PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Commission Advisory and Compliance Division
Telecommunications Branch

RESOLUTION T-14065
May 4, 1990

R E S O L U T I O N

RESOLUTION T-14065. ORDER AUTHORIZING PACIFIC BELL TO REFUND TO RATEPAYERS $44.4 MILLION IN COMPLIANCE WITH THE LABOR PRODUCTIVITY SHARING PLAN ADOPTED IN D.87-12-067.

BY ADVICE LETTER NOS. 15674 AND 15674A, FILED ON JANUARY 31 1990 AND APRIL 13, 1990, REPECTIVELY.

SUMMARY

This Resolution adopts Advice Letter Nos. 15674 and 15674A filed by Pacific Bell (Pacific) on January 31 and April 13, 1990, respectively, to implement the second year of the productivity sharing plan adopted in D.87-12-067. According to that plan, for attrition years 1988 and 1989, if the actual realized productivity factor exceeds the benchmark of 2.9% imputed in the attrition formula for Labor and Labor Overheads expense, Pacific is required to refund 50% of the excess expense savings to ratepayers.

The refund of $44.4 million resulting from the sharing formula will be flowed back to ratepayers over a four-month period, starting on June 1, 1990, in a form of a uniform surcredit of 2.035% to exchange, intraLATA toll and access services.

AT&T and the Division of Ratepayer Advocates (DRA), on February 20, 1990, filed their protests to Advice Letter No. 15674. Both AT&T and DRA contend that Pacific's method of calculating the actual realized productivity factor for 1989 understates the refund amount by approximately $60 million. The protestants advocate the use of an expected 1988 end-of-year Access Lines per Employee (EOY ALPE, an index adopted by the Commission) as the base in computing the 1989 actual productivity gains. Pacific, in its February 26, 1990 response to the protests, argues that actual productivity improvement can only be measured by calculating the change in actual EOY ALPE from one year to another.

We observe that the disagreement between the protestants and Pacific stems from the fact the there exist no explicit instructions by the Commission on the calculation of the second year's actual productivity factor. Guided by the Commission's explicit and implicit directions regarding the implementation of the adopted plan, we conclude that there is no basis for rejecting Pacific's Advice Letter Nos. 15674 and 15674A. Consequently, we must reject the protests filed by AT&T and DRA.

BACKGROUND

The Commission in D.87-12-067, dated December 22, 1987, adopted a labor productivity sharing plan to be used in conjunction with the attrition mechanism for Pacific (1988 and 1989) and GTEC (1989 only). The plan provides an incentive for Pacific and GTEC to exceed the specified labor productivity factor of 2.9%. Essentially a modified version of DRA's proposal, the plan adopted for Pacific contains the following provisions:

a. For attrition years 1988 and 1989, a productivity factor of 2.9% is adopted for use in the attrition formula for Labor and Labor Overheads expense.

b. The Labor and Labor Overheads attrition formula is to be recomputed after the attrition year using the actual realized productivity factor. If that factor is less than or equal to 2.9%, the sharing requirement as described in d. below would not be applicable.

c. The productivity index to be used in measuring productivity improvement, for attrition years 1988 and 1989, is Access Lines per Employee.

d. Fifty percent of the incremental dollar amount computed is to be refunded to ratepayers in the form of a uniform surcredit.

Subsequent Commission resolution and decisions provide additional directions for implementing the plan. In Resolution T-12079, dated April 13, 1988, the Commission ordered a 1988 attrition year revenue requirement reduction of $64.911 million for Pacific. Among other things, the Commission required Pacific to file its 1988 actual realized productivity factor on or before January 31, 1989, and, if there is a productivity sharing, to file an advice letter to implement the refund.

On May 6, 1988, DRA filed an Application For Modification of Resolution T-12079 (A.88-05-009). In the application, DRA requested Commission resolution of certain operational attrition items which included intepretative issues regarding the mechanics for implementing the labor productivity sharing plan. Those intepretative issues were:

a. whether the savings should be shared for only one year or more,

b. whether excess productivity savings should be shared with interest,

c. whether rebates should be on a one-time basis or spread over a time interval, and

d. what rates should be affected.

In D.88-06-024, the Commission declined to consider Item a. at that time, but required that Items b., c. and d. be addressed by

DRA and Pacific. These three issues were resolved through workshops resulting in a stipulation, which was subsequently adopted in D.88-09-028, dated September 14, 1988.

On January 31, 1989, Pacific filed Advice Letter No. 15508 to implement its 1988 productivity sharing, refunding $56 million to ratepayers over four months; the advice letter went into effect without any protest. Pacific arrived at the actual 1988 productivity factor of 6.81% using the following formula:

$$\text{1988 Actual Realized Productivity Factor} = \left[1 - \frac{\text{Actual EOY 1988 ALPE}}{\text{Actual EOY 1987 ALPE}} \right] * 100\%$$

To implement the second year of the productivity sharing plan, Pacific filed Advice Letter No. 15674 on January 31, 1990. The 1989 actual productivity factor of 5.90% is calculated based on a formula similar to that used for 1988 and is as follows:

$$\text{1989 Actual Realized Productivity Factor} = \left[1 - \frac{\text{Actual EOY 1989 ALPE}}{\text{Actual EOY 1988 ALPE}} \right] * 100\%$$

Pacific proposed to flow through the ratepayers' share of $44.1 million over four months, effective May 1, 1990. On April 13, 1990, Pacific filed Supplemental Advice Letter No. 15674A to revise the requested effective date to June 1, 1990. This later effective date lengthens the period for which interest is applicable, and, therefore, increases the refund amount to $44.4 million. The corresponding billing surcredit is 2.035% applicable to exchange, intraLATA toll and access services.

PROTESTS

On February 20, 1990, AT&T and DRA filed their protests to Pacific's Advice Letter No. 15674. Both AT&T and DRA object to Pacific's use of the actual EOY 1988 ALPE as the base, or denominator, in calculating the actual 1989 productivity factor. The appropriate base, AT&T and DRA contend, should be the "expected" EOY 1988 ALPE level. This "expected" or "projected" EOY 1988 ALPE base is found by growing the actual EOY 1987 ALPE by 2.9%, a factor which the protestants claim reflect the minimum productivity improvement expected by the Commission. The 1989 actual productivity factor formula reflecting the protestants' method is as follows:

$$\text{1989 Actual Realized Productivity Factor} = \left[1 - \frac{\text{Actual EOY 1989 ALPE}}{\text{Actual EOY 1987 ALPE} * 1.029} \right] * 100\%$$

The protestants' approach would result in a 1989 actual productivity factor of 9.92%, as compared to 5.90% per Pacific's method, and would require Pacific to refund $104 million, $60 million more than Pacific's proposed amount. The following subsections summarize the basis of AT&T's and DRA's protests.

AT&T Protest : AT&T supports its position primarily on the testimony of DRA's witness Harry Strahl. Mr. Strahl sponsored DRA's proposed productivity sharing plan, which the Commission adopted with certain modifications. Citing witness Strahl's response on cross examination (A.85-01-034, Strahl, 70 TR 8434-8436), AT&T states:

> "The Commission's plan is premised on the proposal of the Division of Ratepayer Advocates. The DRA explained in testimony that the projected productivity factor should be derived by inflating a base figure ALPE by 3.5 percent (the Commission adopted 2.9%, instead of 3.5%) for each attrition year, such that an initial ALPE would grow from a base of 156 at the outset to 161.5 at the end of the first year and to 167.2 at the end of the second year. This "baseline" of expected productivity would be the benchmark against which actual productivity would be measured to determine expense savings to be shared equally between ratepayers and shareholders."

In addition, AT&T contends that Pacific's method deviates from accepted attrition principles. On this subject, AT&T argues that

> "Pacific's 1988 rates were set based on the premise that it would achieve a 2.9 percent gain in productivity above 1987 adopted results. Rates for 1989 were established based on an expected additional productivity gain of 2.9 percent above <u>expected</u> 1988 levels. Rates for 1989 were not set on productivity actually achieved by Pacific in 1988. To have done so would have resulted in the capture of Pacific's realized 1988 productivity gains in the form of permanent rate decreases."

Based on the above reasons, AT&T concludes that the Commission in adopting the plan "contemplated calculation of expense savings by comparing realized productivity gains to Commission projected levels of productivity cumulatively year to year." AT&T believes that its method is consistent with the intent of the Commission, and, therefore, should be adopted.

DRA's protest: DRA, like AT&T, cited the same portion of witness Strahl's testimony. In addition, DRA offers a hypothetical situation where DRA contends that using Pacific's method would serve to "unfairly penalize" Pacific's stockholders.

In its example, DRA assumes an actual realized EOY 1988 ALPE of 180.00, which is below 1988 "standard" level (1988 "standard" level, as defined by DRA, is EOY 1987 ALPE grown by 2.9%, or 185.40). For 1989, DRA uses the actual EOY ALPE of 209.69. Under this scenario, there would be no sharing for 1988. DRA shows that using Pacific's method would yield an actual 1989 productivity factor and refund amount higher than those calculated using DRA's method. The effect, DRA observes, would be to penalize Pacific's shareholders twice, first in 1988 and then in 1989, for Pacific's substandard 1988 performance.

In conclusion, DRA finds that "Pacific has taken advantage of an apparent ambiguity in the record to apply a creative interpretation to the calculation of the productivity sharing", and urges the Commission to order a refund of $60 million more than the amount proposed by Pacific.

RESPONSE TO PROTESTS

In its February 26, 1990 response to AT&T's and DRA's protests, Pacific contends that the protestants' charges are based on "strained interpretation" of the adopted labor productivity plan, and, therefore, should be rejected.

Pacific points out that nowhere in D.87-12-067, or in any other decision, did the Commission state that there would be any comparison of actual levels of labor productivity to the prior year's projected levels. Pacific went on to cite Ordering Paragraph Nos. 13.b. and 13.d of D.87-12-067 which state:

> "The labor attrition formula should be recomputed after the attrition year using the actual realized productivity factor. If the actual realized productivity factor is less than or equal to 2.9%, the incentive plan described below will not go into effect for that year.
>
> .....
>
> "The incremental dollar amount computed (as verified by the E&C staff) shall be disbursed in the following proportions: 50% shall be refunded back to ratepayers in the form of a uniform surcredit and 50% to Pacific Bell." (Emphasis added.)

Pacific maintains that the only appropriate way to compute the actual realized productivity factor is to measure the change in actual EOY ALPE from one year to another. In Pacific's opinion, if the Commission had contemplated the "convoluted" method now proposed by AT&T and DRA, the Commission would not have used a straightforward phrase such as actual realized productivity factor.

Pacific also asserts that AT&T's and DRA's reference to the testimony of DRA's witness Strahl fails to support the protestants' method. As intepreted by Pacific, the

> "cross examinations concerned a hypothetical example which first dealt with the level of productivity that would be automatically imputed through a permanent rate reduction for two successive attrition years (in the DRA's proposal, a 3.5% improvement). The DRA's witness was then asked additional questions concerning how the labor productivity sharing mechanism would work in the first attrition year. .... the DRA's witness was not asked, nor did he offer to explain, how the sharing mechanism would operate in the second attrition year."

Moreover, Pacific points out that in the same testimony, witness Strahl responded to a question concerning how labor force changes under the DRA's productivity sharing proposal would operate as an adjustment in the attrition formula with the following statement:

> "Well, presumably the Commission would have to -- and its staff would have to keep track of the number of employees per access lines at the beginning of the attrition year and at the end of the attrition year." (A.85-01-034, 70 TR 8387.)

AT&T's and DRA's proposed method, Pacific observes, would not be consistent with the above statement since their method relies on a projected figure which would eliminate the need to track the actual ALPE level at the beginning of the attrition year.

Lastly, to counter DRA's example, Pacific offers a hypothetical scenario which serves to point the illogic of the protestants' method. In this example, Pacific assumes a productivity improvement of 0.00% in 1989 (i.e., no change in EOY ALPE) and uses the actual 6.81% productivity improvement figure for 1988. Using the protestants' method, Pacific would have to refund $14 million after attrition year 1989 despite the fact that Pacific experienced zero productivity gains in that year. The second year's refund, Pacific contends, is illogical and unfair since it is based entirely on the first year's improvement. Pacific argues that if the Commission had contemplated adopting a plan such as now presented by the protestants, the Commission would have ordered a permanent refund of the productivity gains.

DISCUSSION

We have reviewed the advice letter filing, the protests, response to protest, relevant record and Commission orders. We agree that existing Commission decisions and resolution on the adopted productivity plan do not contain explicit instructions for developing the second year's actual factor. However, our review of those orders and the record supporting them has enabled us to make the following observations and conclusions:

1. The productivity factor, as used in the context of the adopted plan, is an indicator of a company's labor productivity improvement and is reflected by measuring the change in end-of-year access lines per employee over a given year. The "actual realized productivity factor" then refers to the change in the actual EOY ALPE from one year to another and, therefore, its computation requires two actual data points. For 1989, those two data points are actual EOY 1988 ALPE and actual EOY 1989 ALPE. Comparing an actual ALPE figure from one year with a fictitious ALPE level from the previous year, as suggested by the protestants, would fail to reflect the actual level of productivity improvement, as envisioned by the Commission.

2. The Commission in D.88-06-024 declined to formally address DRA's request to clarify whether the refund should be for one year or on-going. However, in allowing Pacific to implement the 1988 productivity sharing through a one-time

refund (Advice Letter No. 15508), the Commission in effect determined that refund is to be one year only. The protestants' method entails extending the sharing of 1988 excess savings to a second year, and, therefore, is contrary to the Commission intent.

3. The hypothetical scenario offered by Pacific effectively demonstrates the potential unfairness of the protestants' method. Clearly, it would be nonsensical and contrary to D.87-12-067 to order a refund related to a year in which the company experienced no productivity improvement.

4. We also find that Pacific's citation and intepretation of witness Strahl's testimony where he described how DRA's productivity sharing proposal would work under the attrition environment is more descriptive of the intended implementation of the adopted plan. (The Commission adopted a modified version of the plan sponsored by witness Strahl; however, the modifications were related mainly to benchmark levels and sharing proportions.)

5. We agree with the protestants that Pacific's current on-going rates reflect the imputed 2.9% labor productivity improvement for 1988, and not the actual and higher productivity improvement realized by Pacific in that year. As the result, after making the one-time refund, Pacific is allowed to continue to enjoy, without sharing, the excess expense savings realized in 1988.

The last point (Item 5) is, however, a consequence of the productivity sharing mechanism as adopted. Thus, it cannot be used as a basis for rejecting Pacific's filing. Guided by the Commission's explicit and implicit directions regarding the implementation of the plan, we must conclude that Pacific's filing is in compliance and should be adopted without modifications. Consequently, without prejudice, we must reject the protests filed by AT&T and DRA.

FINDINGS

1. Pacific filed Advice Letter Nos. 15674 and 15674A to implement the second year of the productivity sharing plan adopted in D.87-12-067.

2. The 1989 actual realized labor productivity factor of 5.90% as calculated by Pacific results in an amount of $44.4 million to be refunded to ratepayers.

3. Based on the 5.90% actual labor productivity improvement figure, the $44.4 million represents 50% of the incremental dollar amount to be refunded to ratepayers, as specified by the plan.

4. The refund is to be implemented over four months and through a uniform surcredit of 2.035%, starting on June 1, 1990.

5. Pacific calculated the 1989 actual realized labor productivity factor using the actual EOY 1988 ALPE as the base.

6. AT&T and DRA filed their protests to Pacific's Advice Letter No. 15674, disputing Pacific's method of computing the 1989 actual realized labor productivity factor.

7. AT&T and DRA both contend that the 1989 actual productivity factor should be calculated using the "projected" EOY 1988 ALPE (EOY 1987 ALPE grown by 2.9%) as the base.

8. Using the protestants' method would yield a 1989 actual productivity factor of 9.92% and a refund amount of approximately $104 million.

9. There exist no explicit instructions by the Commission on the calculation of the second year's (1989) actual realized productivity factor.

10. In order to compute a meaningful "actual realized productivity factor" for any given year, it is necessary to use the actual EOY ALPE figures.

11. Pacific's filing uses actual 1988 and 1989 EOY ALPE figures to compute the 1989 actual realized productivity factor; this method is consistent with the Finding No. 10.

THEREFORE, IT IS ORDERED that:

1. Pacific Bell's Advice Letter No. 15674, as supplemented by Advice Letter No. 15674A, is authorized as filed.

2. AT&T's and DRA's protests to Advice Letter No. 15674 are rejected without prejudice.

3. All tariff sheets filed under Advice Letter No. 15674, as supplemented by Advice Letter No. 15674A, shall be marked to show that such sheets were authorized by this Resolution.

4. This Resolution is effective today.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on May 4, 1990. The following Commissioners approved it:

G. MITCHELL WILK
President
FREDERICK R. DUDA
STANLEY W. HULETT
JOHN B. OHANIAN
PATRICIA M. ECKERT
Commissioners

Neal J. Shulman
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