PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Telecommunications Branch
Commission Advisory and Compliance Division

RESOLUTION T-14668
December 18, 1991

R E S O L U T I O N

RESOLUTION T-14668. PACIFIC BELL (U-1001-C). ORDER APPLYING THE ADOPTED PRICE CAP MECHANISM IN COMPLIANCE WITH DECISIONS 89-10-031 AND 91-09-072 THROUGH ADJUSTMENTS TO SURCHARGES/SURCREDITS TO BE EFFECTIVE JANUARY 1, 1992.

BY ADVICE LETTER 16069, FILED ON OCTOBER 1, 1991.

SUMMARY

This Resolution orders Pacific Bell (Pacific) to reduce its annual revenue requirement by $132.052 million as a result of its 1992 annual price cap index filing (Advice Letter (AL) 16069).

This decrease reflects Pacific's 1992 intraLATA SPF-to-SLU settlement effects and 1992 interLATA SPF-to-SLU revenue shift (revenue neutral to Pacific), a 1992 price cap index decrease of $12.846 million, and a net Z-factor adjustment decrease of $119.206 million. These adjustments will be reflected effective January 1, 1992.

Protests to Pacific's AL 16069 were filed by the Commission's Division of Ratepayer Advocates (DRA), MCI Telecommunications Corporation (MCI), and AT&T Communications of California, Inc. (AT&T)

The adopted revenue requirement changes are summarized in the following table:

1992 Price Cap Revenue Requirement Change, $000
Note - revenue reduction in ()

Price Cap Impact (0.2 %) without Z-factors	(12,846)
Z-factors:	
USOAR Step Down	(23,122)
$200/$500 Expense Limit	(3,150)
Expensing Station Connections	(107,850)
Dial Equipment Minutes	14,916
Investment Tax Credit Phase Out	0
Excess Deferred Tax Phase Out	0
Sales Tax Increase	0
Net Z-factor adjustments	(119,206)
Total Price Cap Impact with Z-factors	(132,052)

BACKGROUND

In our Decision (D.) 89-10-031, we adopted an incentive-based regulatory framework for Pacific and GTE California Incorporated (GTEC). In that decision, we stated:

> "This new regulatory framework is centered around a price cap indexing mechanism with sharing of excess earnings above a benchmark rate of return level..."
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> . . .
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> "Following a startup revenue adjustment...[D.89-12-048]... prices for the utilities' basic monopoly services and rate caps for flexibly priced services will be indexed annually according to the Gross National Product Price Index (GNP-PI) inflation index reduced by a productivity adjustment of 4.5%."
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> . . .
>
> "The indexing formula also allows for rate adjustments for a limited category of exogenous factors whose effects will not be reflected in the economywide GNP-PI. While all such costs cannot be foreseen completely, we recognize that the following factors may be reflected in rates as exogenous factors [called Z-factors]: changes in federal and state tax laws to the extent that they affect the local exchange carriers disproportionately, mandated jurisdictional separations changes, and changes to intraLATA toll pooling arrangements or accounting procedures adopted by this Commission."

In our D.90-09-084, we granted the requests of Pacific and GTEC to implement the 1991 price cap rate adjustments envisioned by D.89-10-031 through a change to the utilities' billing surcharges/surcredits rather than through changes to tariffed rates. Similarly, our D.91-09-072 granted a request by GTEC, as concurred in by Pacific, to implement the 1992 price cap rate adjustments through the billing surcharge/surcredit mechanism. We called for GTEC and Pacific to file advice letters no later than October 1, 1991, for Commission consideration and approval to apply adjustments to their surcharges/surcredits to be effective January 1, 1992.

On October 1, 1991, Pacific filed AL 16069 requesting billing surcharge/surcredit changes to be effective January 1, 1992, due to the 1992 price cap index mechanism, certain Z-factor adjustments, 1992 intraLATA SPF-to-SLU settlement effects, and 1992 interLATA SPF-to-SLU revenue shifts.

The 1992 price cap filing revenue requirement adjustments requested by Pacific in its AL 16069 are reflected in Column A of Appendix A to this Resolution.

Pacific's filing consists of proposed revenue requirement adjustments (reductions in parentheses) for:

1. Price Cap Index, ($12.846 million) - A 1992 Price Cap Index factor of -0.2%.

2. USOAR Stepdown, ($23.122 million) - A Z-factor adjustment to reflect the Uniform System of Accounts (USOA) step down revenue requirement reduction ordered by D.88-09-030, I.87-02-023.

3. $200 to $500 Expense Limit, ($3.150 million) - A Z-factor adjustment to reflect the increased costs associated with an accounting change that allows Pacific to place certain items of plant costing between $200 to $500 in expense accounts rather than rate base (D.90-09-029, A.90-02-050).

4. Expensing Station Connections, ($106.709 million) - A Z-factor adjustment to reflect eleven months' refund of annual amortization of station connections ordered by D.93728 and D.82-01-100, including a rate base related revenue adjustment for 1992 required by Resolution T-14235.

5. Dial Equipment Minutes, $14.916 million - A Z-factor adjustment to reflect a Federal Communications Commission (FCC) adoption of a separations change in apportioning local switching costs based on dial equipment minutes (D.E.M.).

6. Investment Tax Credit Phase Out, $23.180 million - A Z-factor adjustment to recognize reduced tax benefits resulting from the Tax Reform Act of 1986 (TRA-86) repeal of the Investment Tax Credit.

7. **Excess Deferred Tax Phase Out, $28.411 million** - A Z-factor adjustment to reflect declining excess deferred taxes that resulted from the TRA-86 reduction of the statutory corporate income tax rate from 46% to 40% in 1986 and to 34% in 1987.

8. **Sales Tax Increase, $0.932 million** - A Z-factor adjustment to reflect an incremental increase of sales tax that disproportionately affects business in California.

Pacific also identified in its AL 16069 potential Z-factors for the required Computer Link in our Phase II monitoring decision but deferred until its next price cap filing, a prefunding adjustment for its Phase I rehearing application for Post-Retirement Benefits Other than Pensions (PBOP Prefunding), and a repricing of Inside Wire Maintenance (IWM Reprice) due to re-tariffing (ALs 16019 and 16019A).

The Price Cap Index factor of -0.2% is based on a change in the GNP-PI of 4.3% for Second Quarter 1991 over Second Quarter 1990. When the 4.5% productivity gain offset is applied, a Price Cap Index of -0.2% results. Applied to a billing base of $6,423,576,000, this factor results in a revenue requirement decrease of $12.846 million.

Pacific's total proposed 1992 Price Cap Index and Z-factor revenue requirement adjustments amount to a $78.388 million decrease.

SPF-to-SLU Revenue Requirement Shift

Ordering Paragraph 15 of D.89-10-031 required interLATA SPF-to-SLU revenue shifts and intraLATA SPF-to-SLU cost and settlement effects to be included in the price cap filing. The SPF-to-SLU interLATA transition in allocation of non-traffic-sensitive costs to access services was prescribed by D.85-06-115, to be accomplished through six annual steps beginning in 1986 and continuing in 1988 and each year thereafter through 1992.

The revenue requirement impact of the SPF-to-SLU transition is revenue neutral to Pacific. The interLATA SPF-to-SLU revenue shift for 1992 is:

Exchange	$44.133 million
Toll	$36.408 million
Access	($80.541 million)

The intraLATA SPF-to-SLU settlement effect is:

Exchange	($1.111 million)
Toll	$1.111 million

The change in the Carrier Common Line Charge (CCLC), excluding High Cost Fund increment, is:

CCLC	From	To
Premium Access Minute, each	$0.0170	$0.0123
Discounted Access Min.,each	$0.0133	$0.0096

PROTESTS

One timely protest to Pacific's AL 16069 was filed by DRA on October 21, 1991. Late-filed protests were also made on October 22, 1991, by AT&T and by MCI on October 23, 1991. AT&T's and MCI's protests are accepted due to extenuating circumstances resulting from the East Bay Hills fire at that same time.

Pacific responded to the protests of DRA, AT&T and MCI on October 29, 1991.

No protests were received with respect to Pacific's revenue requirement adjustments for Price Cap Index, USOAR Stepdown, $200 to $500 Expense Limit, and Dial Equipment Minutes

DRA protested Pacific's adjustments for Investment Tax Credit Phase Out, Excess Deferred Tax Phase Out, and Sales Tax Increase.

DRA also concurred with Pacific's proposed Z-factor adjustment deferral for the Computer Link, and commented on future Z-factor adjustment for the Pacific-DRA settlement agreement concerning the Research and Development (Telesis) Audit, IWM Reprice, and PBOP Prefunding.

AT&T protested Pacific's adjustments for Expensing Station Connections, Investment Tax Credit Phase Out, Excess Deferred Tax Phase Out, and Sales Tax Increase. MCI protested Pacific's adjustments for Investment Tax Credit Phase Out, Excess Deferred Tax Phase Out, and Sales Tax Increase.

We will discuss the protests in further detail below, and adopt a final revenue requirement adjustment for Pacific.

DISCUSSION

I. Expensing Station Connections

Pacific's Z-factor adjustment for a $106.709 million Expensing Station Connections revenue requirement decrease includes a $102.830 million decrease to reflect eleven months' amortization of depreciation reserves and a $6.464 million decrease required by the Commission in last year's price cap Resolutionn T-14235 to reflect rate base changes. Pacific has offset these decreases by a $2.585 million amount to adjust for separations and settlements effects. Pacific computed the $2.585 million by taking 36.7% (or 6.464/17.630) of the $7.044 million adjustment for separations and settlements accepted by the Commission in Resolution T-14235, where $17.630 million was the rate base change required by the Commission for 1991.

AT&T protests the $2.585 million separations and settlements adjustment. AT&T states that separations and settlements effects do not exist for 1992, since the amortization will be completed in 1991. Pacific responds that the Commission required a rate base change Z-factor of $6.464 million for this year, and it should be entitled to a separations and settlements adjustment.

When we required Pacific to consider rate base changes as Z-factors for Expensing Station Connections in Resolution T-14235, we explained that we computed the rate base changes on a point-to-point period basis, comparing relevant effects at the time rates become effective to comparable effects a year prior, considering the periods January 1, 1990, to January 1, 1991, and January 1, 1991, to January 1, 1992.

From CACD's workpaper of 12/5/90, we computed a change in average rate base for ratemaking for 1991 of ($90.649 million) [line 17a]; and for 1992, ($33.239 million) [line 17b]. We responded to Pacific's petition (Attachment A, Response of October 29, 1990 to Protests of AT&T and DRA to Pacific's AL 15821) that effects of deferred taxes, separations, and settlements would be considered in any rate base change Z-factor treatment we should adopt. We accepted Pacific's proposed adjustment of $3.100 million for settlement effects and $3.944 million for separations effects (or a total adjustment of $7.044 million).

However, we now note that Pacific's adjustment of $7.044 million was based on a 1991 rate base change of $102.817 million, instead of our average rate base change for 1991 of $90.649 million. Since Pacific has not submitted a separations and settlements adjustment for 1992 based on our computed average change of $33.239 million, we will simply increase the $7.044 million we accepted last year by the ratio of the total 1991 and 1992 adopted rate base change ($90.649 million plus $33.239 million, or $123.888 million) to the rate base change of $102.817 million assumed by Pacific. Hence we compute a total adjustment (1991 and 1992) for separations and settlements of $8.488 million (7.044*123.888/102.817).

Since Pacific has already received $7.044 million in last year's Resolution T-14235, we will apply the balance of $1.444 million ($8.488 million less $7.044 million) as the separations and settlements adjustment this year.

We will adopt a revenue requirement decrease for Expensing Station Connections of a $107.850 million, consisting of $102.830 million decrease for amortization expense, $6.464 million decrease for rate base change, and $1.444 million increase for separations and settlements effects for rate base changes.

II. Investment Tax Credit (ITC) and Excess Deferred Tax (EDT) Phase Out

DRA protests Pacific's inclusion of the ITC and EDT Phase Out as Z-factor adjustments in the 1992 price cap filing for three reasons. First, the Phase Out is not due to new tax law changes, it is an existing regulatory requirement and a normal cost of doing business. Therefore, the Phase Out does not meet the criteria for Z-factor treatment. Second, there has been no Commission directive to flow ITC and EDT cost changes into rates as with with other Z-factor adjustments such as the USOA Rewrite and the $200 to $500 expense limit increase. Third, DRA maintains that the FCC's decision to allow Z-factor treatment for the ITC and EDT Phase Out does not preempt this Commission.

DRA also points out that Pacific and GTEC use different methodologies for calculating the ITC and EDT Phase Out Z-factor adjustments, and should the Commission find that ITC and EDT Phase Out effects are allowable Z-factor adjustments, DRA recommends that a consistent methodology be determined, or that Pacific and GTEC file separate applications requesting recovery for ITC and EDT Phase Out, which would allow the development of a full record on this issue.

Pacific's response to DRA's protest is that DRA has an incorrect understanding of Z-factor criteria. Pacific contends that the Commission never held that if an exogenous event affects the utility's costs and is beyond the utility's control, it cannot qualify as a Z-factor even if the exogenous event causing the cost change originated before the new regulatory framework. Such a rule would contradict the purpose of the Z-factor, which Pacific explains is to allow adjustments for exogenous events over which the utility has no control. Pacific points out that the Commission has previously allowed Z-factor treatment for exogenous events originating before the adoption of NRF (e.g. USOA Rewrite, the $200 to $500 Expense Limit Increase, and Expensing Station Connections), and states that the Commission has found that tax law changes qualify as a Z-factor, referring to D.89-10-031, p.182, as support for its position.

AT&T and MCI protest Pacific's proposed Z-factor treatment for ITC and EDT Phase Out because it is their understanding that Pacific's 1990 start-up revenue requirement calculation did not reflect any ITC or EDT effects in the net-to-gross multiplier. If this understanding is correct, the ratepayers are not experiencing any ITC and EDT benefits now, and therefore should not be charged for any reduction in ITC and EDT.

Pacific's response is that ITC and EDT was reflected in the federal income tax component of the startup revenue adjustment calculation, and that the net-to-gross multiplier has nothing to do with ITC and EDT. In its response, Pacific recalculates the EDT Z-factor revenue requirement adjustment to be $28.411 million.

AT&T and MCI state that should Z-factor treatment be appropriate for ITC Phase Out, Pacific's calculation is incorrect because two years of change have been used, as opposed to one year. AT&T refers to Resolution T-14235, which compares effects on a point-to-point basis. AT&T also points out that D.89-10-031 requires that historical data be used when future cost changes are not known with a high degree of certainty, and suggests that Pacific does know what future levels of ITC and EDT will be because Pacific has filed this information with the FCC in its April 1, 1991 FCC price cap filing. Given that Pacific knows future ITC and EDT levels, AT&T believes that Pacific's methodology is inappropriate.

MCI contends that Pacific's method dips into previous periods and allows Pacific the discretion to revisit past periods in an attempt to create Z-factors.

In response to MCI's protest, Pacific states that MCI ignores the actual incremental change that has occurred as a result of the TRA-86 tax law change.

We agree with DRA that the Phase Out of ITC and EDT as a result of TRA-86 occurred prior to the adoption of the New Regulatory Framework, that the Phase Out is an existing regulatory requirement, and that there has been no Commission directive to flow ITC or EDT cost changes into rates as has occurred with other Z-factor adjustments such as the USOA Rewrite and the $200 to $500 expense limit increase.

We will adopt DRA's recommendation that Pacific's request for Z-factor treatment for ITC and EDT Phase Out be denied.

III. Sales Tax Increase

DRA protests Pacific's proposal to treat the 1.25% increase in California sales and use tax as a Z-factor, because the increase does not meet the criteria for Z-factor treatment as stated in D.89-10-031. DRA points out that in that decision changes in federal and state tax laws qualify as Z-factor adjustments to the extent that they affect local exchange carriers disproportionately. DRA also contends that the sales and use tax increase would be captured in the GNP-PI, and that Pacific has not met its burden to show that this increase in sales and use tax will not be picked up in the GNP-PI.

AT&T protests the inclusion of the sales and use tax increase as a Z-factor adjustment because the GNP-PI captures sales tax increases, and because Pacific has not met its burden of proof that the tax change affects Pacific disproportionately. AT&T also points out that the sales tax increase does not substantially impact Pacific's costs, which is a requirement for Z-factor treatment.

MCI protests the inclusion of the sales and use tax increase as a Z-factor because the increase does not affect Pacific disproportionately. MCI states that the increase does not represent a major impact intended for Z-factors, and believes that the GNP-PI will reflect the increase in future years.

Pacific responds to these protests by stating that the GNP-PI is a national index and therefore will not capture the tax increase because the increase is California specific. It believes that Pacific and other California companies are disproportionately affected and that the disproportionate effect is not reflected in changes in the GNP-PI. Pacific states that the cumulative effect of the sales tax increase could amount to several million dollars and is large enough to qualify as a Z-factor.

We agree with the arguments presented by DRA, AT&T, and MCI that the sales and use tax increase does not qualify for Z-factor treatment. The sales and use tax increase will impact all businesses in California and therefore will not have a disproportionate effect on the local exchange carriers. As to whether the GNP-PI captures the increase in sales and use tax, CACD has verified that the Department of Commerce office responsible for calculating the index uses gross receipts for its calculation. It is clear that the GNP-PI will capture the increase in sales and use tax.

In addition, while it may be true that a California sales tax increase in isolation will have a smaller effect on the GNP-PI than on a California utility, it is also true that sales tax increases frequently occur in other states and affect the GNP-PI more than they affect California utilities. Over the longer term, those effects will be offsetting and Pacific will be made whole by considering the GNP-PI alone.

For these reasons we deny Pacific's request to treat the sales and use tax increase as a Z-factor adjustment.

IV. Computer Link, Telesis Audit, IWM Reprice, and PBOP Prefunding

Regarding the proposed Z-factor deferral for the Computer Link, we note that GTEC has filed a petition for modification of our monitoring decision to allow for recovery of Computer Link costs in future price cap filings. Accordingly, we take no action with regard to Pacific's request for deferral of these costs herein and will address that request in GTEC's petition. The Telesis Audit will also be considered at a future time. IW Reprice will be reflected in Pacific's 1993 price cap filing, and the PBOP Prefunding issue has been deferred to Phase II of a later proceeding by our D.91-10-024.

FINDINGS

1. Pacific's AL 16069 filed October 1, 1991, as revised by its October 29, 1991, response to protests, proposes a $78.388 million revenue requirement decrease associated with its 1992 annual price cap index filing.

2. AL 16069 is filed in compliance with D.89-10-031 as modified by D.91-09-072.

3. Pacific's proposed revenue adjustments reflect:

   a. 1992 intraLATA SPF-to-SLU settlement effects (revenue neutral).

   b. 1992 interLATA SPF-to-SLU revenue shift (revenue neutral).

   c. 1992 Price Cap Index of -0.2% (revenue requirement decrease of $12.846 million).

d. Z-factor revenue requirement adjustments to reflect exogenous effects not reflected in the GNP-PI:

i.) USOAR Stepdown, revenue requirement decrease of $23.122 million.

ii.) $200 to $500 Expense Limit, revenue requirement decrease of $3.150 million.

iii.) Expensing Station Connections, revenue requirement decrease of $106.709 million.

iv.) Dial Equipment Minutes, revenue requirement increase of $14.916 million.

v.) Investment Tax Credit Phase Out, revenue requirement increase of $23.180 million.

vi.) Excess Deferred Tax Phase Out, revenue requirement increase of $28.411 million.

vii.) Sales Tax Increase, revenue requirement increase of $0.932 million.

In addition, Pacific identified potential Z-factors for:

viii.) Computer Link (deferred until next price cap filing).

ix.) PBOP Prefunding

x.) IWM Reprice

4. The 1992 interLATA SPF-to-SLU revenue shift is accomplished by a billing surcharge increase for exchange and toll services, a billing surcharge decrease for access services, and Carrier Common Line Charge decreases from $0.0170 to $0.0123 for each Premium Access Minute and from $0.0133 to $0.0096 for each Discounted Access Minute. The 1992 intraLATA SPF-to-SLU revenue shift is accomplished by a billing surcharge decrease for exchange services.

5. DRA, AT&T, and MCI protested Pacific's proposed revenue adjustments due to Expensing Station Connections, Investment Tax Credit Phase Out, Excess Deferred Tax Phase Out, and Sales Tax Increase. DRA has concurred with Pacific's proposed deferral of the Computer Link Z-factor.

6. The revenue requirement adjustments proposed by DRA and AT&T are as summarized in Appendix A to this Resolution.

7. $1.444 million is reasonable as the remaining separations and settlements effects adjustment for the total rate base change Z-factor adjustments we have required for Expensing Station Connections.

8. The total revenue requirement adjustment for 1992 for Expensing Station Connections should be a $107.850 million decrease. No further adjustments are required for Expensing Station Connections.

9. The ITC and EDT Phase Out is not the result of new tax law or regulatory requirement changes not anticipated in Pacific's startup revenue requirement, and thus does not meet the requirements for Z-factor treatment.

10. State sales tax increases, including California sales tax increases, are reflected in the GNP-PI and need not be included as Z-factors.

11. Consideration of PBOP Prefunding, Telesis Audit, IWM Reprice and Computer Link adjustments should be deferred.

12. A total price cap mechanism revenue requirement decrease for Pacific of $132.052 million is justified.

THEREFORE, IT IS ORDERED that:

1. Pacific Bell shall implement a $132.052 million revenue requirement decrease associated with its 1992 annual price cap index filing, including interLATA SPF-to-SLU revenue shift and intraLATA SPF-to-SLU settlement effect (Advice Letter 16069).

2. Pacific Bell shall supplement its AL 16069 on or before December 27, 1991, to implement billing surcharges/surcredits reflecting the revenue requirement decrease in Ordering Paragraph 1, applied to a total billing base of $6,423,576,000 for intraLATA exchange and private line services, intraLATA toll services, and intraLATA access service, to become effective on January 1, 1992, subject to review and approval by the Commission Advisory and Compliance Division.

3. We accept Pacific Bell's interLATA SPF-to-SLU revenue shift of $80,541,000, its intraLATA SPF-to-SLU settlement effect of $1,111,000, and its Carrier Common Line Charge (excluding High Cost Fund increment) of $0.0123 for each Premium Access Minute and $0.0096 for each Discounted Access Minute. They shall become effective on January 1, 1992.

This Resolution is effective today.

I certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on December 18, 1991. The following Commissioners approved it:

Neal J. Shulman

NEAL J. SHULMAN
Executive Director

PATRICIA M. ECKERT
President
JOHN B. OHANIAN
DANIEL Wm. FESSLER
NORMAN D. SHUMWAY
Commissioners

APPENDIX A - RESOLUTION T-14668

December 18, 1991

Pacific Bell Advice Letter 16069
1992 Price Cap Filing, $000

ITEM	A. PACIFIC	B. DRA	C. AT&T	D. ADOPTED
1. Price Cap (.2%) Impact	($12,846)	($12,846)	($12,846)	($12,846)
Z-Factors				
2. USOAR Stepdown	($23,122)	($23,122)	($23,122)	($23,122)
3. $200 to $500 expense limit	($3,150)	($3,150)	($3,150)	($3,150)
4. Expensing Station Connections	($106,709)	($106,709)	($109,294)	($107,850)
5. Dial Equipment Minutes	$14,916	$14,916	$14,916	$14,916
6. Investment Tax Credit Phase out	$23,180	$0	$0	$0
7. Excess Deferred Tax Phase out	$28,411	$0	$0	$0
8. Sales Tax Increase	$932	$0	$0	$0
TOTAL Price Cap and Z-Factor Adj	($78,388)	($130,911)	($133,496)	($132,052)