

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Telecommunications Branch
Commission Advisory and Compliance Division

RESOLUTION T-15160
December 16, 1992

R E S O L U T I O N

RESOLUTION T-15160. PACIFIC BELL (U-1001-C). ORDER APPLYING THE ADOPTED PRICE CAP MECHANISM IN COMPLIANCE WITH DECISIONS 89-10-031 AND 92-09-081 THROUGH ADJUSTMENTS TO SURCHARGES/SURCREDITS TO BE EFFECTIVE JANUARY 1, 1993.

BY ADVICE LETTER NO. 16343, FILED OCTOBER 1, 1992, AS SUPPLEMENTED BY ADVICE LETTER NO. 16343A, FILED OCTOBER 13, 1992.

SUMMARY

This Resolution orders Pacific Bell (Pacific) to reduce its annual revenue requirement by \$11.757 million as a result of its 1993 annual price cap index filing in Advice Letter (AL) No. 16343.

This decrease reflects Pacific's 1993 price cap index decrease of \$90.575 million, and a net Z-factor adjustment increase of \$78.818 million. These adjustments will be reflected effective January 1, 1993.

Protests to Pacific's AL No. 16343 were filed by the Commission's Division of Ratepayer Advocates (DRA), AT&T Communications of California, Inc. (AT&T), MCI Telecommunications Corporation (MCI), and Toward Utility Rate Normalization (TURN).

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

1993 Price Cap Revenue Requirement Change, \$000

Price Cap Impact (1.4%) without Z-factors	(90,575)
Z-factors: ongoing revenue requirement impact	
USOAR Stepdown	(23,122)
\$200/\$500 Expense Limit	(2,550)
Inside Wire Maintenance	(3,874)
State Tax Law - Vacation Pay Accrual	(4,300)
Dial Equipment Minutes	8,005
G.O. 133-B Business Office Answer Meas.	2,950
Infrastructure Expense	(11,000)
PBOPs	107,511
Sub-Total	<u>73,620</u>
Z-factors: one-time revenue requirement impact	
Inside Wire Maintenance	(3,228)
Inside Wire Demarcation	8,074
G.O. 133-B	352
Disaster Recovery	0
Sub-Total	<u>5,198</u>
Net Z-factor adjustment	78,818
Total Price Cap Impact with Z-factors	(11,757)

Note - revenue reduction in ()

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. . . .

* * *

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-92-09-081, we granted the requests of Pacific and GTEC to implement the 1993 price cap rate adjustments through the billing surcharge/surcredit mechanism, and called for Pacific and GTEC to file advice letters no later than October 1, 1992, for Commission consideration and approval to apply adjustments to their surcharges/surcredits to be effective January 1, 1993.

On October 1, 1992, Pacific filed AL No. 16343 requesting billing surcharge/surcredit changes to be effective January 1, 1993, in order to implement the 1993 price cap index mechanism and certain Z-factor adjustments. On October 13, 1992, Pacific filed AL No. 16343A clarifying the one-time and on-going aspects of the Z-factors adjustments submitted in AL No. 16343. The 1993 price cap filing revenue requirement adjustments requested by Pacific in its AL No. 16343 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, (\$90.575 million) - A 1993 Price Cap Index factor of -1.4%.
2. USOAR Stepdown, (\$23.122 million) - A Z-factor adjustment to reflect the Uniform System of Accounts Rewrite (USOAR) step down revenue requirement reduction ordered by D.88-09-030, I.87-02-023.
3. \$200 to \$500 Expense Limit, (\$2.550 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 in rate base (D.90-09-029, A.90-02-050).
4. Inside Wire Maintenance, (\$3.874 million) - A Z-factor reflecting an on-going revenue requirement reduction ordered by Resolution T-14688 in response to Pacific's AL No. 16019A, modifying rules and charges for repair of simple inside wire services.
5. State Tax Law - Vacation Pay Accrual, (\$4.300 million) - A negative Z-factor adjustment to reverse the revenue

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adjustment granted for two years by the 1991 Price Cap Index Filing, Resolution T-14235.

6. Dial Equipment Minutes, \$8.005 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 (DEM).
7. G.O. 133-B, \$8.948 million - A Z-factor to reflect on-going expenditures associated with additional force and equipment to comply with G.O. 133-B business office answer standards.
8. Infrastructure Expense, (\$11.000 million) - A Z-factor adjustment to reflect termination of Commission-authorized recovery of expenses associated with certain switch replacements (D.89-10-031).
9. Inside Wire Maintenance, (\$3.228 million) - A Z-factor adjustment to reflect a one-time adjustment for that portion of 1992 during which the new Inside Wire Maintenance rates were effective.
10. Inside Wire Demarcation, \$8.074 million - A Z-factor adjustment to reflect one-time cost recovery associated with implementation of D.92-01-023 Inside Wire Demarcation settlement.
11. G.O. 133-B, \$4.603 million - A Z-factor adjustment to reflect a one-time increase in certain costs associated in compliance with business-office answer-time standards.
12. Disaster Recovery, \$6.861 million - A Z-factor adjustment to reflect one-time recovery of costs associated with restoration of telecommunications service to areas within California impacted by declared disasters.

Pacific also identified in its AL No. 16343 a potential Z-factor adjustment for the Computer Link required in our Phase II monitoring decision but deferred this adjustment until its next price cap filing.

The Price Cap Index factor is based on a change in the GNP-PI of 3.1% for the second quarter 1992 over the second quarter 1991, which, together with the 4.5% productivity gain factor, results in a net Price Cap Index of -1.4%. Applied to a billing base of \$6,469,616,000, this factor results in a revenue requirement decrease of \$90.575 million.

Pacific's total 1993 Price Cap Index and Z-factor revenue requirement adjustments amount to a \$102.158 million decrease as proposed in AL No. 16343. On December 8, 1992, Pacific made a compliance filing pursuant to D.92-12-015 and requested an additional amount of \$107.511 for Post Retirement Benefits Other

than Pensions (PBOPs) funding. Pacific's revised total proposed revenue requirement adjustments amount to a \$5.353 million increase.

PROTESTS

Protests were filed to Pacific's AL No. 16343 and AL No. 16343A by DRA, AT&T, and MCI on October 21, 1992, and by TURN on October 22, 1992.

Pacific responded to the protests of DRA, AT&T, MCI, and TURN on October 27, 1992.

No protests were received with respect to Pacific's revenue requirement adjustments for the Price Cap Index, nor for the following proposed Z-factor adjustments: the \$200/\$500 Expense Limit, the Inside Wire Maintenance, the Inside Wire Demarcation, the State Tax Law - Vacation Pay Accrual, the Dial Equipment Minutes, and the Infrastructure Expense.

DRA and AT&T protested Pacific's adjustments for G.O. 133-B and Disaster Recovery. TURN protested Pacific's adjustments for G.O. 133-B, Disaster Recovery, and USOAR Stepdown. MCI protested Pacific's adjustment for Disaster Recovery.

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

DISCUSSION

I. G.O. 133-B - Service Measurement Standards

Pacific's G.O. 133-B revenue requirement consists of two Z-factor adjustments, a one-time adjustment of \$4.603 million and an ongoing requirement of \$8.948 million, both requested by Pacific to ensure it meets the implementation schedule set in D.92-05-056 for service measurement standards for business office answer response, which were:

70% of business office calls answered within 20 seconds, beginning 1/1/92;

75% of business office calls answered within 20 seconds, beginning October 1, 1992, and

80% of business office calls answered within 20 seconds, beginning July 1, 1993.

These business office answer measurement standards and schedule, which were to begin January 1, 1992, were actually known to Pacific as early as July 31, 1991, because of the company's participation in the G.O. 133 Review Committee meetings. Pacific began to assign new employees and to buy new equipment to meet the proposed business office answer-time implementation schedule, prior to the January 1992 effective date and well in

advance of the May decision date. Of the one-time \$4.603 million revenue requirement, Pacific identifies \$4.385 million for 1991 and 1992 labor and non-labor expenses to meet and maintain the 70% standard (which was to be effective January 1, 1992). The remaining \$0.218 million of the one-time \$4.603 million Z-factor is for 1993 non-labor costs to achieve 1993 standards. Of the \$8.948 million requested in the on-going Z-factor, \$2.950 million is for maintaining the 70% level in 1993, and an additional \$5.998 million would be needed to achieve the 75% level in the same year.

Pursuant to requests from Interexchange Carriers for rehearing of D.92-05-056, an automatic stay was implemented. On July 26, 1992, we issued an indefinite stay of D.92-05-056, and on August 14, 1992, we limited rehearing of the application of G.O. 133 to Interexchange Carriers.

DRA and TURN both protested the entire G.O. 133-B revenue requirement adjustment of Pacific. DRA states that Pacific is barred from recovering its past G.O. 133-B expenditures prior to authorization for recovery of such costs, by specific authorization from the Commission to establish a memorandum account, balancing account, tracking account, or other mechanism for preserving these costs. DRA believes that recovery of costs incurred by Pacific prior to the date of such an authorization would constitute retroactive ratemaking and should not be allowed.

TURN objects to Pacific--a NRF utility, responsible to react to incentives and competition according to its own dictates--asking ratepayers to pay the costs of implementing increased service-level standards. TURN argues that this would permit the company to get full ratepayer funding for a service improvement that, to meet competitive demands, Pacific would have to make anyway.

AT&T states that Pacific should only be granted \$2.950 million in 1993 labor expense needed to remain at the 70% performance standard.

Responding to DRA, Pacific pointed out that D.92-05-056 adopted the business office answering time standard retroactively to January 1, 1992, and this, the 1993 Price Cap filing, is the first opportunity for Pacific to seek recovery of incurred costs resulting from implementation of D.92-05-056. Pacific further states that if the DRA's argument were to be accepted, it would have a chilling effect on Pacific's efforts to respond to exogenous events when costs must be incurred.

To TURN's arguments that the company could make its own decision to improve service levels, Pacific responds that TURN has ignored the fact that the company's management does not have a choice to not implement a standard after the standard has become a Commission requirement.

We agree with Pacific and decide that G.O. 133-B business office answer compliance costs are legitimate Z-factors. We do not consider it necessary for Pacific to have requested prior

authority to track G.O. 133 change compliance costs in order to be eligible to recover such costs. To require our new regulatory framework utilities to request authorization to establish a memorandum account for each possible exogenous event as it occurs would be burdensome, clearly contrary to our goal of low cost, efficient regulation, and, by denying the company the opportunity to recover costs incurred in good faith, not in the spirit of the new framework.

The only issue remaining is the point at which compliance with the 70% standard is required. Decision No. 92-05-056 indicated a date of January 1, 1992. However, due to stays, D.92-05-056 never went into effect. Furthermore, D.92-12-007, effective December 3, 1992, has reset the 70% level compliance date to December 3, 1992. Accordingly, we will accept Pacific's costs necessary to meet that standard on December 3, 1992, and following. These costs are \$0.112 million in equipment costs and 28 days of 1992 labor expense, which equates to \$0.240 million, as well as \$2.950 million in labor expense for 1993.

D.92-12-007 has also reset the dates for compliance with the 75% and 80% standards to October 4, 1993, and July 5, 1994, respectively. Since Pacific's 1993 75% and 80% costs have not been revised to reflect the new schedule, we will defer recovery of those costs until its 1994 Price Cap filing.

Accordingly, Pacific should include in its 1994 Price Cap filing its costs recorded after December 3, 1992 (the effective date of D.92-12-007), which are necessary to attain the 75% standard by October 4, 1993 and the 80% standard by July 5, 1994.

II. Disaster Recovery

Pacific has requested a one-time Z-factor adjustment of \$6.861 million for declared disasters in 1992:

\$1.005 million	Oakland/Berkeley Fire
4.722 million	Los Angeles/Ventura Flooding
0.952 million	South Central Los Angeles Civil Disturbance
0.182 million	Calaveras County Fire

\$6.861 million = one-time Disaster Recovery increase

Pacific booked these costs in its Catastrophic Event Memorandum Accounts (CEMA) in conformance with Commission Resolution E-3238.

DRA protests Pacific's request for Z-factor recovery of costs associated with the four disasters, pointing out that the establishment of a CEMA account does not assure recovery of the costs. DRA believes that these costs should be treated as part of Pacific's cost of doing business. DRA argues further that Pacific's insurance coverage, which in these events would not come into play until a deductible loss of \$60 million had been

incurred, is the product of a management decision, and that these costs should therefore not be treated as exogenous, Z-factor expenses.

AT&T concurs with DRA, and states that under NRF, Pacific is granted management discretion to run its business. AT&T says that if Pacific chooses not to arrange coverage for these types of disasters, it should not now be asking for reimbursement from monopoly ratepayers.

MCI states that incentive regulation allows Pacific to manage its costs without Commission intervention, and that the Commission need not consider Pacific's decision not to insure against disasters, and on this basis, the costs of disaster recovery should be eliminated from the price cap calculation.

TURN states that Pacific has not demonstrated the reasonableness of the costs recorded in the CEMA.

Pacific objects to DRA's belief that the extraordinary costs of the disasters are normal costs of doing business. Pacific states that the Z-factor was intended to recover costs resulting from exogenous events, beyond the utility's control. Pacific believes that if the Commission has to consider possible cost of insurance, possible deductible amounts, possible coverage limits, etc., then this speculative determination would generate the type of controversy the Z-factor was created to avoid.

We agree with AT&T, DRA, and MCI, and believe that NRF allows Pacific sufficient management discretion to run its business. As AT&T points out, the Commission should not make California ratepayers the insurer of last resort for Pacific's shareholders.

We reject Pacific's Z-factor request for \$6.861 million for Disaster Recovery expenses.

III. USOAR Stepdown

TURN protests Pacific's statement in its USOAR Stepdown calculation that the USOAR Stepdown concludes in 1994 as incorrect. TURN states that the USOAR Stepdown should continue after 1994. TURN doesn't state when it should discontinue, if at all.

Pacific responds that TURN is incorrect, that Pacific's USOAR Stepdown methodology is correct, and should be continued only until the USOAR expense balance is eliminated, pursuant to the methodology employed in Pacific's 1990, 1991, and 1992 Price Cap Filings.

We make no conclusion at this time on the propriety or impropriety of Pacific's statement that the stepdown concludes in 1994. Noting that no party has argued that the stepdown for 1993 is inappropriate, we will accept Pacific's calculation for its 1993 Z-factor treatment.

IV. Post Retirement Benefits Other than Pensions - PBOPs

In its Price Cap filing, Pacific did not originally identify a specific funding requirement for the Commission's anticipated adoption of FSAS 106, Employers Accounting for Post Retirement Benefits Other than Pensions (PBOPs). Our Decision No. 92-12-015, December 3, 1992, in I.90-07-037, authorized Pacific to recover the increase in PBOPs costs under FSAS 106 to the extent of its tax-deductible contributions to PBOPs trusts, with certain limitations, and required Pacific to make a compliance filing setting forth the revenue requirement impact of this decision.

On December 8, 1992, Pacific filed a request for a PBOPs revenue requirement of \$107.511 million. We accept this PBOPs funding requirement, filed in accordance with D.92-12-015, as a Z-factor for 1993. Z-factor treatment of PBOPs' costs shall be tried up in each subsequent years' Z-factor filings in accordance with Ordering Paragraph No. 8 of that decision.

FINDINGS

1. Pacific's AL No. 16343 filed October 1, 1992, as supplemented by AL No. 16343A, filed October 13, 1992, proposes a \$102.158 million revenue requirement decrease associated with its 1993 annual price cap index filing.
2. AL No. 16343 is filed in compliance with D.89-10-031 as modified by D.92-09-081.
3. Pacific's proposed revenue adjustments reflect:
 - a. 1993 Price Cap Index of -1.4% (revenue requirement decrease of \$90.575 million).
 - b. 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 \$2.550 million.
 - iii.) Inside Wire Maintenance, a revenue requirement decrease of \$3.874 million, on-going, and a one-time \$3.228 million revenue requirement decrease.
 - iv.) State Tax Law - Vacation Pay Accrual, revenue requirement decrease of \$4.300 million.
 - v.) Dial Equipment Minutes, revenue requirement increase of \$8.005 million.

- vi.) G.O. 133-B, a revenue requirement increase of \$8.948 million, on-going, and a one-time \$4.603 million revenue requirement increase.
- vii.) Infrastructure Expense, revenue requirement decrease of \$11.000 million.
- ix.) Inside Wire Demarcation, revenue requirement increase of \$8.074 million.
- x.) Disaster Recovery, a one-time revenue requirement increase of \$6.861 million.

In addition, Pacific identified a potential Z-factor for its Computer Link, which is deferred until its next price cap filing.

4. DRA and AT&T protested Pacific's proposed revenue adjustments due to G.O. 133-B and Disaster Recovery. TURN protested Pacific's adjustments for G.O. 133-B, Disaster Recovery, and USOAR Stepdown. MCI protested Pacific's adjustment for Disaster Recovery.
5. The revenue requirement adjustments proposed by DRA are summarized in Appendix A to this Resolution.
6. Equipment costs of \$0.112 million and labor costs of \$0.240 should be allowed for compliance with G.O. 133-B 70% answer time standard since the effective date of D.92-12-007.
7. Labor costs of \$2.950 million for compliance with the G.O. 133-B 70% answer time standard should be allowed for 1993. Pacific's request to recover G.O. 133-B 75% and 80% level compliance costs should be deferred until its 1994 Price Cap filing. Pacific should include recorded costs incurred after December 3, 1992 (the effective date of D.92-12-007), to attain the 75% standard by October 4, 1993 and the 80% standard by July 5, 1994.
8. Pacific's request for \$6.861 million for Disaster Recovery expenses should be denied.
9. Consideration of the Computer Link adjustment should be deferred.
10. We will accept Pacific's 1993 USOAR Stepdown calculation.
11. We accept Pacific's request for \$107.511 million in PBOPs costs filed pursuant to D.92-12-015.
12. A total price cap mechanism revenue requirement decrease of \$11.757 million is justified. The adopted revenue requirement adjustments are summarized in Appendix A to this Resolution.

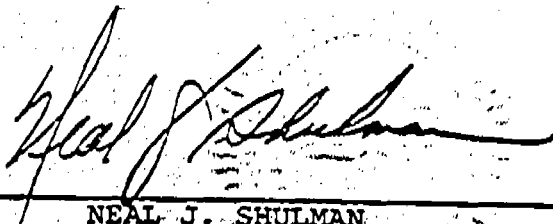
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THEREFORE, IT IS ORDERED that:

1. Pacific Bell shall implement a \$11.757 million revenue requirement decrease associated with its 1993 annual price cap index filing (Advice Letters Nos. 16343 and 16343A).
2. Pacific Bell shall supplement its AL No. 16343 on or before December 28, 1992, to implement billing surcharges/surcredits reflecting the revenue requirement decrease in Ordering Paragraph 1, applied to a total billing base of \$6,469,616,000 for intraLATA exchange and private line services, intraLATA toll services, and intraLATA access service, to become effective on January 1, 1993, subject to review and approval by the Commission Advisory and Compliance Division.

This Resolution is effective today.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on December 16, 1992. The following Commissioners approved it:



NEAL J. SHULMAN
Executive Director

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

APPENDIX A - RESOLUTION T-15160

December 16, 1992

Pacific Bell Advice Letter 16343
1993 Price Cap Filing, \$000

ITEM	A. PACIFIC	B. DRA	C. ADOPTED
1. Price Cap (1.4%) Impact	(\$90,575)	(\$90,575)	(\$90,575)
Z-Factors - ongoing			
2. USOAR Stepdown	(\$23,122)	(\$23,122)	(\$23,122)
3. \$200 to \$500 expense limit	(\$2,550)	(\$2,550)	(\$2,550)
4. Inside Wire Maintenance	(\$3,874)	(\$3,874)	(\$3,874)
5. State Tax Law - Vacation Pay Accrual	(\$4,300)	(\$4,300)	(\$4,300)
6. Dial. Equipment Minutes	\$8,005	\$8,005	\$8,005
7. G.O. 133-B	\$8,948	\$0	\$2,950
8. Infrastructure Expense	(\$11,000)	(\$11,000)	(\$11,000)
9. PBOP	\$107,511	\$0	\$107,511
Z-factors - one-time			
9. Inside Wire Maintenance	(\$3,228)	(\$3,228)	(\$3,228)
10. Inside Wire Demarcation	\$8,074	\$8,074	\$8,074
11. G.O. 133-B	\$4,603	\$0	\$352
12. Disaster Recovery	\$6,861	\$0	\$0
TOTAL Price Cap and Z-Factor Adj	\$5,353	(\$122,570)	(\$11,757)