; from an unspecified amount of revenue requirement savings from avoided rate base and from shareable earnings.

Pacific Bell constructed its financial models differently than GTEC. Hence, comparable results do not exist. Pacific Bell used its EBA model as a reasonableness check to AT&T's HEIRRM model results. This reasonableness check showed that ratepayers have received a $50 million benefit and a $112 million detriment under Pacific Bell's and AT&T's respective model at year-end 1995. The results differed because the parties used different assumptions for factors such as rate of return, depreciation, and net-to-gross multiplier.

Pacific Bell used its alternative RBA model to test the reasonableness of its EBA model results. This alternative model showed a $20 million benefit to its ratepayers at year-end 1995. The alternative benefits shown by Pacific Bell's EBA and RBA models are $50 million and $20 million, respectively, at year-end 1995 as compared to AT&T's $112 million ratepayer detriment for the same time period, a difference of between $132 million and $162 million.

Absent a detailed review of each assumption in both Pacific Bell's and AT&T's models, a practice which we do not intend to undertake, we are unable to conclude how much, if any, Pacific Bell's ratepayers have benefited from the depreciation or amortization of Pacific Bell's embedded capital-to-expense rate base. However, based on our "expected ratepayer benefits" discussion of cost savings from avoided rate base, we can conclude that Pacific Bell's ratepayers have benefited from avoided rate base.

In summary, Pacific Bell's ratepayers benefited from discontinuance of the $136 million rate increase applicable to capital-to-expense revenue requirement deficiency and an unspecified amount of revenue requirement savings from avoided rate base.

Conclusion

The burden of proof for eliminating the USOA turnaround adjustment lies with GTEC and Pacific Bell as set forth in Resolutions T-15696 and T-15695, respectively. Pursuant to these resolutions, the utilities have submitted detailed reasons to eliminate their annual turnaround adjustments.

Without concurrence from the parties on the use of a preferred financial model and on each individual component to be included in the financial model, a precise amount of ratepayer benefits cannot be determined. However, there is no need to determine a specific amount of benefits which ratepayers have received from the capital-to-expense chance before the utilities can discontinue their annual turnaround adjustments. This is because there is no Commission finding, conclusion, or order requiring or guaranteeing that ratepayers receive a specific amount of benefits from the capital-to-expense change. D.87-12-063, Finding of Fact 19, finds that the capital-to-expense change will, in the long term, result in revenue requirement savings. D.88-09-030, Finding of Fact 13, finds that the capital-to-expense change revenue requirement impacts will result in yearly revenue requirement reductions. D.88-09-030, Conclusion of Law 3, concludes that ratepayers should realize the benefit of reduced revenue-requirement impacts in future years. Hence, we need only find that ratepayers have benefited from yearly revenue-requirement savings.

Absent a modification or rehearing of D.87-12-063 and D.88-09-030, we can only conclude that ratepayers should receive their revenue requirement savings from the annual turnaround adjustments and from lower recorded rate bases caused by the amortization of embedded indirect construction costs and avoidance of capitalizing additional indirect construction costs into rate base.

At the time the utilities were provided an opportunity to recover their capital-to-expense revenue requirement deficiencies, we emphasized that there was no intent to "guarantee" them recovery of all costs associated with the capital-to-expense change. The turnaround adjustment was implemented to balance the utilities' and ratepayers' interest. Not only has the turnaround adjustment reduced the utilities' revenue requirement needs on a yearly basis, it has now eliminated the utilities mechanism to recover their capital-to-expense revenue requirement deficiencies. Clearly, the turnaround benefit that ratepayers have received to date is consistent with our recognition in D.87-12-063 that ratepayers would benefit from revenue requirement savings approximately seven years after the capital-to-expense change was implemented.

Irrespective of AT&T's and DRA's objection to the utilities' application of individual components in their financial models, these models and supporting evidence demonstrate that GTEC's and Pacific Bell's ratepayers have at least been made whole and have likely benefited in excess of the turnaround adjustments through avoided rate base. This demonstration is consistent with D.88-09-030's finding that the revenues requirements impacts associated with the capital-to-expense change will result in yearly revenue requirement reductions, and the conclusion that ratepayers should realize the benefit of reduced revenue requirement in future years.

We also remind the intervenors that our decision ordering the initial revenue requirement increase and subsequent downward adjustments was reached at a time when Pacific Bell and GTEC were operating under rate-of-return regulation. It was therefore reasonable for the Commission to ensure that the ratepayers would directly benefit from the accounting shift, while still providing the utilities with an opportunity to earn a reasonable rate of return. Under the NRF, however, shareholders assume greater risks for the operations and earnings results of GTEC and Pacific Bell, and the utilities in turn have greater freedom to manage their expenses and reap the rewards of such management. On the other hand, ratepayers under NRF are more isolated from the utilities' changes in costs, but still stand to gain from the utilities' outstanding management of those costs. Under this balancing of interests, therefore, it is as improper for the Commission to allow ratepayers to obtain greater benefits than those obtained by the shareholders due to the instant accounting change than it would be for the Commission to permit the utilities to collect more revenues from the ratepayers than they need to recover the additional costs associated with the post-retirement-other-than-pensions accounting change.

GTEC's and Pacific Bell's request to discontinue their annual turnaround adjustments should be granted effective January 1, 1996. The utilities should close their respective interest-bearing memorandum accounts established by D.95-11-061 for their 1996 turnaround adjustments, and modified by D.96-11-006 and D.97-11-023 to include their 1997 and 1998 turnaround adjustments, respectively.

Section 311 Comments

The ALJ's proposed decision on this matter was filed with the Docket Office and served on all parties of record on July 14, 1998, pursuant to Section 311 of the PU Code. Comments and reply comments on the ALJ's proposed decision were due on August 3, 1998 and August 10, 1998, respectively.

GTEC, Pacific Bell, and the DRA timely filed comments and reply comments to the ALJ's proposed decision with the Docket Office. Copies of these comments and reply comments were also timely served on all parties of record.

AT&T also submitted comments on the ALJ's proposed decision. However, its comments was tendered with the Docket Office and mailed to all parties of record on August 4, 1998, one day late. Subsequently, on August 10, 1998, AT&T submitted a motion for leave to accept its late-filed comments on the ALJ's proposed decision. A copy of its comments to the ALJ's proposed decision was attached to its motion.

Rule 77.5 requires late-filed comments to ordinary be rejected. However, in extraordinary circumstances a motion for leave to file late may be filed if an accompanying declaration under penalty of perjury is submitted with the motion setting forth all the reasons for the late filing.

By its motion, AT&T explains that it had completed its comments on the ALJ's proposed decision early, on July 28, 1998. However, it tendered its comments for filing and mailed a copy of its comments to all interested parties one day late because AT&T erred in calculating the due date for filing comments and because its regular experienced staff that supervises the calendar and corresponding filing dates was on vacation. An accompanying declaration under penalty of perjury was not submitted as part of its motion to accept late-filed comments.

Comments to an ALJ's proposed decision is due within twenty days of date the proposed decision is mailed. Although AT&T apparently completed its comments early, AT&T chose to calculate and submit its comments on the last day it believed such comments could be filed. We do not believe that an error in calculating the due date for filing comments or the vacation of an employee constitutes an extraordinary circumstance for accepting late-filed comments. Further, AT&T failed to include a declaration under penalty of perjury as required by Rule 77.5. Absent a finding of extraordinary circumstance and a declaration under penalty of perjury, AT&T's motion to accept late-filed comments should be rejected. However, all other parties to this proceeding have acknowledged the receipt and review of AT&T's comments in their reply comments, and to the extent deemed necessary, responded to AT&T's comments in their reply comments. The grant of AT&T' motion will not prejudice any party's rights. Hence, AT&T's motion to accept late-filed comments is granted.

Rule 77.3 of the Commission' Rules of Practice and Procedure specifically requires Section 311 comments to focus on factual, legal, or technical errors in the Proposed Decision and in citing such errors requires the party to make specific references to the record. Comments which merely reargue positions taken in briefs accord no weight and are not to be filed. New factual information, untested by cross-examination, must not be included in comments and must not be relied on as the basis for assertions made in post publication comments. Rule 77.4 requires comments proposing specific changes to the Proposed Decision to include supporting findings of fact and conclusions of law.

We have carefully reviewed the comments filed by the parties to this proceeding that complied with Rule 77.3 and to the extent that such comments required discussion or changes to the Proposed Decision, the discussion or changes have been incorporated into the body of this order. Comments which have not complied with Rule 77.3 were not considered.

Findings of Fact

1. GTEC and Pacific Bell filed separate applications for authority to eliminate their Turnaround Adjustment effective January 1, 1995.

2. GTEC was authorized a $69 million and Pacific Bell a $136 million revenue-requirement increases in 1988 to recover capital-to-expense revenue requirement deficiencies.

3. GTEC and Pacific Bell were required to file turnaround adjustments annually until the utilities' next general rate filings.

4. The purpose of the turnaround adjustment was to enable ratepayers to benefit from the reduced revenue requirement impacts associated with the capital-to-expense accounting shift.

5. The traditional general rate case proceeding was replaced with NRF before the utilities filed their next general rate proceedings.

6. Rates based on reasonable changes in the utility's costs under the traditional method were replaced under NRF with adjustment to rates based on a price cap formula that includes inflationary and productivity factors as well as Z-factor adjustments.

7. The utilities continued with their annual turnaround adjustments as a Z-factor adjustment under NRF.

8. Annual turnaround adjustments were included in GTEC's and Pacific Bell's price cap filings for the years 1991 through 1994, in accordance with D.89-12-048.

9. GTEC and Pacific Bell were required to continue with their turnaround adjustment in 1995.

10. GTEC and Pacific Bell filed applications for rehearing of the requirement that they continue their turnaround adjustment in 1995.

11. The utilities' application for rehearing of their 1995 turnaround adjustment was denied on September 20, 1996.

12. The utilities' rate increases and subsequent turnaround adjustments were made permanent, and not subject to refund or adjustment as the result of any application for rehearing.

13. The utilities established turnaround adjustment memorandum accounts for their 1996, 1997 and 1998 turnaround adjustments pending a final order in this proceeding.

14. Pacific Bell utilized its EBA and RBA models to demonstrate benefits its ratepayers have received to date.

15. The use of a deferred account for capital-to-expense costs and benefits was considered and rejected by D.87-12-063.

16. The issue of tax normalization applicable to the capital-to-expense change was considered and rejected by D.87-12-063.

17. AT&T and DRA oppose the utilities' request for authority to discontinue their turnaround adjustments until the utilities provide significant additional benefits to their respective ratepayers.

18. The utilities were provided an opportunity, not a "guarantee," to recover their revenue requirement deficiencies associated with the capital-to-expense change.

19. The turnaround adjustments were adopted to balance the utilities' and ratepayers' interests from the capital-to-expense change.

20. D.88-09-030 provided for the annual turnaround adjustments to remain in existence until the utilities filed their next general rate case proceedings.

21. The utilities never filed their next general rate case proceeding because NRF made such filings obsolete.

22. The cumulative benefits and annual turnaround adjustments, received by GTEC and Pacific Bell by year-end 1995 were approximately $230 million and $457 million, respectively.

23. Ratepayers were to benefit from the capital-to-expense change in the long-term through lower recorded rate base and from the turnaround adjustment.

24. Lower recorded rate base results from both the amortization of indirect construction costs previously capitalized and from the avoidance of recording future indirect construction costs into rate base.

25. The expensing of indirect construction costs, instead of capitalizing such costs, results in the least revenue requirement cost to ratepayers.

26. The annual turnaround adjustments, on a cumulative basis through year-end 1995, have equaled the utilities' 1988 rate increases applicable to the capital-to-expense shift.

27. Neither AT&T nor DRA reflected any benefits that ratepayers have received from avoided ratebase in their models or analyses.

28. GTEC has made seven annual turnaround adjustments of $11.5 million each and has fully reversed the start-up revenue requirement granted to it.

29. GTEC's ratepayers benefited from discontinuance of the $69 million rate increase applicable to capital-to-expense revenue requirement deficiency, an unspecified amount of revenue requirement savings from avoided rate base, and from $48 million in contributions through shareable earnings in 1990, 1991, 1992, and 1993.

30. Pacific Bell's $156 million cumulative turnaround adjustments through year-end 1995 have more than fully reversed the $136 million start-up revenue requirement granted to Pacific Bell in 1988.

31. Pacific Bell's ratepayers benefited from discontinuance of the $136 million rate increase applicable to capital-to-expense revenue requirement deficiency, the additional and permanent $23 million revenue requirement reduction ordered in Resolution T-15695, and an unspecified amount of revenue requirement savings from avoided rate base.

32. There is no Commission order requiring or guaranteeing that ratepayers receive a specific amount of benefits from the capital-to-expense change.

33. The capital-to-expense change results in revenue requirement savings over the long-term.

34. AT&T tendered an August 10, 1998 motion for leave to accept late-filed comments on the ALJ's proposed decision.

Conclusions of Law

1. GTEC's and Pacific Bell's requests for recovery of their 1995 turnaround adjustments are moot.

2. The appropriate assessment of ratepayer benefits from the capital-to-expense change should be dependent on the cumulative amount of turnaround adjustments, and on whether the change has reduced rate base, considering both the actual amortization of embedded indirect construction costs and avoidance of capitalizing indirect construction costs, subsequent to adoption of the capital-to-expense change in 1988.

3. The benefit that ratepayers have received from the turnaround adjustment to date is consistent with D.87-12-063's recognition that ratepayers would benefit from revenue requirement savings approximately seven years after the capital-to-expense change was implemented.

4. The NRF balances the risks and rewards of shareholders in the interest of the ratepayers. In such a balance, it is unreasonable for one or the other group to unduly benefit from accounting shifts.

5. GTEC's and Pacific Bell's turnaround adjustments should be discontinued effective January 1, 1996.

6. GTEC's and Pacific Bell's 1996, 1997 and 1998 turnaround memorandum accounts should be closed.

7. The applications should be granted to the extent provided for in the following order.

8. The 1988 rate increases and subsequent yearly turnaround adjustments through year end 1995 cannot now be adjusted.

9. AT&T's motion for leave to accept late-filed comments on the ALJ's proposed decision should be granted.

FINAL ORDER

IT IS ORDERED that:

1. GTE California Incorporated's (GTEC) and Pacific Bell's Uniform System of Accounts turnaround adjustments shall be discontinued effective January 1, 1996.

2. GTEC's and Pacific Bell's 1996, 1997 and 1998 turnaround adjustment memorandum accounts shall be closed within 60 days after the effective date of this order.

3. Application (A.) 95-02-011 and A.95-05-018 are closed.

This order becomes effective 30 days from today.

Dated September 3, 1998, at San Francisco, California.

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