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Mailed 11/24/98

Decision 98-11-066 November 19, 1998

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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

OPINION

I. Background

This decision addresses the disposition of Pacific Bell's (Pacific) and GTE California Incorporated's (GTEC) requests for recovery of implementation costs for local competition which are being recorded in memorandum accounts on an ongoing basis. In connection with the transition to a competitive market, the two large incumbent local exchange carriers (ILECs) have incurred costs to implement required systems and processes to enable other carriers to interface with the ILECs' existing facilities. In Decision (D.) 96-03-020, we deferred consideration of the large ILECs' requests for immediate recovery of the costs of implementation of local competition, but authorized them to record such costs incurred since January 1, 1996, in memorandum accounts subject to later disposition and possible recovery. In conformance with that decision, the ILECs have each filed a report summarizing the implementation costs incurred for the calendar year 1996. We also authorized the mid-sized ILECs (Roseville Telephone Company and Citizens Telephone Company) to establish

memorandum accounts on a similar basis in D.97-09-115. We shall address the disposition of implementation costs for the mid-sized ILECs in a later decision.

On April 25, 1997, the Administrative Law Judge (ALJ) issued a ruling soliciting comments on whether the procedures instituted by the major ILECs to track and report their implementation costs were adequate for purposes of conducting a review of the reasonableness of those costs. Comments were filed on May 13, 1997, and replies on May 23, 1997.

In their filed comments, the parties representing competitive local carriers (CLCs) as well as the Commission's Office of Ratepayer Advocates (ORA) claimed that the reports filed by Pacific and GTEC regarding their implementation costs were inadequate to meet the needs of the Commission or of the parties in conducting a meaningful review. The California Telecommunications Coalition (Coalition)[1] further argued that even if the ILECs' cost reports were perfect, there was not enough competition in place at that time to analyze any requests for cost recovery.

In its October 1, 1997, comments filed in the Open Access and Network Architecture Development (OANAD) proceeding, GTEC raised the issue of whether the recovery of Operations Support Systems (OSS) implementation costs should be moved from the Local Competition proceeding to the OANAD docket (Rulemaking (R.) 93-04-003/Investigation 93-04-002). The Coalition's October 8, 1997 reply comments in OANAD opposed this suggestion, noting that "the

[1] The Coalition members joining in comments were AT&T Communications of California, Inc. (AT&T); California Association of Long Distance Telephone Companies; ICG Telecom Group, Inc.; MCI Telecommunications Corporation (MCI); Sprint Communications Company L.P.; Teleport Communications Group; the California Cable Television Association; Time Warner AxS of California, L.P.; and The Utility Reform Network (TURN).

Commission has made it clear that implementation costs should be considered in phase III of the local competition docket." (Coalition Reply Comments at 2.)

In a ruling dated October 27, 1997, the assigned ALJs in the OANAD docket stated that for the time being, the issue of recovering implementation costs would remain in the Local Competition docket. The ALJs concluded that the schedule for the OSS/Nonrecurring Charge (NRC)/Changeover phase of OANAD was already very compressed, and that adding the implementation cost recovery issue would make it impossible to set interim unbundled network element prices by early 1999, as intended. However, the ALJs agreed to confer with the assigned ALJ in the Local Competition docket further about whether to keep this issue in the Local Competition docket, or to consider it under the OANAD umbrella.

On December 31, 1997, an ALJ ruling was issued in this proceeding soliciting further comments concerning (1) the basis upon which implementation cost recovery could be justified and what sort of cost recovery mechanism may be appropriate, (2) any modifications to the ILECs' accounting and reporting of implementation costs necessary to permit adequate discovery to proceed, (3) the timing and coordination of any schedule for further Commission consideration of the recovery of implementation costs. Comments in response to the December 31, 1997, ruling were filed on February 20, 1998, with replies filed on March 6, 1998. The findings and conclusions set forth in this decision are based upon the comments which have been filed.

There are four broad issues in dispute regarding local competition implementation costs: (1) whether any special provision for ILEC cost recovery should be granted at all; (2) if so, what specific amount of costs should be subject to recovery; (3) what means should be used to accomplish the cost recovery; and (4) under what schedule should these issues be adjudicated, when should cost

recovery begin, and for how long should it continue? In this decision, we substantively address the first question, and provide procedural guidance regarding the disposition of the remaining questions.

II. Parties' Positions

Pacific claims that it is entitled to an authorization from this Commission to recover its implementation costs without further delay. Pacific proposes to include in its 1999 annual New Regulatory Framework (NRF) filing a provision to recover its 1996, 1997, and 1998 implementation costs. Pacific proposes to start recovery of these costs through a surcharge applied to exchange and toll services, but not to access. Beginning in 1999, Pacific would recover one-third of its 1996, 1997, and 1998 implementation costs.

As an attachment to its comments, Pacific has provided its "Cost Tracking Manual" which prescribes internal company procedures as to how implementation costs are identified and accounted for through tracking codes. Pacific states that an exhaustive independent audit of its implementation cost data performed by Coopers & Lybrand, an independent accounting firm, found that its cost report filed with the Commission fairly represented the amounts tracked in the memo account. Pacific denies that any of its implementation costs have been double-counted in the costs used to set prices in the OANAD proceeding. Pacific claims parties in those proceedings have already reviewed those costs, including an examination of whether there was any improper inclusion of implementation costs, and the Commission has already adopted Total Service Long-Run Incremental Cost and recurring Total Element Long-Run Incremental Cost studies for Pacific. Pacific states that because only forward-looking ongoing costs are quantified in OANAD, while only one-time costs are quantified as local competition implementation costs, there is no connection between OANAD costs and one-time implementation costs.

Pacific argues that it has adequately justified its costs, and objects to any further delays in recovery of its implementation costs. Pacific sees no need to wait until all processes and activities are completed before cost recovery can begin. Pacific expresses concern that the balances in the memo accounts continue to grow and represent an increasing liability to the ILECs the longer cost recovery is delayed.

A summary of Pacific's implementation costs for 1996 is set forth in Appendix A. For 1996, Pacific reports net expenditures of $46.6 million[2] for complying with Commission mandates to modify its processes and systems to implement local competition. While Pacific has not totaled the amount for 1997, Pacific estimates the amount to be greater than what was spent in 1996, resulting in total accumulated costs of approximately $100 million. Pacific argues that the Commission has consistently permitted incumbent utilities to recover costs they incur in furthering competition, and that it is unfair for the incumbent to absorb such costs that primarily benefit competitors and customers as a whole.

Pacific proposes that it be permitted to recover its implementation costs from its own end use customers through a three-year amortization of expenses through the New Regulatory Framework (NRF) proceeding. Under its proposal, Pacific would initiate recovery in its 1999 annual NRF filing by including an amortization surcharge sufficient to recover one-third of its accumulated implementation costs for 1996 through 1998. Pacific would apply the surcharge to exchange and toll services, but not to access.

Pacific does not believe evidentiary hearings are necessary as a basis for Commission authority to recover its implementation costs. Pacific proposes that

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[2] The $46.6 million reflects total implementation costs of $47.4 million less $0.8 million transfer priced to Nevada Bell.

the Commission limit any further proceedings on this issue, at most, to one more round of expedited comments, with a Commission decision determining the recovery amount by the Summer of 1998.

GTEC also believes that it is entitled to recover the costs it has incurred to implement local competition. For the year ended December 31, 1996, GTEC reported total expenses of $1,503,395 and capital expenditures of $349,515 for implementation of local competition. GTEC's 1996 implementation costs are summarized in Appendix B. Through June 30, 1997, GTEC had incurred nearly $4 million of local competition implementation costs attributable to California. While GTEC has not yet finished compiling the total 1997 costs, it believes that the total recorded California implementation costs for 1996 and 1997 could exceed $10 million. GTEC expects to continue to incur implementation costs throughout 1998, and likely beyond.

Contrary to Pacific, GTEC believes that comprehensive pricing hearings should be scheduled to address recovery of implementation costs, as well as for customer-specific prices for Unbundled Network Elements (UNEs) and nonrecurring ordering and provisioning activities. GTEC has offered to make its cost experts available to work with interested parties to explain the information contained in the reports and respond to questions. However, without direction from the Commission as to a specific schedule and procedure for analyzing this information, GTEC notes that little activity has occurred. GTEC believes that the Commission should issue a further procedural schedule and establish some kind of focused procedure such as workshops to permit parties to review and analyze the costs contained in GTEC's memorandum accounts.

GTEC believes that a certain amount of overlap may exist between the costs identified in the memorandum account and those which were used to develop GTEC's NRCs and, to a lesser extent, its monthly recurring costs (MRCs)

which are subject to recovery through the OANAD proceeding. For example, certain system development costs appear in both the memorandum account and the NRC study. In GTEC's memorandum account, these costs are reported on an as-incurred basis, while in the NRC study, these costs were projected on a forward-looking basis through 1999 and beyond.

GTEC is preparing a reconciliation of the costs between implementation costs in the memorandum account, and the OANAD-related nonrecurring and recurring costs, but the reconciliation was not yet complete when its comments were filed. GTEC recognizes that such reconciliation should be a part of any procedure for analysis of the costs recorded in the memorandum account. In order to make the results of such analysis meaningful and consistent with other ongoing Commission reviews of costs, GTEC proposes that final reconciliation and determination of recoverable implementation costs be scheduled only after final decisions are issued in the OSS/NRC cost phase of OANAD and in GTEC's recurring cost phase. Once the NRC and MRC costs are finalized, the remaining portion of implementation costs can be identified with a greater degree of certainty.

Contrary to Pacific, GTEC recommends the use of evidentiary hearings to address the issue of implementation cost recovery, noting that all other pricing decisions are currently set for hearing, and there is no legitimate reason to treat one component of cost recovery in a more abbreviated manner. GTEC recommends that a joint pricing phase be held which addresses MRCs, NRCs, and recovery of implementation costs. For GTEC, this would likely occur in the GTEC UNE pricing phase of OANAD. GTEC argues that this approach will permit coordinated Commission review which will allow for: (1) sequential determination of costs via the completion of the NRC and recurring cost dockets already underway, followed by determination of the remaining implementation

costs; and (2) concurrent determination of prices and cost recovery for all identified costs.

GTEC proposes that the precise mechanism for cost recovery should be addressed in pricing hearings in conjunction with setting UNE and NRC prices. GTEC claims, however, that competing carriers should bear the costs of activities undertaken by the ILECs to implement local competition. GTEC argues that it is the competing carriers which are the "cost causers" since the implementation activities enable competing carriers to enter the local exchange market. GTEC cites the Eighth Circuit Court decision in Iowa Utilities Board v. FCC, 120 F.3d 753, 810 (8th Cir. 1997), in support of its claim that competing carriers, as "cost causers," should more properly bear the costs of implementation activities undertaken for their benefit.

The Coalition and ORA filed comments addressing the general question of whether any implementation cost recovery should be granted, and if so, what substantive issues it believes must be resolved before the amount of any cost recovery could be determined. The Coalition and ORA oppose the ILECs' request for any special recovery of implementation costs. The Coalition claims the ILECs' implementation costs are merely costs of doing business in a new competitive environment, and are no different from the types of costs that their competitors must incur to get started in the local market. The Coalition also attached three appendices (A-C) to its comments, each of which was sponsored by different members of the Coalition addressing the question of what cost recovery mechanism would be appropriate in the event the Commission authorized recovery notwithstanding the Coalition's objections. Appendix A was sponsored jointly by AT&T and MCI. Appendix B was sponsored by TURN. Appendix C was sponsored by a group of facilities-based CLCs.

Members of the Coalition believe that it is premature at this time to adopt any cost recovery mechanism, assuming cost recovery is warranted at all. Nonetheless, in the event the Commission adopts a cost recovery mechanism over the objections of the Coalition, its individual members offer the following comments on what considerations should underlie such recovery.

MCI/AT&T believe that any recovery granted for implementation costs must be done in a competitively neutral manner to comply with the Act. Section 251(e)(2) of the Act mandates that number portability costs be borne by all telecommunications carriers in a competitively neutral manner. MCI/AT&T argue that these principles apply equally to the recovery of implementation costs, and that all carriers should share the collective implementation cost burden in proportion to their respective market positions.

TURN argues that implementation cost charges should not be levied on customer groups which have not tangibly benefited from local competition. Specifically, TURN questions whether residential and small business customers will benefit much, if at all, from local competition. TURN further believes that implementation costs should be borne by carriers, not by customer, arguing that the incumbents and competing carriers are the obvious beneficiaries of competitive changes. In the event, however, that carriers are permitted to recover such charges from the end use customers, TURN proposes that the ILECs not be allowed to pass through a disproportionate share of any such charges to any customer group to avoid the possibility that captive customers be charged with an unfair cost burden.

Separate comments were filed by certain facilities-based carriers (FBC)[3] regarding cost recovery principles. The FBC emphasizes their concern that the selection of a cost recovery mechanism is premature because the total amount of recoverable costs is still unknown. The FBC believes that the magnitude of costs found to be recoverable (or whether any costs should be recoverable) will have an important bearing on the selection of cost recovery mechanism. The FBC argues that it will be much less complicated if the Commission separately considers the question of how costs are to be recovered only after it has determined the amount subject to recovery.

Cox California Telecom, Inc. (Cox) states that, if implementation cost recovery is to be permitted, the ILECs should be required to apply for a Z-factor adjustment to recover such costs through the NRF mechanism. Cox disagrees with GTEC's proposal that competitive carriers bear the burden of implementation cost recovery. Cox denies that competitive carriers constitute the "cost causers" with respect to implementation costs. Cox argues that all end users of telecommunications services are beneficiaries of local competition, not just the competitive carriers.

The Coalition does not believe the ILECs are entitled to any special recovery of implementation costs because the ILECs actively solicited the legislative changes that have caused such costs to be incurred and are reaping significant financial benefits from the package of changes enacted by the Telecommunications Act (Act) that the Coalition claims will likely exceed the implementation costs. The Act provides the Regional Bell Operating Companies (RBOCs) the opportunity to enter the long distance market, but only after they

[3] FBC is represented by ICG Telecom Group, Inc., Teleport Communications Group, California Cable Television Association, Nextlink California LLC, and Time Warner AxS of California LP.

have taken specified actions prescribed in Section 271 to open the local markets to competition. GTEC is already able to take part in the long distance market because of the nullification of the restrictions in the GTEC Consent Decree. (Act, Section 601(a)(2).) Industry analysts estimate GTEC reached two million long distance customers by year end 1997.

In the event the Commission permits special recovery of implementation costs, the Coalition argues that complex, protracted evidentiary hearings will be necessary to ensure that the ILECs do not recover unreasonable levels of costs. The hearings would address issues such as: (1) double recovery of costs; (2) necessity for the expenditures; (3) reasonableness of the level of expenditure; (4) value of the work product of the expenditure; (5) whether the expenditure was intended to enhance the ILEC's competitive opportunities; (6) whether the expenditure fits the adopted definition of implementation cost; and (7) whether the expenditure produced offsetting benefits.

The Coalition argues that such hearings would be extremely time-consuming for all parties and the Commission, and would detract from more important work that the parties and the Commission need to do to promote the development of robust competition in the local market. The Coalition proposes postponement of any proceeding to examine the ILEC costs until both the OANAD pricing proceedings and the OSS performance standards rulemaking have been completed and the ILECs' satisfaction of the OSS performance standards can be assessed. The Coalition expresses concern that there is a serious risk of double recovery of costs related to wholesale services via both an implementation cost recovery mechanism and the recurring and nonrecurring ILEC charges to be established in the OANAD. The Coalition believes that in order to guard against such an outcome, no recovery of implementation costs should be considered until the setting of final OANAD rates.

The Coalition claims the ILECs' accounting procedures as reflected in the memorandum accounts do not provide sufficient information to facilitate a reasonable analysis, and fail to distinguish competitive implementation costs from the product-specific costs which the ILECs seek to recover through the prices set in the OANAD proceeding. The Coalition proposes certain measures that the Commission could order, but believes that even with these measures, detecting double recovery would be an extremely difficult and time-consuming task, rivaling or even surpassing the OANAD cost study analysis in terms of complexity and drain on resources.

The Coalition notes that the compliance filings of Pacific and GTEC appear to be project-based rather than Uniform System of Accounts (USOA) account-based.[4] The Coalition argues that the lack of USOA account identifiers frustrates any attempt even to begin the test for double counting.

As a starting point for examining implementation costs, the Coalition proposes that the ILECs, at a minimum, should categorize their reported costs of competition by the USOA accounts to which each company actually booked the reported implementation costs to enable an analyst to determine whether the USOA account for a claimed implementation cost was also included in an OANAD cost study.

In addition to USOA identification as a starting point for screening out double recovery, the Coalition argues that more detailed cross-referencing, on an activity-by-activity basis, is ultimately necessary. In order to provide adequate

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[4] The Coalition notes that the possibility of double recovery is not only an issue with respect to OANAD costs. In interconnection agreements with some CLCs, there are activities for which the CLCs are already required to directly compensate the ILECs that the Coalition believes may fall within the cost categories described in the implementation cost reports.

information to scrutinize the ILEC cost claims, the Coalition argues, the ILEC cost reports would need to be much more detailed than the previously filed reports, cross-referenced to the specific activities for which costs have been identified in OANAD.

III. Discussion

A. Definition of Implementation Costs

In order to address the question of how any ILEC implementation costs should be treated, we must first define such costs. In establishing the memorandum account procedure in D.96-03-020, we generally defined implementation costs to include those costs which are not recovered through prices charged to CLCs for specific services, but which are incurred "to implement the infrastructure for local exchange competition." The general characteristic of an "implementation cost" is that it relates to development of processes and functions which are not linked to a particular carrier or transaction, but which relates to the underlying competitive infrastructure developed for the use of carriers generally.

We agree with the definition of implementation costs used by Pacific in its "Cost Tracking Manual" in which "demand-driven" costs (i.e., those recurring and nonrecurring costs related to the demand of a particular CLC for a specific process or function recovered through OANAD-determined prices) are excluded from the memorandum account. Pacific's Cost Tracking Manual defines "implementation costs" as:

> those one-time costs which Pacific Bell incurs specifically to implement CPUC and FCC local competition orders. These are expenses that Pacific Bell would not incur in its normal course of operations. Implementation costs include the costs of purchasing, creating, or modifying network and system capabilities, and product offerings to comply with CPUC and FCC local competition orders; developing or revising

> processes, methods and procedures needed to support the orders; training personnel in the use of the new capabilities, processes, methods, and procedures; and educating employees and customers about the impacts of local competition. As a rule, implementation costs are expenses rather than capital items.

For purposes of our definition of local competition "implementation costs," we will exclude costs for implementation activities which are common to all carriers. All telecommunications carriers incur certain costs as part of the process of competing in the local exchange market. Such costs which are common to all carriers reflect the cost of labor and facilities required for each carrier to construct its own facilities and implement internal processes to serve its customers in a manner to maximize its competitiveness and ability to acquire new customers. Our previous policy has been to require each carrier to bear its own costs related to competitive activities which are common to all carriers. For example, we applied this policy in denying the request of Pacific to recover NXX code opening costs. This approach is consistent with a competitive market in which both ILECs as well as CLCs generally recover their costs through revenues earned by marketing of their services to customers.

We shall define "implementation costs" as those expenses incurred in response to a regulatory order implementing the infrastructure to enable CLCs to compete with the ILEC. The essential characteristic of such costs is that they are not intended to enable the ILEC to compete in the local exchange market, but are for the general benefit of competing carriers. These sorts of costs are different than costs incurred by the CLCs. The ILEC must incur these costs for the benefit of the CLC by virtue of the ILEC's control over essential bottleneck facilities and related processes. The implementation measures associated with such expenses are nonrecurring and necessary to transition to a competitive environment, but are an artifact of a previously monopolistic environment in which the

infrastructure for competition did not exist. Such costs are unique to this transitional period and cannot be dismissed as just another ongoing aspect of doing business by carriers in general.

Defining implementation costs in this manner is also generally consistent with our criteria for cost recovery adopted in D.98-10-026 in which we modified certain elements of NRF regulation for Pacific and GTEC. While we eliminated prospective recovery of Z-factor adjustments, we still allowed continuation of a streamlined process for the ILECs' requests in prescribed narrow areas. One such area included costs related to matters mandated by this Commission. To distinguish this process from the Z-factor mechanism, we designated it as the LE (limited exogenous) factor mechanism.

We stated that we would limit rate changes for Commission-mandated cost changes (either increases or decreases) to only those costs for which an LE factor adjustment is authorized in the underlying Commission decision. Moreover, in considering whether the cost will be allowed, we stated that we would consider whether the cost is unique to Pacific and/or GTEC, or is a cost generally borne uniformly by all industry carriers. We conclude that the implementation costs incurred by the ILECs are based upon such a Commission-ordered program, and may also be fundamentally different than the implementation costs incurred by other carriers in that only the ILECs are incurring costs to enable competition in their own previously protected market franchise.

Pacific has excluded capitalized costs from its memorandum account while GTEC has included them. Hence, we shall require GTEC to provide further justification as to why capitalized items should be treated as implementation costs.

Our definition of implementation costs is clear enough to provide a general basis for identifying appropriate costs to record in the memorandum account. To the extent any ILEC costs have been sought for recovery in the OANAD or OSS proceedings which fit the definition of implementation costs, as described above, such costs should be removed from the OANAD or OSS proceedings. To the extent such costs were not previously booked into the memorandum account, they may be transferred into the account for potential recovery as implementation costs. Any implementation costs recovered through compensation provided in interconnection agreements should be excluded from the memorandum accounts. Where parties disagree over whether a particular cost meets the definitional criteria we have established, the dispute will need to be resolved on a case-by-case basis. In some cases, apparent disputes over definition may simply be a question of whether prescribed accounting procedures are being properly followed. For example, Pacific does not dispute the Coalition's claim that certain training costs do not qualify for recovery as implementation costs. Pacific merely argues that its accounting system has already excluded the portion of the costs which do not relate to local competition implementation from the memorandum accounts.

B. Rationale for Cost Recovery

No party denies that some level of implementation costs must be incurred in order for the public to derive benefit from the opening of the local exchange market to competition. Those costs must therefore be paid by someone. The question is what is the most equitable, competitively neutral, and economically efficient means of assigning responsibility for payment of such costs.

Parties representing CLCs, as well as ORA, have argued that implementation cost recovery should be denied because the ILECs will be

adequately compensated on a quid-pro-quo basis for such costs by the profit opportunities realized from entry into the long distance market. Yet, we find no basis to deny any recovery of implementation costs by applying profits which may be realized from entry into the long distance market to offset local competition implementation costs. Section 271 of the Act does require Pacific to satisfy a prescribed checklist indicating that local competition has been implemented as a condition of their entry into the in-region interLATA (Local Access and Transport Area) market. Pacific thus is given a financial incentive to cooperate in the implementation of local competition to the extent its entry into the interLATA market depends on meeting the Section 271 checklist. There is nothing in the Act, however, that states or implies that, as a condition of the ILECs' entry into the interLATA market, they are to be denied recovery of costs incurred to implement the infrastructure of local competition.

Similarly, we concluded in D.97-04-083 that the ILECs' profits from entering the interexchange market should not be used to offset implementation costs in connection with intraLATA presubscription. In the case of local competition implementation costs, a similar principle applies.

In the franchise impacts phase of this proceeding, we also addressed the issue of whether the ILECs' potential profits from nonregulated operations, (e.g., entering the long distance market) should be applied as an offset in considering the ILECs' potential losses from the initiation of local exchange competition. In D.96-09-089, we concluded that, in analyzing the total effects on ILEC earnings resulting from local competition, only those earnings obtained from "regulated assets" should be considered, but not from of out-of-service-territory earnings. (D.96-09-089 at 34-35.)

Moreover, even to the extent the ILECs benefit through entry into the interLATA market, the record has not been developed as to what net effect in

profits the ILECs will ultimately realize from such opportunities, or whether changes in net profits would exceed the local competition implementation costs the ILECs incur for the benefit of CLCs. On the one hand, the ILECs risk losing existing local exchange customers to competitors, but they also have opportunities to enter new markets, particularly the interLATA market, and to earn additional profits. We have no basis to quantify how such profit opportunities could offset otherwise recoverable implementation costs.

In any event, we concluded in D.96-09-089 that the ILECs may not seek to be made whole for any competitive losses which may result from the advent of local exchange competition (Decision at 61), but must bear the risk of such losses. Consistent with this principle, the ILECs should likewise not be deprived of competitive gains that may be realized from entry into the long distance or other markets. The question of implementation cost recovery should be evaluated independently of the ILECs' competitive gains or losses in various markets. Therefore, in accord with our past policies on this issue, we find no basis to dispose of the ILECs' cost recovery requests by applying potential earnings from unregulated services as an offset to implementation costs.

Although the Act does not explicitly address the recovery of local competition implementation costs, it does require that the ILECs be compensated for the CLCs' interconnection to ILEC facilities and equipment, and for the unbundling of network elements. We find it incongruent that ILECs would be compensated for the discrete transactions costs associated with interconnection, yet denied any recovery of the costs to create the underlying infrastructure that makes such interconnection possible. It is consistent with the intent of the Act for some recovery provision to be authorized for implementation costs

Moreover, in similar past instances, our policy has been to allow a provision for recovery of at least some implementation costs associated with

opening a new market to competition. D.97-04-083 noted that the FCC's Second Report and Order suggested that ILECs like Pacific and GTEC were entitled to recover the incremental costs of implementing intraLATA dialing parity. We concluded in that decision that it was equitable to establish a mechanism for the recovery of ILEC implementation costs associated with establishing intraLATA equal access—the ability to place local toll calls through another telephone carrier without having to dial additional numbers. We stated in that decision:

> In providing intraLATA equal access, a local exchange carrier will incur expenses that directly benefit its competitors in the intraLATA toll market. If the costs were recovered just from the originating intraLATA toll and switched access minutes of use, the local exchange carriers, as the incumbent intraLATA toll providers would bear a disproportionate share of the costs. (Decision at 24.)

We find that local competition implementation costs are similar in character in that they are incurred by the ILECs for the direct benefit of competitors, and that similar principles justifying a provision for cost recovery apply. If all cost recovery were denied, the ILECs would be left with funding the cost of implementing local competition while the benefits of that implementation would be enjoyed by their competitors. This outcome would be in conflict with D.97-04-083 where we declined to disproportionately impose the full cost burden of implementation costs on the ILECs.

We conclude that it is consistent both with our own past policies as well as with the cost recovery principles embodied in the Act to consider a provision for recovery of the ILECs' reasonably incurred implementation costs.

C. Amount and Timing, and Method of Cost Recovery

Although we agree, in principle, that there should be some opportunity for recovery of the ILECs' reasonably incurred implementation costs, the question remains as to whether the specific costs for which the ILECs seek

recovery have been adequately justified and when cost recovery should begin. Various parties enumerated issues that they believe should be litigated before any cost recovery is authorized. We agree that before a final determination is made of the total amounts which the ILECs can recover, these outstanding disputes must be resolved.

Before a final determination of the proper level of cost recovery, we must find that the costs reflect finished work products that have been prudently and effectively implemented. We find the Coalition's proposal, however, unduly restrictive that *no* cost recovery can begin for *any* program until *all* work is completed for *all* implementation programs. It is unclear as to how much more time may be required before all costs have been incurred for all implementation programs. The accumulated balance of implementation costs could grow very large while waiting for the final dollar from the last program to be spent. It would not be in the best interests of customers to subject them to the potential liability of such a huge buildup of costs which could tend to distort competitive market prices.

On the other extreme, we find Pacific's proposal that it should simply be authorized to recover its implementation costs, without further showing that the costs are reasonable, to be unjustified. The contested issues raised relating to the propriety of the ILECs' costs must be satisfactorily resolved before a final determination of cost recovery can be made. We shall therefore institute a procedural plan below to review those costs for specific implementation programs for which work products have been completed.

We also find no basis to directly link the timing of recovery of implementation costs with some predetermined level of competition. No practical way has been offered to employ such a mechanism which would quantify the recovery of specific cost levels calibrated to some yet-to-be-defined

measure of competition. As noted previously, the longer that implementation cost recovery is delayed, the greater the build up of costs in the memorandum accounts and the greater the financial liability of the ILECs and potential for end-user price distortions once the final recovery allowance is ultimately determined. As an interim measure, we therefore conclude that some allowance for implementation cost recovery is warranted to mitigate the potential distortion in prices resulting from continued accumulation of implementation costs over multiple years in the ILEC memo accounts. Since we have not yet determined the reasonableness of the amounts which should be permitted for recovery, we shall authorize interim recovery, subject to refund.

We disagree with those parties which claim that it is premature to adopt a cost recovery mechanism at this time. Parties have been given ample opportunity to comment on the manner in which implementation cost recovery should be accomplished. We believe the record is adequate to determine a mechanism at least for interim cost recovery to proceed.

We reject the proposal that the ILECs be permitted to charge each CLC for the costs of implementation. Such an approach would place a disproportionate burden on the CLCs and their limited customer base while relieving the ILEC and its customers from any sharing of such costs. Similarly, a "Limited Exogenous" factor adjustment applicable exclusively to the ILECs' customers would place the burden disproportionately on those customers. We believe that a more equitable approach is for the cost to be recovered through a end user surcharge to be applied to all customers irrespective of which carrier provides them service. This approach equitably spreads the cost burden among all customers in a competitively neutral manner. We shall thus authorize a cost recovery allowance in the form of a uniform surcharge on uniform cents per line basis to each carrier's end use customers.

Pacific has asked to begin recovering one-third of the accumulated costs from 1996 through 1998 in its 1999 NRF filing. Pacific has not yet filed cost reports for 1997 or 1998. Therefore, it is premature to authorize interim cost recovery for amounts incurred beyond 1996 at this time. However, we find that amortizing one-third of the proposed amount on an interim basis does not sufficiently cure the problem of accumulated implementation costs. Hence, we shall authorize that an end user surcharge to amortize 75% of the 1996 year-end balance in the memo account of Pacific and GTEC to become effective for service rendered on and after January 1, 1999. For purposes of computing the surcharge, we shall use the data on end-user lines in effect as of December 31, 1997 which we have previously collected pursuant to D.98-04-066 for purposes of computing an INP end user surcharge.

The resulting surcharges are adopted as derived below:

Calculation of implementation cost surcharge

	Pacific	GTEC
Total Active Lines (12/31/97)	18,244,078	4,455.059
1996 Implementation Expenses	$46,600,000.00	$1,503,395.00
3/4 of 1996 Costs	34,950,000.00	1,127,546.00
Annual Charge per line	$ 1.92	$ 0.25
Monthly Charge per line	$ 0.16	$ 0.02

We shall authorize that the above surcharges be instituted on an interim basis, subject to later true-up, once the final amount of recoverable costs has been determined. We shall direct that all carriers institute this charge for service rendered on and after January 1, 1999. Those CLCs whose end use customers are in the Pacific service territory shall bill their customers at the Pacific end use rate. Likewise, those CLC end use customers within the GTEC service territory shall be billed at the GTEC rate. Each carrier other than the ILECs shall forward the proceeds from the surcharge collected from their end use

customers to Pacific or GTEC, respectively, on a monthly basis. Since the vast majority of end use customers are served by Pacific and GTEC, most of the implementation costs will be recovered through charges to Pacific's and GTEC's own customers. Other carriers will share in the cost only in proportion to their share of total customer lines. Pacific and GTEC shall keep track of all revenues received under the interim surcharge so that a later true up can be made once the final amounts to be recovered have been determined.

This approach to cost recovery is consistent with D.96-03-020 in which we first authorized the accrual of implementation costs in memorandum accounts. In that decision, we found that "(I)t would be a disproportionate burden on the LECs and their customers if there was no means for implementation costs to be shared among other competitive local carriers." (FOF 57). In D.96-03-020, we also concluded that since the general body of telephone customers as a whole benefits from the implementation of competition, it is not unreasonable that end-users be charged for such costs.

Although we provide for the interim recovery of implementation costs to proceed, we shall also establish a procedural plan for parties to challenge the reasonableness of specific cost amounts which the ILECs seek to recover. Any costs ultimately found to be unreasonable will be disallowed in determining the amount of final cost recovery. We shall not wait for 12 months beyond the conclusion of the UNE and NRC phase of OANAD, as proposed by the Coalition and ORA, before beginning the process of addressing cost recovery issues.

Parties have challenged the recovery of implementation costs on a number of grounds. For example, some parties claim that costs should be disallowed on the basis that certain implementation systems or processes produced by the ILECs were defective and failed to produce the intended results. The Coopers & Lybrand report renders no opinion regarding the performance

standards that were applicable to the work products that are the subject of Pacific's implementation costs, and whether the work products were completed in a satisfactory manner. Even if the ILEC has completed a given program, questions may exist as to whether it could be defective or fail to work as it was intended. We shall expect an augmented direct showing from the ILECs explaining, for each claimed category of expenditure, whether the resulting project was successfully completed and performed as intended.

Pacific states that all implementation costs incurred for 1996 represent activities which have already been completed. Pacific has submitted a report summarizing implementation costs incurred for 1996, but has not yet disclosed the amount of costs spent during 1997, or what portion of those costs represent completed versus ongoing activities. GTEC has filed a report of incurred costs for 1996 and a subsequent report for costs incurred only through June 30, 1997.

Before consideration of cost recovery of amounts spent subsequent to December 1996, Pacific and GTEC shall be required to provide an updated report of implementation costs incurred through December 1997, and to separately identify the costs for those programs which have been successfully completed. Costs for unfinished programs shall not be addressed at this time, but shall continue to be deferred for potential consideration of future recovery pending completion of the work products and subsequent review of the costs. Consideration of cost recovery for 1997 costs shall be limited to those programs which have been completed. This is the same criterion for recovery we adopted for implementation cost recovery for intraLATA presubscription. The ALJ shall issue a procedural ruling to deal with these issues.

Another of the disputed issues relates to the quality of documentation controls underlying the recorded costs. We recognize that there

are differences in the quality of cost accounting and reporting documentation of implementation costs between Pacific and GTEC. Pacific's Local Competition Cost Tracking Manual sets forth in some detail the methods and criteria by which Pacific has accounted for its costs. Yet, even in the case of Pacific's reported costs, there remain disputed factual issues as to the propriety of such costs. Pacific has provided the report of Coopers & Lybrand, a major accounting firm, attesting that the cost schedule as of year-end 1996 "presents fairly, in all material respects, the implementation costs accumulated in the local competition tracking codes for the year ended December 31, 1996, on the basis of presentation described in Note 1" of Pacific's Cost Schedule. The accountant's report provides no opinion, however, regarding whether the implementation costs were prudently incurred under the Commission's criteria. The report is limited in scope to the schedule of implementation costs and does not address whether any implementation costs may also have been included in costs being recovered through prices being set in the OANAD proceeding. Likewise, the report does not disclose whether any of the implementation activities provided benefits to Pacific. Thus, while the accountant's opinion helps to support the reasonableness of Pacific's costs in certain respects, it does not eliminate all factual disputes raised by parties.

We are mindful of the concerns raised regarding the possibility of double recovery of costs, once through the implementation cost memorandum account and again in the currently pending pricing phase of OANAD. Pacific claims its accounting system incorporates controls designed to avoid double counting of implementation costs. Parties dispute Pacific's claim. GTEC concedes there may be the potential for double counting in its tracking of implementation costs. Further scrutiny of both Pacific's and GTEC's costs will be necessary to confirm whether any misclassification or double counting of costs has occurred. Even if the Coalition's proposal to deny recovery of all

implementation costs were granted, it would not avoid the necessity to scrutinize the costs being sought for recovery in the UNE phase of the OANAD proceeding to ascertain that implementation costs were properly excluded. Even if all implementation costs were disallowed, and double recovery was not a problem, there would still be the risk of *over recovery* to the extent that implementation costs were erroneously included in prices set in the UNE phase of OANAD. Thus, the time and resources needed to check for double counting of implementation costs would have to be performed in OANAD in any case. Appropriate coordination with the OANAD and Local Competition proceedings will help prevent the possibility of double recovery.

We shall require a true up of any interim recovery of implementation costs for Pacific or GTEC once the costs being established in the OSS/NRC and UNE phases of the OANAD proceedings have been finalized and disputes over double counting and other cost recovery disputes have been resolved. In this way, we can guard against the likelihood of implementation costs being erroneously included in the costs adopted in the UNE and OSS/NRC dockets. Once costs in the OSS/NRC and UNE phases of the OANAD docket are adopted for Pacific, parties will be given an additional 30 days to file comments in this docket seeking to challenge specific cases of double counting of implementation costs in the costs established in the OSS/NRC phase of the OANAD proceeding and to raise any challenges to the reasonableness of specific implementation costs. Pacific will be given 30 days to respond. Pacific's response will include appropriate documentation and mapping that demonstrates whether and how double counting has occurred or been cured. Since UNE costs have not yet been finalized for GTEC, a separate schedule will be set to deal with challenges to the reasonableness of GTEC's implementation

costs at a later date. A separate ALJ ruling shall define the schedule for GTEC's true up.

We will not entertain motions that seek to relitigate instances of double counting that have been disposed of in the appropriate UNE and OSS/NRC phase of the OANAD docket. We are well aware of the arguments of double recovery of implementation costs in the current OSS/NRC phase of the OANAD docket. We will allow the OSS/NRC docket to resolve those instances or remove implementation costs, as allowed by this order.

Given the contested facts raised by the parties, we conclude that evidentiary hearings may be warranted to determine the appropriate level of final implementation costs subject to recovery. However, we also believe that at least some of the disputes identified in parties' comments may be the result of lack of clear communication regarding how implementation costs are identified, defined, accounted for, and segregated from other costs. Thus, following receipt of parties' filed comments regarding disputed cost as noted above, we shall schedule a preliminary technical workshop to address questions relating to implementation cost accounting methods to enable parties to adequately review the cost. The ILECs' designated subject matter experts should attend the workshop to address questions concerning the cost reporting issues raised in parties' comments. Such workshops should focus on narrowing the scope of disputed issues to be addressed in evidentiary hearings.

For example, one issue which may be amenable to resolution in workshops is whether costs must be translated into USOA categories to permit adequate review, and to detect whether double counting has occurred. We are not convinced that translation of costs into USOA categories is useful to detect whether double counting of costs has occurred. For example, since Pacific's OANAD cost studies were not based on the USOA, but used separate work

group analyses, it is unclear how USOA translation of the memorandum account costs will assist in determining whether any double counting has occurred. The more relevant cost analysis involves a breakdown of the individual cost activities codes and functions performed with a comparison between OANAD and the memorandum accounts. Before ordering any translation of implementation costs into USOA categories, we shall direct the parties first to focus on the cost reporting methodology which was actually used to develop OANAD costs as a basis for testing for double counting. In the workshops, Pacific and GTEC should provide a representative who can explain in detail how the cost accounting system can be used to cross reference and compare the manner in which costs were identified for OANAD purposes as opposed to booking into the memorandum account. Pacific's and GTEC's representative should also be prepared to explain and clarify what internal accounting controls are in place to guard against double counting. The reconciliation report being prepared by GTEC may also be of some use in detecting any double-counting problems.

We shall direct the ALJ to issue a ruling setting the schedule and agenda for the workshop. The ILECs should make sure that the appropriate subject matter experts attend the workshop to ensure the most productive exchange of information.

Following conclusion of the workshop, a prehearing conference (PHC) shall be scheduled to address the scope, timing, and coordination of issues related to evidentiary hearings on implementation costs consistent with the principles adopted in this order. The PHC shall address the scheduling of further discovery, testimony, and evidentiary hearings required to address the recovery of Pacific's and GTEC's implementation costs.

At this point, we have only considered a procedural schedule for hearings on implementation costs incurred during 1996. It is premature to

address recovery of implementation costs incurred during 1997 until the ILECs have submitted cost reports for year-end 1997. We shall further address the schedule for potential recovery of implementation costs incurred during 1997 and subsequent years once the ILECs have filed reports updating the actual amounts spent in 1997, and any subsequent years as data become available. The ALJ shall set a schedule for production of those filings.

Findings of Fact

1. Implementation costs must be incurred by the ILECs in order for competitive local carriers to interconnect and utilize bottleneck network elements controlled by the ILEC to in turn allow for the development of a competitive local exchange market.

2. In D.96-03-020, each of the ILECs was authorized to record implementation costs in a memorandum account pending further proceedings to consider the disposition of such costs.

3. Implementation costs subject to the memorandum account are limited to those one-time costs which are incurred to implement the infrastructure for local exchange competition to enable CLCs to compete.

4. Implementation costs subject to the memorandum account are not tied to any specific demand-driven transaction with a CLC, and are not recoverable through prices charged to competing carriers for specific services and network elements which are subject to recovery through OANAD or OSS proceedings or separate interconnection agreements.

5. Policy disputes exist concerning whether any special provision for ILEC cost recovery should be granted at all, and if so, what means should be used to accomplish the cost recovery .

6. Factual disputes exist as to whether the specific ILEC implementation costs were prudently incurred and properly accounted for.

7. Previous Commission policy has been to not allow special recovery of ongoing costs related to competitive activities which are common to all carriers, such as costs for promoting and developing one's own business.

8. Past policy has been to allow a provision for recovery of one-time implementation costs incurred by the ILECs for the benefit of their competitors associated with opening a new market to competition, as, for example, in the case of intraLATA presubscription as authorized in D.97-04-083.

9. The ILECs' request for recovery of implementation costs cannot be disposed of by applying profits realized from entry into the long distance market to offset the local competition implementation costs.

10. Section 271 of the Act requires that Pacific satisfy a prescribed checklist that local competition has been implemented as a condition of its entry into the in-region interLATA market.

11. Nothing in the Act states or implies that as a condition of entry into the interLATA market, the ILECs are to be denied recovery of costs incurred to implement the infrastructure of local competition.

12. Although the Act does not explicitly address the recovery of local competition implementation costs, it does require that the ILECs be compensated for the CLCs' interconnection to ILEC facilities and equipment, and for the unbundling of network elements.

13. D.96-09-089 determined that in analyzing the total effects on ILEC earnings resulting from local competition, only those earnings obtained from "regulated assets" should be considered, but not from of out-of-service-territory earnings.

14. It would not be consistent with past Commission policy to dispose of the ILECs' cost recovery requests by applying potential earnings from unregulated services as an offset to implementation costs.

15. To the extent the ILECs benefit through entry into the interLATA market, it is uncertain as to how any net profit increases would compare with the local competition implementation costs.

16. Significantly more problems have been identified with the reliability of GTEC's cost reporting in comparison with that of Pacific's, including potential cases of double counting of costs for recovery in separate Commission proceedings.

17. Pacific's "Local Competition Cost Tracking Manual" sets forth the methods and criteria by which Pacific has accounted for its costs.

18. Coopers & Lybrand, a major accounting firm, attested that Pacific's cost schedule presents fairly, in all material respects, the implementation costs accumulated in the local competition tracking codes for the year ended December 31, 1996.

19. The Coopers & Lybrand report provides no opinion, however, regarding whether the implementation costs were prudently incurred and justified cost reimbursement under the Commission's criteria.

20. The Coopers & Lybrand report lends support to the reasonableness of Pacific's costs, but does not eliminate the factual disputes raised by parties.

21. All implementation costs incurred for 1996 represent activities which, Pacific reports, have already been completed.

22. Pacific and GTEC each filed a report summarizing implementation costs incurred for the 12 months ended December 31, 1996 .

23. While Pacific's accounting system incorporates measures designed to guard against double counting of implementation costs, parties still dispute Pacific's claim that no double counting has occurred.

24. Further scrutiny of both Pacific's and GTEC's costs is needed to confirm whether any misclassification or double counting of costs has occurred in coordination with the UNE and OSS/NRC phases of the OANAD proceeding.

25. The checking for double counting of implementation costs would have to be performed even if cost recovery was denied in order to guard against the risk of over recovery to the extent that implementation costs had been erroneously included in prices set in OANAD.

26. Certain implementation costs relate to OSS elements for which the Commission has yet to adopt performance measures.

27. No convincing argument has been made that translation of costs into USOA categories will help to detect double counting of costs since the OANAD cost studies were not based on the USOA, but used separate work group analyses.

28. Authorizing interim cost recovery for implementation costs, subject to a later true up, mitigates the excessive build up of balances in the memo accounts while preserving the opportunity to determine the reasonableness of the amounts which the ILECs seek to recover.

29. For purposes of computing an interim surcharge employing the data on end-user lines in effect as of December 31, 1997 previously collected pursuant to D.98-04-066, the calculation is shown below is reasonable on a per-line basis.

	Service Territory	
	Pacific	GTEC
Total Active Lines (12/31/97)	18,244,078	4,455.059
1996 Implementation Expenses	$ 46,600,000.00	$1,503,395.00
3/4 of 1996 Costs	34,950,000.00	1,127,546.00
Annual Charge per line	$ 1.92	$ 0.25
Monthly Charge per line	$ 0.16	$ 0.02

Conclusions of Law

1. It is consistent with the cost recovery principles embodied in the Act and past Commission policy to allow for recovery of the ILECs' reasonably incurred implementation costs.

2. It is premature to authorize any specific cost recovery allowance for implementation costs at this time in light of the disputed issues which are outstanding over the reasonableness of the recorded costs.

3. It would be unduly restrictive to prohibit any cost recovery to begin for *any* program until *all* work is completed for *all* implementation programs.

4. It would not be in the best interests of a competitive market for the potential liability for implementation costs to grow indefinitely, resulting in an inordinately large surcharge which could tend to distort market prices.

5. Pacific's proposal seeking authority immediately to begin recovering its implementation costs has not been fully justified.

6. Proceedings for the recovery of costs should be scheduled, but should only cover specific implementation programs for which work products have been completed.

7. Recovery of "implementation costs" should exclude costs for activities which are common to all carriers incurred to implement the carrier's own facilities, and internal processes in order to serve its own customers and to maximize its competitiveness.

8. Costs for unfinished programs should not be addressed at this time , but should continue to be deferred for potential future recovery pending completion of the work products and subsequent reporting and review of the final costs.

9. It would be premature to approve final recovery of costs for a particular implementation activity prior to satisfactory completion of the activity.

10. Allegations that certain systems or processes produced by the ILECs were defective or failed to produce the intended results must be adequately scrutinized before approving final recovery of implementation costs for such work products.

11. Even if a given work product is completed, if it is defective or fails to work as it was intended, then cost recovery would not be appropriate for such a program. Nonetheless, there is no basis to link the timing of recovery of implementation costs with some predetermined level of local competition.

12. There is no justification to wait 12 months beyond the conclusion of the pricing phase of OANAD before beginning the process of addressing implementation cost recovery issues.

13. An interim allowance for implementation cost recovery is warranted to mitigate the potential distortion in prices resulting from continued accumulation of implementation costs over multiple years.

14. If the ILECs were permitted to charge each CLC for the costs of implementation, it would place a disproportionate burden on the CLCs and their limited customer base while relieving the ILECs and their customers from any sharing of such costs.

15. The ILECs' customers should not bear all the implementation costs by paying for an LE factor adjustment.

16. An equitable approach is for implementation costs to be recovered through a end-user surcharge to be applied to all customer lines irrespective of which carrier provides them service.

17. The data previously collected pursuant to D.98-04-066 from carriers regarding active end user lines as of December 31, 1997, within the Pacific and GTEC service territories forms a reasonable basis for deriving an end user surcharge for interim implementation cost recovery.

18. Before consideration of cost recovery of amounts spent subsequent to December 1996, Pacific and GTEC should provide an updated report of implementation costs incurred through December 1997, separately identifying the costs for programs which have been successfully completed.

19. Adoption of costs should be concluded in the UNE and OSS/NRC proceedings before final approval of implementation cost recovery is initiated to avoid the possibility of double recovery, once through the amortization of the implementation cost memorandum account and again through the pricing phase of the UNE or OSS/NRC proceedings.

20. The relevant cost data for analyses of potential double counting is a breakdown of individual cost activity codes and functions performed with a comparison between OANAD and the memorandum accounts.

21. Given the contested facts raised by the parties, evidentiary hearings may be warranted as a basis to determine the appropriate level of implementation costs subject to final recovery.

O R D E R

IT IS ORDERED that:

1. Effective January 1, 1999, Pacific Bell (Pacific), GTE California Incorporated (GTEC), and all other competitive local carriers serving customers within the Pacific and GTEC service territories are hereby ordered to amend their retail tariffs to impose an end-user surcharge as presented below to amortize one-third of the accumulated balance in the implementation cost memo accounts as of December 31, 1996.

2. The applicable surcharge shall be applied uniformly to each active end-user line in the following amounts on a monthly basis.

	For customers served in Pacific's territory	For customers served in GTEC's territory
Monthly Surcharge Per Line	$0.16	$0.02

3. Each Competitive Local Carrier shall remit on a monthly basis the surcharge revenues collected to Pacific or GTEC, respectively.

4. Pacific and GTEC shall credit their respective memo accounts for any revenues received pursuant to the implementation cost surcharge subject to later true up.

5. The assigned Administrative Law Judge (ALJ) is directed to establish a further procedural schedule to address issues relating to the recovery of implementation costs incurred by Pacific and GTEC and recorded in memorandum accounts pursuant to Decision 96-03-020.

6. Once costs are adopted for Pacific in the Operations Support Systems/Nonrecurring Charge phase of the Open Access and Network Architecture Development (OANAD) proceeding, parties shall have 30 calendar days to file comments in this docket seeking to challenge specific instances of double counting of implementation costs by the costs established in the OANAD proceeding and to raise any other challenges to the reasonableness of implementation costs incurred.

7. Because Unbundled Network Element (UNE) costs have not yet been finalized for GTEC, a separate schedule shall be set at a later date to address challenges of double counting of its UNE costs.

8. After the filing of comments pursuant to the above ordering paragraphs, replies shall be due 30 days thereafter.

9. A preliminary technical workshop shall subsequently be scheduled in this docket to address questions relating to the methods of accounting for implementation costs to enable parties to adequately review the costs, to narrow the scope of any disputed hearing issues, and to provide a basis for necessary discovery and preparation of testimony relating to cost recovery issues.

10. The ALJ is directed to solicit parties' comments concerning a proposed agenda for the workshop and description of the specific cost reporting issues on which they seek clarification or further explanation

11. Pacific and GTEC shall make available appropriate subject matter experts at the workshop to address cost reporting issues raised in parties comments, including how the accounting system can be used to track, cross reference, and compare the types of costs identified as applicable to UNE and OSS/NRC cost categories versus those for booking into the memorandum account.

12. Following the conclusion of the workshop, the Telecommunications Division shall prepare a workshop report to be provided to the ALJ and served on parties of record, summarizing any agreements reached or issues raised requiring further action.

13. After the mailing of the workshop report, a prehearing conference shall be scheduled to address procedural issues related to evidentiary hearings on implementation costs incurred during 1996.

14. A process to address recovery of implementation costs incurred during 1997 and subsequent years shall be scheduled once the incumbent local exchange

carriers have filed reports updating the actual amounts booked to the memorandum accounts subsequent to 1996.

This order is effective today.

Dated November 19, 1998, at San Francisco, California.

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

APPENDIX A
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PACIFIC BELL

SCHEDULE OF CERTAIN IMPLEMENTATION COSTS ACCUMULATED IN LOCAL COMPETITION TRACKING CODES

for the year ended December 31, 1996

Cost Category	Amount
Resale	$ 24,419,300
Interconnection	5,634,900
Data Exchange	1,137,100
DNCF	1,148,800
LISA	3,035,500
Operator Support Services	4,879,400
E911	742,400
Switch	574,000
Port	571,700
Link	2,007,100
Bill Reconciliation Unit	1,299,100
CLC Interface/CLC Access Information/CLC Usage Reconciliation	1,840,200
Rate Center Inconsistencies	84,400
	$ 47,373,900

The accompanying note is an integral part of this schedule.

PACIFIC BELL

NOTE TO SCHEDULE OF CERTAIN IMPLEMENTATION COSTS ACCUMULATED IN LOCAL COMPETITION TRACKING CODES

1. **Basis of Presentation:**

The Schedule has been prepared for purposes of compliance with certain requirements of the CPUC as set forth in its Decision 96-03-020. The Schedule includes only certain specified costs incurred in order to provide access to network facilities as required by the CPUC local competition orders (Decisions 95-12-056, 96-02-072, 96-03-020, and 96-04-052; collectively, the CPUC Orders) and on the basis of Pacific Bell's interpretation thereof. Therefore, the Schedule is not necessarily intended to present all costs incurred by Pacific Bell in connection with the implementation of local competition.

Implementation costs are defined as being limited to those incremental costs specifically incurred implementing the CPUC Orders. These are expenses that Pacific Bell would not incur in its normal course of operations. Implementation costs include the costs of purchasing, creating, or modifying network and system capabilities, and product offerings to comply with the Orders; developing or revising processes, methods, and procedures needed to support the Orders; training personnel in the use of the new capabilities, processes, methods, and procedures; and educating employees and customers about the impacts of local competition.

A description of the cost categories included in the Schedule follows:

Resale: costs incurred to facilitate leasing of Pacific Bell's circuits or the provision of other Pacific Bell services to carriers that resell them to individual users.

Interconnection: costs incurred for training and development of personnel related to the setup of the Local Interconnection Service Center and Interconnection Service Center to facilitate the provisioning and maintenance of trunks and/or local interconnection projects.

Data Exchange: costs incurred to facilitate the two-way exchange of billing and usage records between Pacific Bell and competing local exchange carriers (CLC).

Directory Number Call Forwarding (DNCF): costs incurred to facilitate remote call forwarding of telephone numbers to CLC switch and related transport requirements. Provides end-users the ability to retain their telephone number when changing local service providers.

PACIFIC BELL
NOTE TO SCHEDULE OF CERTAIN IMPLEMENTATION COSTS ACCUMULATED IN LOCAL COMPETITION TRACKING CODES

1. **Basis of Presentation, continued:**

Local Interconnection Service Arrangement (LISA): costs incurred to facilitate trunk-switched network interconnection between a CLC network point of interface and a Pacific Bell access tandem or end-office.

Operator Support Services: costs incurred to provide operator-assisted dialing, directory assistance and directory listings for CLC customers and content for alternate directory assistance providers.

E911: costs incurred to provide the capability for CLCs to provide their customers with access to E911 service.

Switch Unbundling: costs incurred to facilitate local switching network elements. There are three types of switch unbundling: basic routing; route "0" and "411" to CLC with shared transport; and, complex custom routing.

Port: costs incurred to provide local switching without distribution facilities.

Link: costs incurred to provide loop transport between end user minimum point of entry and Pacific Bell's point of interconnection at central office.

Bill Reconciliation Unit: costs incurred to permit the identification of all of the different billing sources that CLCs may receive from Pacific Bell and developing the processes needed to respond to requests from CLCs for assistance in reconciling their various bills.

CLC Interface/CLC Access Information/CLC Usage Reconciliation: costs incurred regarding the coordination of access to service negotiation ordering and provisioning information including gateway to premises information system for telephone number assignment.

Rate Center Inconsistencies: costs incurred to provide the ability to appropriately rate and route calls to numbers in CLC prefixes assigned outside of the current approved Rate Area Boundary.

(END OF APPENDIX A)

APPENDIX B
Page 1

GTE California

Local Competition Implementation Cost Report
Period: December 31, 1996 Y-T-D

Description	Total
Dedicated Resources - Local Competition	$199,256
Final Solution Costs	444,011
Total Dedicated Resources	$643,267
Systems Cost:	
Customer Billing Services System (CBSS)	$59,264
Electronic Interface (EI)	151,761
National Order Collection Vehicle (NOCV)	18,171
Network Profile System (NPS)	20,966
Universal Measured Service System (UMS)	10,978
Mechanized Assignment Record Keeping (MARK)	6,181
Automated Work Assignment System (AWAS)	1,754
Trouble Administration System (TAS)	42,375
Total Initial Systems	$311,450
Outboard Systems	47,551
Resale	216,762
Operations Support Systems	284,365
Network Interconnection Costs	0
Total Systems Costs	$860,128
Customer Notification	0
Total California Expense	$1,503,395
Capital Expenditures (Buildings, Office Equipment and General Purpose Computers)	349,515
Total Expense and Capital	$1,852,910

GTE California

Local Competition Cost Report
Period: December 31, 1996 YTD

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Description	Explanation	Total GTE	GTE California
Dedicated Resources - Local Competition	Costs associated with full time employees dedicated to local competition implementation efforts including ordering, provisioning, repair, billing, etc.	$788,944	$199,256
Final Solutions Costs	Costs associated with the facilities, hardware, and labor to operate the order center dedicated to local resale and unbundling activities.	$1,892,470	$444,011
Initial Systems Costs	Modifications to certain ordering and billing systems will be required in order to provide functionality on an interim basis as the full scope and requirements of local competition become known. These modifications may not represent the optimal long run solution but provide interim solutions to ensure compliance with regulatory mandates. A description of each impacted system and YTD expense amounts are provided below:		
Customer Billing Services System (CBSS)	This system is currently used by GTE to bill its end user customers for exchange services. As an interim solution, CBSS will be used to bill CLCs for unbundled and resold services and provide local billing detail. To accommodate this requirement, this system needs modification to accept new electronic interfaces, billing parameters and output formats.	$231,945	$59,264

Description	Explanation	Total GTE	GTE California
Electronic Interface (EI)	This system will provide real time communications between the CLCs' and GTE's ordering, provisioning and repair systems. With future implementation, GTE will create seamless CLC customer service. Initial phases will provide the capability to transmit, receive secure and route trouble reporting and PIC data on a real time basis with ordering capabilities provided only after completion of related final solutions.	$593,955	$151,761
National Order Collection Vehicle (NOCV)	This system is the order entry interface into CBSS billing process. NOCV will require modification to allow for the billing of the new resale and unbundled service offerings and to accommodate the split billing of local usage to the CLC and toll usage to the end user customer.	$71,117	$18,171
Network Profile System (NPS)	This system supports the development of marketing studies/analysis, reporting on local and toll revenues and ad-hoc regulatory requests.	$82,054	$20,966
Universal Measured Service (UMS)	This is the usage collection, aggregation and administration system for all switch recorded usage. These modifications will be necessary to accommodate new call record types, screening files, and parsing functions to satisfy tariff structure(s).	$42,966	$10,978

GTE California

Local Competition Cost Report
Period: December 31, 1996 YTD

File:OMTDESYE.wk4

Description	Explanation	Total GTE	GTE California
Mechanized Assignment Record Keeping (MARK)	This system provides facility assignment and record maintenance functions. Enhancements are required to accommodate the additional record information required for unbundled and resold services (e.g., CLC equipment and facility data, unbundled loop port data, cross references and CLC circuit identification).	$24,189	$6,181
Automated Work Assignment System (AWAS)	Modifications to AWAS will allow GTE to include CLC data and coordinate repair and installation activities on resold and unbundled services (e.g., CLC equipment and facility data, cross references and CLC circuit identification.	$6,864	$1,754
Trouble Administration System (TAS)	This system is used for trouble reporting and trouble analysis to facilitate the isolation, correction and dispatching of trouble tickets.	$165,844	$42,375
Operations Support Systems	Associated costs for network and hardware, contracted support for system development and enhancements, as well as the requirements gathering for local competition implementation.	$1,112,838	$284,365

GTE California

Local Competition Cost Report
Period: December 31, 1996 YTD

File:OMTDCSYE.wk4

Description	Explanation	Total GTE	GTE California
Outboard Systems	This system provides an interface between the NDM (Network Data Mover) which will deliver the local service request to the CLC ordering center and GTE's order entry systems. It also serves as a mechanized work-aid providing front-end editing of the data submitted by the CLCs.	$186,102	$47,551
Resale	These costs represent systems development and enhancement (D&E) expenses associated with creation of the Line Screen Table (allowing for identification of resold lines) and Call Record Processing for toll billing through UMS. Line Screen Table administration is performed in the CLC Ordering Center. Electronic/Magnetic interface was not required by the CLCs.	$848,351	$216,762
Network Interconnection Costs	Costs associated with the provisioning of trunkside interconnection are not tracked as part of the Company's resale / unbundling efforts.	$0	$0
Capital Expenditures	Assets placed in a state that support operations across several other states. The cost of this investment is allocated across all the states receiving benefits via an allocation factor.	--	$349,515
Customer Notification	Production, mailing and other costs associated with mandated customer and/or public notification.	--	$0
Total Expense		$6,047,639	$1,852,910

(END OF APPENDIX B)

Commissioner Jessie J. Knight, Jr., Concurring:

I support this decision regarding interim recovery of local exchange competition implementation costs with the fervent hope that this Commission will remain vigilant in ensuring that only reasonable implementation costs are ultimately recovered. The Commission must be exacting when examining the claims of the incumbents' for implementation costs in order to prevent any over-recovery, or payment for costs which would have been incurred even without local exchange competition. The Commission must remember that if costs are inappropriately included, competitors are ultimately harmed by an accidental regulatory subsidy to the incumbent.

During the course of my term at the Commission, I have consistently placed great importance on scrutinizing claims of this sort and I urge my colleagues and successors to do the same as we mature during this anticipated short transitional period.

Dated November 19, 1998 at San Francisco, California.

/s/ Jessie J. Knight, Jr.
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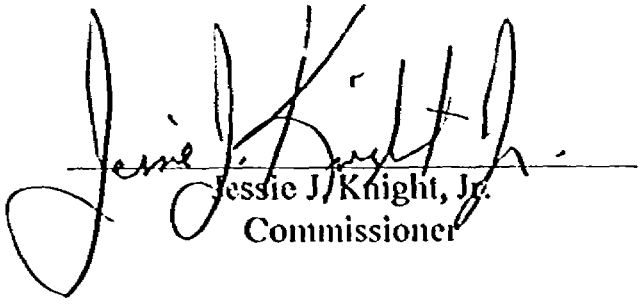

Jessie J. Knight, Jr.
Commissioner