# PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Telecommunications Branch
Commission Advisory and Compliance Division

RESOLUTION T-14669
December 18, 1991

## RESOLUTION

RESOLUTION T-14669. GTE CALIFORNIA INCORPORATED (U-1002-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 5350, FILED ON OCTOBER 1, 1991, AS SUPPLEMENTED BY ADVICE LETTER 5350A, FILED OCTOBER 16, 1991, IN CONJUNCTION WITH ADVICE LETTER 5355, FILED NOVEMBER 8, 1991.

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**SUMMARY**

This Resolution orders GTE California Incorporated (GTEC) to reduce its annual revenue requirement by $29.693 million as a result of its 1992 annual price cap index filing (Advice Letter (AL) 5350/5350A).

This decrease reflects GTEC's 1992 interLATA SPF-to-SLU revenue shift (revenue neutral to GTEC), a 1992 price cap index decrease of $3.403 million, and a net Z-factor adjustment decrease of $26.290 million. These adjustments will be reflected effective January 1, 1992.

In addition, we authorize a monthly surcharge of 2.70% for the months of January, February, and March, 1992, to recover $10.181 million over-refunded by GTEC in October, 1991 as a result of a billing base error made by the company in conjunction with its sharable earnings refund AL 5343. AL 5355 filed November 8, 1991 corrects the error.

Protests to GTEC's AL 5350 were filed by the Commission's Division of Ratepayer Advocates, AT&T Communications of California, Inc., and Toward Utility Rate Normalization.

No protests were received concerning GTEC's AL 5355.

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 | (3,403) |
| Z-factors: | |
| USOA Turnaround | (11,527) |
| D.E.M. Transition-Interstate | 7,977 |
| Station Connection Amortization | (23,622) |
| Interstate High Cost Fund | 882 |
| Sales Tax Impact | 0 |
| Investment Tax Credit Phase Out | 0 |
| Excess Deferred Income Taxes Phase Out | 0 |
| Net Z-factor adjustments | (26,290) |
| Total Price Cap Impact with Z-factors | (29,693) |

## BACKGROUND

In our Decision (D.) 89-10-031, we adopted an incentive-based regulatory framework for Pacific Bell (Pacific) and 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..."
>
> . . .
>
> "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%."
>
> . . .
>
> "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, GTEC filed AL 5350 requesting billing surcharge/surcredit changes to be effective January 1, 1992, due to the 1992 price cap index mechanism, certain Z-factor adjustments, and 1992 InterLATA SPF-to-SLU revenue shifts. GTEC filed supplemental AL 5350A on October 16, 1991, updating its earlier request and correcting certain errors in the original advice letter.

The 1992 price cap filing revenue requirement adjustments requested by GTEC in its AL 5350/5350A are reflected in Column A of Appendix A to this Resolution.

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

1. Price Cap Index, ($5.347 million) - A 1992 Price Cap Index factor of -0.3%.

2. USOA Turnaround, ($11.527 million) - A Z-factor adjustment to reflect the Uniform System of Accounts (USOA) step down revenue requirement reduction ordered by D.87-12-063, I.87-02-023.

3. D.E.M. Transition - Interstate, $7.977 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.).

4. Station Connection Amortization, ($23.622 million) - A Z-factor adjustment to reflect the change of 1992 over 1991 in the amortization of station connections on GTEC's books.

5. Interstate High Cost Fund, $0.882 million - A Z-factor adjustment to account for less recovery from the Interstate High Cost Fund, applicable to local exchange billing base only.

6. **Sales Tax Impact, $0.880 million** - A Z-factor adjustment to reflect an incremental increase of sales tax that disproportionately affects GTEC's business in California.

7. **Investment Tax Credit Phase Out, $7.375 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.

8. **Excess Deferred Tax Phase Out, $2.921 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.

GTEC also identified in AL 5350 a Z-factor for prefunding adjustment for 1991 and 1992 pertaining to Post-Retirement Benefits Other than Pensions (PBOB Prefunding). GTEC deleted its PBOP Prefunding Z-factor with its Supplemental AL 5350A.

GTEC's total proposed 1992 price cap index and Z-factor revenue requirement adjustments amount to a $20.461 million decrease.

SPF-to-SLU Revenue Requirement

Ordering Paragraph 15 of D.89-10-031 required interLATA SPF-to-SLU revenue shifts to be included in the price cap filing. The SPF-to-SLU 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. This is the final SPF-to-SLU revenue shift.

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

| | |
|---|---|
| Exchange | $6.833 million |
| Toll | $7.708 million |
| Access | ($14.541 million) |

The change in the Carrier Common Line Charge (CCLC), which does not include the High Cost Fund increment, is:

| CCLC | From | To |
|---|---|---|
| Premium Access Min., each | $0.02154433 | $0.01756920 |
| Discounted Access Min., each | $0.01683151 | $0.01372600 |

Sharable Earnings Billing Base Error Correction

On November 8, 1991, GTEC filed AL 5355 to correct an error in the sharable earnings surcharge filed as AL 5343, effective October 1, 1991. When GTEC filed its AL 5343 requesting to refund $7.6 million as a sharable earnings surcharge, it made a billing base miscalculation which resulted in GTEC refunding $10.181 million more than was intended. AL 5355 proposes to correct the error through an adjustment of 2.70% to the toll and local billing adjustment factor surcharges during the period January 1, 1992, through March 31, 1992, to go into effect concurrently with AL 5350/5350A.

PROTESTS

One timely protest to GTEC's AL 5350/5350A was filed by the Commission's Division of Ratepayer Advocates (DRA) on October 21, 1991. Late-filed protests were also made on October 22, 1991, by AT&T Communications of California (AT&T) and by Toward Utility Rate Normalization (TURN) on October 23, 1991, and are accepted due to extenuating circumstances resulting from the East Bay Hills fire at that same time.

GTEC responded to the protests of DRA and AT&T on October 28, 1991.

No protests were received with respect to GTEC's revenue requirement adjustments for USOA Turnaround, D.E.M. Transition-Interstate, Station Connection Amortization, and Interstate High Cost Fund.

DRA's protest concerns GTEC's adjustments for the Price Cap Index, Sales Tax Impact, Investment Tax Credit Phase Out, and Excess Deferred Tax Phase Out

Although GTEC has not proposed a Z-factor adjustment for the required Computer Link in our Phase II monitoring decision, DRA suggests deferring any compensation for the Computer Link until a future Price Cap Filing. 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 will take no action with regard to Computer Link costs herein, and will address the matter in response to GTEC's petition.

TURN protested GTEC's proposed Z-factor adjustment for PBOP Prefunding. GTEC deleted its PBOP Prefunding Z-factor with its Supplemental AL 5350A.

AT&T protested GTEC's adjustments for Investment Tax Credit Phase Out, Excess Deferred Tax Phase Out, and Sales Tax Impact.

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

## DISCUSSION

### I. Price Cap Index

DRA points out that GTEC uses a GNP-PI of 4.2% in its filing, whereas Pacific uses a figure of 4.3%. DRA believes the latter number is correct, since it reflects the most current information available for verification at the time of both advice letter filings.

GTEC does not oppose DRA's recommendation; we concur with DRA and accept a figure of 4.3% for the GNP-PI. The GNP-PI less productivity factor of 4.5% results in a Price Cap Index factor of -0.2%, or a revenue decrease of $3.403 million.

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

DRA protests GTEC's inclusion of the ITC and EDT Phase Out as a Z-factor adjustment in its 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 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 GTEC and Pacific 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. Finally, DRA points out that GTEC had an error in the workpapers that accompanied GTEC's supplemental advice letter filing, but states that GTEC has provided assurance that the error will be corrected in a supplement to AL 5350A.

GTEC's response to DRA's protest is that DRA has an erroneous interpretation of the language in D.89-10-031 regarding Z-factor treatment, and that effects beyond the utility's control qualify for Z-factor treatment. GTEC contends that DRA's interpretation of Z-factor treatment is that there must be a future impact on the utility to qualify for Z-factor treatment, and that this interpretation is incorrect. According to GTEC, Z-factor treatment has no reference to time. GTEC believes that TRA-86 effects are beyond their control and therefore qualify as Z-factors. GTEC points out that the FCC has allowed Z-factor treatment for the effects of TRA-86.

Regarding DRA's statement that GTEC and Pacific are using different methodologies for calculating the revenue requirement impact of the ITC and EDT Phase Out, GTEC maintains that the estimation methodology used in its price cap filing is consistent with the procedures set forth in D.89-10-031 for calculating Z-factor adjustments. GTEC also believes that there is no requirement that Pacific and GTEC use the same estimation methodology.

AT&T protested GTEC's treatment of ITC and EDT Phase Out because GTEC did not have support in its price cap filing workpapers to verify that ITC and EDT Phase Out effects were reflected in GTEC's startup revenue requirement calculation.

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 and 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 GTEC's request for Z-factor treatment for ITC and EDT Phase Out be denied.

## III. Sales Tax Impact

DRA protests GTEC'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 effect local exchange carriers disproportionately. DRA also contends that the sales and use tax increase would be captured in the GNP-PI, and that GTEC has not met its burden to show that this increase in sales and use tax will not be picked up in the GNP-PI. DRA also objects to the method GTEC used to estimate the effect of the sales and use tax increase. Specifically, DRA believes that it is incorrect to include the rate base impact of the tax increase because: it will create future controversy; including a growth factor adjustment for expenses based upon estimated plant increases is improper for Z-factor treatment because it is speculative; the tax rate difference GTEC uses is incorrect; and because a portion of the tax increase is temporary and GTEC did not incorporate this fact in its filing. For these reasons, DRA recommends that the Commission not treat the increase as a Z-factor.

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 GTEC has not met its burden of proof that the tax change affects GTEC disproportionately. AT&T also points out that the sales tax increase does not substantially impact GTEC's costs, which is a requirement for Z-factor treatment.

GTEC responds to these protests by stating that its analysis indicates that the GNP-PI will not be significantly impacted by the tax increase because state specific tax changes do not have a measurable impact on the GNP-PI. This is so because the GNP-PI is a national index and the tax change in California is disproportionate to the national economy as a whole. Additionally, GTEC addresses DRA's protest regarding the inclusion of a temporary tax increase in its Z-factor by stating that while .25% of the tax increase was dropped January 1, 1991, GTEC will experience an ongoing .5% increase. This increase was not reflected in its price cap workpapers and will more than offset the .25% decrease.

We agree with the arguments presented by DRA and AT&T 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 increase will be captured in the GNP-PI.

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 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 GTEC will be made whole by considering the GNP-PI alone.

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

**FINDINGS**

1. GTEC filed AL 5350 on October 1, 1991, and supplemented it by AL 5350A on October 16, 1991, to propose a $20.461 million revenue requirement decrease associated with its 1992 annual price cap index filing.

2. ALs 5350/5350A are filed in compliance with D.89-10-031 as modified by D.91-09-072.

3. GTEC's proposed 1992 price cap index filing revenue adjustments reflect the:

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

   b. 1992 Price Cap Index of -0.3% (revenue requirement decrease of $5.347 million).

   c. Z-factor revenue adjustments to reflect exogenous effects not reflected in the Price Cap Index:

      i. USOA Turnaround - revenue requirement decrease of $11.527 million.

      ii. D.E.M. Transition - Interstate - revenue requirement increase of $7.977 million.

      iii. Station Connection Amortization - revenue requirement decrease of $23.622 million.

      iv. Interstate High Cost Fund - revenue requirement increase of $0.882 million.

      v. Sales Tax Impact - revenue requirement increase of $0.880 million.

      vi. Investment Tax Credit Phase Out - revenue requirement increase of $7.375 million.

      vii. Excess Deferred Tax Phase Out - revenue requirement increase of $2.921 million.

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 $0.02154433 to $0.01756920 for each Premium Access Minute and from $0.01683151 to $0.01372600 for each Discounted Access Minute.

5. Protests were filed by DRA, AT&T, and TURN against GTEC's proposed revenue adjustments due to the Price Cap Index, Sales Tax Impact, Investment Tax Credit Phase Out, and Excess Deferred Tax Phase Out.

6. TURN's protest of GTEC's proposed PBOP Prefunding was made moot by GTEC's Supplemental AL 5350A which deleted GTEC's proposed PBOP Prefunding.

7. Consideration of GTEC's Computer Link Z-factor should be deferred.

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

9. The most current figure for the GNP-PI at the time of GTEC's filing was 4.3%. This results in a Price Cap Index factor of -0.2%, or a revenue requirement decrease of $3.403 million.

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

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

12. A total price cap mechanism revenue requirement decrease for GTEC of $29.693 million is justified.

13. GTEC made a billing base error in its AL 5343 that resulted in GTEC's over-refunding $10.181 million in sharable earnings in October, 1991.

14. GTEC's AL 5355 proposes a surcharge of 2.70% for the months of January, February, and March, 1992, to recover the $10.181 million over-refunded in connection with its October, 1991 sharable earnings AL 5343.

15. No protests were received concerning GTEC's request to correct its sharable earnings over-refund.

16. GTEC's proposal to recover the $10.181 million sharable earnings over-refund is reasonable.

THEREFORE, IT IS ORDERED that:

1. GTE California (GTEC) shall implement a $29.693 million revenue requirement decrease associated with its 1992 annual price cap index filing, including interLATA SPF-to-SLU revenue shift (Advice Letters 5350/5350A).

2. GTEC shall supplement its Advice Letters 5350/5350A 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 $1,782,236,000 for local exchange services, intraLATA toll services, and intrastate access services, to become effective on January 1, 1992, subject to review and approval by the Commission Advisory and Compliance Division.

3. We accept GTEC's interLATA SPF-to-SLU revenue shift of $14.541 million and its Carrier Common Line Charge (excluding High Cost Fund increment) of $0.01756920 for each Premium Access Minute and $0.01372600 for each Discounted Access Minute. They shall become effective on January 1, 1992.

4. GTEC shall include among its billing adjustment factors, as requested by Advice Letter 5355, a monthly surcharge of 2.70% applied to local and toll services, effective January 1, 1992, through March 31, 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-14669

December 18, 1991

GTE California, Inc. Advice Letter 5350/5350A
1992 Price Cap Filing, $000

| ITEM | A. GTEC | B. DRA | C. AT&T | D. ADOPTED |
|---|---|---|---|---|
| 1. Price Cap (.3%) Impact | ($5,347) | ($3,403) | ($5,347) | ($3,403) |
| Z-Factors | | | | |
| 2. USOA Turnaround | ($11,527) | ($11,527) | ($11,527) | ($11,527) |
| 3. D.E.M. Transition-Interstate | $7,977 | $7,977 | $7,977 | $7,977 |
| 4. Station Connection Amortization | ($23,622) | ($23,622) | ($23,622) | ($23,622) |
| 5. Interstate High Cost Fund | $882 | $882 | $882 | $882 |
| 6. Sales Tax Impact | $880 | $0 | $0 | $0 |
| 7. Investment Tax Credit Phase Out | $7,375 | $0 | $0 | $0 |
| 8. Excess Deferred Tax Phase Out | $2,921 | $0 | $0 | $0 |
| TOTAL Price Cap and Z-Factor Adj | ($20,461) | ($29,693) | ($31,637) | ($29,693) |