L/ACG/nas*

MAIL DATE
11/24/98

Decision 98-11-069 November 19, 1998

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks	R.93-04-003 (Filed April 7, 1993)
Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks.	I.93-04-002 (Filed April 7, 1993)

ORIGINAL

ORDER DENYING REHEARING OF DECISION 96-08-021

This order denies applications for rehearing filed by GTE California Incorporated (GTEC), MCI Telecommunications Corporation (MCI), and Toward Utility Normalization (TURN).[1]

I. BACKGROUND

This proceeding has its genesis in our New Regulatory Framework (NRF) Decision (D.) 89-10-031, 33 CPUC 2d 43(1989). That proceeding changed our method of regulation from the cost of capital approach to an incentive based price cap methodology in recognition of the state and national policy to promote competition within the service areas of protected monopoly franchises of regulated utilities. In the NRF decision we announced:

---

[1] TURN has since changed its official name to "The Utility Reform Network".

> "... the need for unbundling, uniform pricing and non-discriminatory availability of the local exchange carriers ... essential services and facilities... raised by many competitors and potential competitors ..." (33 CPUC 2d at 119).

The rulemaking in this docket was issued April 7, 1993. There were other telecommunications proceedings in process which might overlap issues to be considered herein. This included the Implementation Rate Design (IRD) proceeding (I.97-11-033), and the Open Access Network Architecture Development proceeding (OANAD; R.93-04-003/I.93-04-002). Accordingly, in D.94-12-053; 58 CPUC 2d 392 (1994), (the "roadmap" decision), we indicated that in the instant docket we would decide expanded interconnection and local transport issues first and then move to the preparation of cost studies for unbundling (58 CPUC 2d 395). Subsequently, after an eleven day workshop in June and July of 1995, the active parties in this proceeding reached agreement on a consensus set of Total Service Long Run Incremental Cost (TSLRIC) principles as well as a list of Basic Network Functions (BNFs) and services for which TSLRIC cost studies would be performed. The consensus principles were adopted in D.95-12-016; 62 CPUC 2d 575, 583 (1995) See Appendix C (62 CPUC 2d at 616).

After extensive discovery, briefing, and comments D.96-08-021 was issued August 2, 1996. The decision adopted, with modification, the TSLRIC studies submitted by Pacific Bell (Pacific) as being sufficiently consistent with the consensus TSLRIC principles adopted in D.95-12-016. It was determined that the Pacific studies were sufficient to serve as a basis for setting prices for bundled and unbundled BNFs and services on Pacific's system.

It also was determined in D. 96-08-021 that the GTEC cost studies did not conform to the consensus TSLRIC principles adopted in D.95-012-016. It was determined that the GTEC studies were flawed in methodology and lacking in supporting data, so that they could not reasonably be used to set prices for BNFs

and services on GTEC's system. Unlike Pacific, GTEC's cost studies departed from the consensus costing principles because they did not reflect deployment of Next Generation Digitial Loop Carrier (NGDLC). Consequently, the GTEC cost studies failed to reflect cost savings brought about by using the least cost technology. Accordingly, GTEC was ordered to modify its unbundled loop analysis to reflect the deployment of least cost technologies, including NGDLC, and to submit its new cost studies by August 2, 1997, one year from the effective date of D.96-08-021.

D.96-08-021 noted that the Federal Communications Commission (FCC) had issued an order that adopted rules to implement the competition provisions of the Telecommunications Act of 1996 (TA96) codified in various places at 47 USCA 151 et seq. (1996). A comment cycle was to be established by an ALJ ruling to allow parties in the instant proceeding to submit comments as to what steps, if any, the Commission should take to bring D.96-08-021 up to date with the FCC's order.

A. APPLICATIONS FOR REHEARING

1. MCI

The Application for rehearing by MCI asserted that the FCC August 8, 1996 First Report and Order, FCC 96-325 (First Local Competition Implementation Order) adopting a Total Element Long Run Incremental Cost (TELRIC) methodology, required revisions by Pacific and GTEC of their cost studies. MCI alleged that there were six significant differences between the FCC's TELRIC methodology and this Commission's TSLRIC methodology adopted in D.96-08-021. It was asserted that the TELRIC methodology focuses on network elements while the Commission's TSLRIC methodology focuses upon telecommunications services as defined in the Telecommunications Act of 1996. Accordingly, a new round of review and hearings was proposed in order to bring

the cost studies adopted in D.96-08-021 in line with the FCC's TELRIC methodology. It also was alleged by MCI that the Commission relied on cost study materials that the interested parties did not have a reasonable opportunity to review and that parties did not receive adequate notice regarding non-costing issues decided by the Commission. Therefore, the parties were denied due process of law. Finally, MCI alleged that the Commission erred regarding various costing issues in the Pacific and GTEC cost studies.

The California Cable Television Association (CCTA) comments supported the MCI application for rehearing. At page 3 of its Comments CCTA asserted that the TELRIC methodology adopted by the FCC is a costing and pricing methodology that is consistent with this Commission's TSLRIC costing methodology. CCTA asserted that the California commission had not yet determined a pricing methodology in addition to the costing methodology adopted by D.96-08-021. Accordingly, CCTA asserted that to be consistent with the FCC adopted TELRIC methodology, this Commission must also adopt a pricing methodology. CCTA, like MCI, also disagreed with the Commission's treatment of cost elements in the Pacific and the GTEC studies.

2. GTEC

GTEC sought rehearing of D.96-08-021 only as to the provision requiring GTEC to use NGDLC as the least cost technology for provisioning loops on a going forward basis. GTEC alleged that D.96-08-021 ignored substantial new and additional costs associated with unbundling GTEC's existing integrated network which did not reflect the use of NGDLC technology to any sufficient extent. GTEC argued that if it is not permitted to recover such additional costs of unbundling, the Commission-imposed requirement of using NGDLC will result in an unconstitutional taking.

General argued that D.96-08-021 does not take into account GTEC's current network design or the architectural enhancements required to accommodate unbundling of its system. GTEC asserted that its use in some cases of integrated digital loop carriers (IDLCs) remote from the central office, was engineered on the assumption that a single, integrated company would provide local telephone service to every subscriber. It was asserted that much of GTEC's network must be reengineered to accommodate competitors' requests for unbundled loops. In order to unbundle local loops at central offices that use ILDC, GTEC argued that it was necessary to add channel banks at both the ILDC sites and at the central office.

GTEC argued that the cost of reengineering was significant and is not covered by the NGDLC methodology. NGDLC technology was deployed only to a very limited extent in the network and was originally designed to separate private line and switched circuits in an integrated single network configuration such as GTEC's present network design. NGDLC, when fully deployed, would be very cost effective in provisioning unbundled loops without the need to add the expensive channel banks or comparable equipment GTEC said will be required in the interim. GTEC asserted that by setting prices based on a TE/TSLRIC standard which reflects the costs of NGDLC as the forward looking technology of choice, the substantial additional costs of the channel banks and/or non-integrated technology is completely ignored. Therefore, because those costs were excluded from the TE/TSLRIC calculation, the costs cannot be recovered in the costs of unbundled elements.

GTEC argued that unless the cost of provisioning the equipment needed to price unbundled loops in a non-NGDLC environment can be recovered from the requesting carriers through some means other than the loop price, GTEC would be forced to sell its unbundled elements to CLCs below cost and would be left uncompensated for substantial costs which it must necessarily incur over the

near term. Consequently, GTEC argued that NGDLC methodology is not the appropriate least cost technology for the development of a TE/TSLRIC based rate.

GTEC concluded its arguments by stating that it cannot be compelled to exclude the costs of non-intergrated technology from the price for which it must sell its unbundled loops. GTEC stated that D.96-08-21 would result in below cost pricing of the product even to its competitors, and would be a violation of the takings clause of state and federal constitutions even if it was able to offset such loss by selling other services above cost. GTEC relies upon Brooks-Scanlon Co. v. Railroad Commission of Louisiana, 251 U.S. 396, 399 (1920); Cal. Farm Insurance Co. v. Duekemejian 48 Cal. 3rd 805 (1989).

3. TURN

Turn sought rehearing of D.96-08-021 on the ground that the decision's determination that the local loop is not a shared cost is factually and legally erroneous. TURN requested that the decision be modified to enter findings of fact and conclusions of law to the effect that with respect to the provision of retail services that use the local loop, the local loop is a shared cost as that term is defined in D.95-12-016. TURN cited decisions in other jurisdictions which TURN asserted adopted its position.

B. Replies To The Applications For Rehearing

A joint response to the application for rehearing by GTEC was filed by AT&T Communications of California Inc. (AT&T) and MCI. A response to the application for rehearing of MCI and the application for rehearing of TURN was filed by GTEC. Pacific filed a response to the applications for rehearing of MCI and TURN.

The joint response of AT&T and MCI asserted that the Commission properly directed GTEC to use NGDLC in its revised cost studies in order to bring those studies of the loop into compliance with the consensus costing principles

adopted in D.95-12-016. It also was asserted that GTEC continued to ignore the proper legal scope of a takings analysis.

AT&T and MCI argued that GTEC's rehearing application concedes that the use of NGDLC methodology is the least cost forward looking methodology it would deploy if it were a start-up company. It was argued that GTEC does not dispute the conclusion in D.96-08-021 that NGDLC appears to be the least cost technology for provisioning local loops. It was asserted that the concept behind adopting the consensus costing principles in D.95-12-016 was to insure consistency in the cost studies for unbundled elements. According to the response, GTEC should not be permitted to pick and choose what technologies it is going to use based on whatever criteria it deemed appropriate. It was argued that GTEC should not be permitted to build embedded costs into the forward-looking cost of local loops and therefore should not be allowed to include the additional costs it would incur when unbundling its exiting loops, such as channel banks, in order to unbundle local loops that use IDLC technology.

It was further asserted that GTEC's reliance on Brooks Scanlon Company v. Railroad Commission, and Cal Farm v. Deukmeijan was misplaced. It was argued that confiscation must be judged with an eye toward the regulated firm as an enterprise, citing 20th Century Insurance Company v. Garamendi 8 Cal. 4th 216, 293 (1994). It was asserted that the Cal Farm Court noted that the term "confiscatory" must be understood in light of surrounding circumstances. Thus, the court held that "confiscation" is judged with an eye toward the regulated firm as an enterprise. In that context "confiscatory" depended on the condition of the insured as a whole and not on the fortunes of any one or more of its lines (8 Cal 4th at 322).

Further, AT&T and MCI assert that GTEC has misread Brooks Scanlon and Cal Farm. In Brooks Scanlon a Railroad company sought to withdraw entirely from maintaining a particular route. The state railroad

commission refused permission to do so and required the carrier to charge rates that would result in a loss on that route. The court recognized the distinction between a willing and an unwilling participant in a regulated enterprise. Thus, although a carrier cannot be compelled to carry on even a branch of a business at a loss if the enterprise continues to exercise its state charter it may be required by the state to fulfill an obligation imposed by the charter even though fulfillment in that particular may cause a loss, citing Brooks Scanlon 251 U.S. at 399. It was argued that GTEC had never indicated that it was an unwilling participant in California's Telecommunications markets.

It was further claimed that in Cal Farm the court did not prohibit below-cost prices. It was argued that in Cal Farm the below cost rates could not be justified merely because other consumers in the past were supposedly charged too much. The ability of an insurer to earn profits from unregulated, or out-of-state lines of insurance, could not be used as a procedural bar to preclude the insurer from seeking review of allegedly confiscatory rates (48 Cal. 3rd 819). Thus, the court ruled that the insurance commissioner had to consider applications from all insurers, not just insolvent ones (48 Cal. 3rd at 825).

Therefore, according to AT&T and MCI, contrary to GTEC's argument, nothing in Cal Farm changed the established rule that no constitutional claim arises unless the overall effect of a regulatory scheme precludes the opportunity to earn a fair return. Accordingly, GTEC had no valid basis for focusing solely on a cost issue that it disliked without considering its other business opportunities.

Pacific's response to MCI asserted that the FCC's first interconnection order does not invalidate the TSLRIC studies. It was argued they are primarily service cost studies which remain valid for the services studied. The TELRIC methodology employed by the FCC is primarily a pricing mechanism which could be implemented in the then pending arbitration and the pricing phase of OANAD.

The TELRIC method was a costing and pricing methodology for unbundled network elements (UNE's). However, calculating TELRICs for certain UNEs did require some adjustments to the existing TSLRIC's studies. The major difference between the existing TSLRIC's and FCC's TELRICs was that the cost object for the TELRICs is at a higher level of aggregation than the TSLRIC service cost studies. The TELRIC studies resulted in more costs being attributed directly to the network element and fewer costs assigned to shared common costs. It was argued that the size of TSLRIC shared and common costs were known and approved. Therefore, all that was required was the assignment of some of those adopted costs to unbundled elements. Likewise, the removal of retail related costs from TELRICs, an FCC requirement, could be accomplished without difficulty and without need to reopen the TSLRICs studies. All that was required was to identify the shared and common retail functions.

Pacific argued that further hearings were not required, that it had met the burden of proof for its TSLRIC studies, and that the studies accurately reflected forward looking requirements consistent with consensus costing principles.

Finally, Pacific argued that MCI and other parties were not deprived of a reasonable opportunity to review all studies submitted and were allowed a legally sufficient opportunity for review and comment upon Pacific's cost studies. Pacific concluded with the statement that the Commission's D.98-08-021 correctly finds that Pacific's TSLRIC studies 1) comply with the costing principles adopted in D.95-12-016, 2) are supported by the weight of evidence in the record, and 3) can serve as the basis for setting prices.

In response to TURN, Pacific argues that the Commission had correctly found in D.96-08-021 that the loop is not a shared cost. There is a separate demand for the loop itself, so that loops cannot reasonably be viewed as mere input to the basic exchange services that consumers want. Pacific contended

that the issue was raised by TURN previously and that the commission had determined that the loop was not a shared cost of retail services (D.94-09-065, 156-157 (1994)); application by TURN for Rehearing denied (D.96-02-023, 623 (1996).

II. DISCUSSION

In D.98-02-106 issued February 19, 1998 we adopted the TELRIC methodology set forth in the August 8, 1996 First Report and Order of the FCC. It was concluded that the TSLRIC methodology we adopted in D.95-12-016 and applied in D.96-08-021 is very similar to the TELRIC methodology. First, TELRIC requires that shared family and common costs be allocated as much as possible to individual network elements, thus reducing the total number of shared and common costs that would have been required under TSLRIC adopted in D.96-08-021. Second, TELRIC requires that retail costs not be included in the costs of network elements because retail costs are not attributable to the production of network elements that are offered to interconnecting carriers. Third, TELRIC makes the detection of cross-subsidization easier.

It should be noted that in October 1996 the United States Court of Appeals for the Eighth Circuit issued a stay of various portions of the FCC August 8th First Report and Order. Although the Eighth Circuit did not disturb the list of UNE's described by the FCC it did stay those portions of the First Report and Order that directed the use of TELRIC methodology. See Iowa Utilities Board v. Federal Communication Commission et al. 109 F.3rd 418 (8th Cir.), Motion to Vacate Stay denied 117 S.Ct. 429 (1996). Thus, this Commission, if it chose to do so, could set UNE prices based on TSLRIC costs adopted in D.96-08-021. Accordingly, after directing Pacific to modify its TSLRIC's studies to conform to the FCC TELRIC methodology, further proceedings were held resulting in D.98-

02-106 which adopted Pacific's TELRIC methodology after making downward adjustments of approximately $677,000,000.

AT&T and MCI challenged D.98-02-106 on grounds other than their attack on Pacific's TSLRIC adopted in D.96-08-021. Their charge that the Commission's TSLRIC studies do not conform with the FCC TELRIC study is moot.

On July 18, 1997 the Eighth Circuit issued its decision on the merits concerning the challenges to the FCC First Report and Order Iowa Utilities Board v. FCC, 120 F. 3rd 753 8th Cir. (1997). The decision upholds the judgements about the boundaries of state and federal jurisdiction reflected in its October 15th Stay Order and rejects most of the other challenges that the Regional Bell Operating Companies (RBOCs) and GTE had raised to the First Report and Order. The decision emphatically rejected the contention that the FCC had authority to require the use of TELRIC studies by the states (Id. at 794-796, 798-799). Further, the Eighth Circuit decision addressed the utilities' argument that basing prices on any measure other than direct embedded costs would necessarily constitute a taking. The court indicated that even though the LEC's taking claims were not ripe for review it was "skeptical" that the limited number of FCC unbundling rules it was upholding would "effect an actual taking" (Id at 793 n. 8, 818). The court noted that many states had suspended their proceedings pending its ruling. Further, no litigant had yet used a state-mandated procedure and had been denied just compensation. The incumbent LEC and a requesting carrier may negotiate rates for unbundled access on their own. This can be followed by an arbitration proceeding and state approval subject to review in federal court. Therefore, the court deferred to the responsible agency for initial interpretation of TA 96. (Id. at 818). It should be noted, however, that the United States Supreme Court granted petitions for writ of certiorari on January 26, 1998. Oral argument was held in mid-October 1998.

It appears for now that GTEC's taking argument in its application for rehearing of D.96-08-021 is moot unless the Supreme Court revives the issue. In the absence of any reversal by the Supreme Court of the Eighth Circuit decision on this issue, we believe that both the TSLRIC and TELRIC methodologies we have adopted properly reflect long-run incremental cost principles and differ only in their "cost objects". The parties were not denied due process nor have we erred in evaluating the record. The parties had ample opportunity to review data and to state their position throughout the proceeding. We evaluated the record as discussed in D.96-08-021 and made the pragmatic adjustments called for by the particular circumstances. City of Los Angeles v. Public Utilities Commission 15 C. 3d 680, 698 (1975).

Finally, we agree with Pacific that the loop cost is not a shared cost at the retail level. As explained in D.96-08-021 (mimeo, pp. 48-49) there is a separate demand for the loop itself so that loops cannot reasonably be viewed as a mere input to basic exchange services. Loop costs are specific to a particular output and not to a group of outputs as is required by the consensus costing principles for a cost to be shared (D.95-12-016, 62 CPUC 2d 618, Appendix C). Loop costs are avoided when no basic access service is provided, and therefore, according to the consensus costing principles, loops are an incremental cost of such services.

III. CONCLUSION

Accordingly, MCI's, GTEC's and TURN's applications for rehearing have failed to show legal error in D. 96-08-021 and therefore rehearing is denied as to each of those applications.

IT IS ORDERED that:

1. The Application for Rehearing filed by MCI and supported by CCTA is denied.

2. The Application for Rehearing by GTEC is denied.

3. The Application for Rehearing by TURN is denied.

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