PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Telecommunications Division

RESOLUTION T-15996
Date March 7, 1997

R E S O L U T I O N

RESOLUTION T-15996. APPROVES MODIFICATIONS TO PACIFIC BELL'S (PACIFIC'S) TOTAL SERVICE LONG RUN INCREMENTAL COST (TSLRIC) STUDIES REGARDING THE ASSIGNMENT OF OPERATING EXPENSES AND VOLUME SENSITIVE UNBUNDLED LOOP COSTS AS ORDERED BY DECISION (D.) 96-08-021 OF THE COMMISSION'S OPEN ACCESS AND NETWORK DEVELOPMENT PROCEEDING.

BY ADVICE LETTER NO. 18434, FILED ON AUGUST 16, 1996 AND SUPPLEMENTED BY ADVICE LETTER NOS. 18434A, FILED ON OCTOBER 18, 1996 AND 18434B FILED ON DECEMBER 23, 1996.

/

SUMMARY

This Resolution approves Pacific's Advice Letter No. (AL) 18434 and Supplemental AL No.s 18434A & 18434B which adjusts loop costs associated with copper cable as ordered in D.96-08-021 and identifies total operating expense dollars associated with trouble report generation.

This Resolution also requires Pacific to reassign operating expenses associated with trouble report generation (inclusive of database management operating expenses) and special access testing to Pacific's retail services.

BACKGROUND

On August 8, 1996 the Commission adopted Decision (D.) 96-08-021. In so doing, the Commission ordered Pacific to revisit several categories of operating expenses treated as shared family and shared common costs (joint and common costs) in Pacific's TSLRIC studies (submitted January of 1996). D.96-08-021 also listed several categories of numeric codes (also referred to as function codes) that were to be reviewed by Pacific and then assigned to services and/or basic network elements as direct costs if appropriate. D.96-08-021 directed Pacific to review the following expense categories:

1)Trouble Report Generation (this function is used to process 611 calls by end users)
2)Database Management (for trouble report generation)
3)Advertising (which includes product specific as well as corporate wide advertising)
4)Special Access Testing
5)Company Officers (sixth level and above)
6)Lifeline Fund Reimbursement (reimbursement for ULTS administrative expenses)

In directing Pacific to revisit the manner in which these operating expenses were originally assigned D.96-08-021 stated the following:

> Further analysis is required because we do not believe that Pacific has furnished an adequate justification for its treatment of the expenses represented by these (function) codes as "shared family" costs. With respect to these expenses, Pacific has not demonstrated that the costs would be avoided if the services were not furnished, which as the Coalition notes is the basic test for a volume-sensitive cost. Moreover, it appears from our own examination of the tracking codes related to these function codes that in some cases, the tracking codes can be assigned to specific services.

Adjustments to the Pacific's TSLRIC cost studies (to be submitted under General Order (G.O.) 96-A) were not limited to the issue of operating expense assignments. In addition, D.96-08-021 directed Pacific to revise certain inputs to its unbundled loop study for buried copper cable costs. As such, D.96-08-021 contemplated a reduction in unbundled loop costs once Pacific made the adjustments set forth in its Compliance Reference Document (CRD).

PROTESTS

Protest were filed by AT&T Communications of California (AT&T) and MCI Telecommunications Corporation (MCI) on September 5, 1996 and by the California Cable Television Association (CCTA) on September 6, 1996. All protesting parties took issue with Pacific's treatment of operating expenses. However, only AT&T protested Pacific's adjustment for buried copper cable costs. No protests were filed with regard to Pacific's supplemental Advice Letter (AL) Nos. 18434A or 1834B. Pacific filed its response to the protests of the parties on September 12, 1996.

and therefore should be assigned directly to services. The basis for this argument is the parties interpretation of our own Consensus Costing Principle (CCP) Number 1, adopted in D.95-12-016, which states:

> Long run is a period of time long enough so that all costs are treated as avoidable. Avoidable costs can include both volume sensitive and volume insensitive costs. The purpose of this principle is to preclude the possibility of cross-subsidization by ensuring that TSLRIC estimates include all costs necessary to provision a telecommunications service.

This principle conflicts with our definition of shared cost (also adopted in D.95-12-016) which defines shared costs as,

> Costs that are attributable to a group of outputs but not specific to any one within the group, which are avoidable only if <u>all</u> outputs within the group are not provided."

From a practical matter, as the protesting parties note, unassigned shared and common costs may serve to allow Pacific the opportunity to establish excessively low price floors. Also we note that D.96-08-021 contemplated such a divergence in principles and cost study methodology and therefore stated the following:

> Rather than prejudging how price floors should be set, as the Coalition implicitly asks us to do, we will allow parties to litigate in the hearings, the extent to which shared family costs should be included in price floors.

Thus although we may not find merit in all of the parties arguments as summarized above, an additional layer of comfort exists in D.96-08-021's assurance that shared family expenses may be considered for the purpose of setting price floors. Also we note that our adopted definition of shared cost does not suggest that all volume sensitive costs of the firm are without question service specific in nature. None the less (in some instances) we will require Pacific to make certain adjustments to its operating expense analysis in order to reduce the size of its unassigned shared and common costs.

<u>Trouble Report Generation</u>

In Pacific's September 12, 1996 filed response to parties protests Pacific stated that if the Commission rejected Pacific's argument that trouble report expenses

AT&T's Protest

AT&T protests Pacific's treatment of trouble report generation costs (which includes database expenses associated with trouble report generation). AT&T's principal argument is that trouble report generation costs are directly related to the number of customers. Therefore, fewer customers result in fewer trouble report calls; as such trouble report generation expenses should be assigned to services and treated as volume sensitive in nature.

AT&T also protests Pacific's treatment of advertising expenses arguing that Pacific has not adequately supported its position that its 1995 advertising expense assignment is reasonable and is an attempt to obtain maximum pricing flexibility by inflating common overhead expenses (and minimizing service specific costs).

Finally AT&T states that it believes Pacific has not entirely modified costs for buried A and B loop costs as ordered by D.96-08-021. In failing to do so, AT&T argues that Pacific has overstated the costs for unbundled loops and related access line services.

MCI's Protest

MCI also protests Pacific's treatment of Trouble Report Generation and Advertising expenses for reasons similar to AT&T's argument. In addition, MCI argues that 6th Level and above managers and executives should also be treated as volume sensitive expenses because such positions vary directly with the number of customers. As such, all function codes associated with these management positions should be reassigned to relevant retail services.

CCTA's Protest

CCTA's protest with regard to Trouble Report Generation expenses, Company Offices and Advertising expenses are similar to those of AT&T and MCI. In addition, CCTA protests Pacific's apparent willingness to assign special access testing expenses directly to services without a fuller showing of how such expenses will be assigned. CCTA also argues that operating expenses for the Lifeline Fund Reimbursement should be assigned to residential services.

DISCUSSION

Consistently, AT&T, MCI and CCTA maintain that virtually all operating expenses are volume sensitive in nature were shared in nature, alternatively the Commission could assign trouble report expenses based on the number of calls per service. Since AT&T endorses a similar approach in its September 5, 1996 protest we will direct Pacific to assign trouble report generation costs associated with 611 to services via the allocation methodology proposed by Pacific in its August 16, 1996 AL 18434. Also we will direct Pacific to reassign all support expenses identified in its December 23, 1996 supplemental AL 18434B to appropriate retail access line services..

Trouble Report Generation Expenses (for databases)

Unlike trouble report generation costs, database management costs are a product of processing errors caused by work order entry. Pacific argues in its September 12, 1996 response to parties that unlike trouble reports themselves, accurate tracking records for the types of trouble report processing errors do not exist. We have no factual reason to believe that errors associated with processing will occur more or less frequently than trouble report calls themselves. Therefore we will direct Pacific to assign all trouble report generation (database) expenses using the same percentages identified by Pacific for trouble report generation calls as required above.

Advertising Expenses

As noted above, protesting parties argue that all advertising expenses should be assigned directly to services as ultimately being volume sensitive in nature. Pacific argues in its September 12, 1996 response to protests that it identified three types of advertising expenses in its TSLRIC submissions. The first type of advertising expenses are brand name recognition campaigns (treated as a shared common cost), the second type are advertising campaigns that target a group or family of services (treated as a shared family cost) and the third type of advertisement expenses are unique to a single service.

Unlike trouble report generation costs above, a reliable method has not been proposed that would allow us to accurately reassign advertising expenses for corporate branding and families of services. Also Pacific's assignment process has correctly assigned several million dollars in advertising expenses directly to services rather than as a shared or common cost as the protests suggest. Finally, as noted above in our price floor discussion, parties will be free to litigate the extent to which shared family expenses should be assigned to price floors in the pricing phase of OANAD.

Therefore we will not require additional reassignment of advertising expenses at this time.

Special Access Testing

Pacific's support for AL 18434 notes that an error in assigning special access testing expenses was detected and that such expenses should be assigned to dedicated services. As noted above CCTA, agrees that special access testing expenses should be assigned to services; however, CCTA requests that Pacific provide the parties of record the overlay methodology Pacific will use to reassign these operating expenses. We agree and will direct Pacific to reassign special access testing expenditures to dedicated services in a uniform manner and will require that Pacific resubmit this assignment methodology in compliance with this resolution.

Company Officers (Sixth Level & Above)

The issue of whether or not officers of the company (so called 6th level and above management) are volume sensitive most accurately characterizes the differences between the parties. As noted above, both MCI and CCTA argue that such expenses are directly tied to services and the number of customers. Pacific maintains that company officers are not assigned to services because such individuals have broad company wide responsibilities. AT&T is silent on this issue.

Our own order on costing methodology, D.95-12-016 adopted the following definition for common costs.

> Costs that are common to all outputs offered by the firm. While these costs are not considered part of a TSLRIC study, recovery of such costs is required. Recovery of common costs is a pricing issue.

We find Pacific's assignment process for 6th level reasonable only to the extent that such treatment comports to our own definition of common costs. However, we will defer to the pricing phase of OANAD to determine an appropriate level of common cost recovery (and by default 6th level and above expenses)

Lifeline Reimbursement Fund

As noted above, CCTA argues that a portion of these costs (as they relate to 6th level and above officers) should be reassigned to residential services. No other parties protest this aspect of Pacific's assignment process. As above, we will withhold judgement on this issue until the pricing phase of OANAD.

Unbundled Loop Costs for (A & B Plant)

Pursuant to D.96-08-021, Pacific was directed to make modifications to its unbundled loop costs for so called A & B costs. A & B cost are inputs into Pacific Bell's loop cost proxy model. As noted above, AT&T protested Pacific's adjustments to its A & B costs for buried underground cable stating that Pacific did not revise its A & B costs for buried underground copper distribution and feeder. In Pacific's response to AT&T's protest, Pacific argues that it has indeed made the adjustments ordered in D.96-08-021 noting that it submitted its corrected A & B costs on May 10, 1996.

At the request of the Telecommunications Division, Pacific issued supplemental AL 18434A. Pacific's AL 18434A included an additional adjustment for the distribution component of the unbundled loop. After our staffs review of supplemental AL 18434A we conclude that AL 18434A reasonably captures the reduction in loop costs (and loop related services) ordered in D.96-08-021. We also note that no additional protest has been made with regard to this adjustment. Therefore, AL 18434A should be approved.

FINDINGS

1) Decision (D.) 96-08-021 directed Pacific to review several categories of operating expenses and assign them to services as necessary.

2) It is reasonable to assign Trouble Report Generation operating expenses to access line services because such expenses are tracked based on the customer that initiates the call.

3) It is reasonable to assign Trouble Report Generation operating expenses for databases to access line services because such expenses should occur at a frequency consistent with the number of trouble report calls.

4) Pacific's assignment of Advertising Expenses is reasonable and should be approved.

5) Pacific concedes that an error has been made in the assignment of Special Access Testing operating expenses.

6) Operating expenses for the category Sixth Level and Above Company Officers should be treated as a common costs of the firm and thus subject to recovery in the pricing phase of OANAD.

7) Operating expenses for Lifeline Fund Reimbursement as they pertain to Sixth Level and Above Company Officers should also be treated as a common cost of the firm and thus subject to recovery in the pricing phase of OANAD.

8) Pacific's AL 18434A which supplements Pacific's AL 18434 and modifies Pacific's A & B costs is reasonable and should should be approved

THEREFORE, IT IS ORDERED that:

1) Pacific Bell's (PB) Advice Letter No. 18434 and Supplemental AL No's 18434A and 18434B should be approved pursuant to the modifications ordered by this Resolution (Res).

2) The modifications ordered herein will be completed by Pacific and served upon all parties who have executed an Appropriate Nondisclosure Agreement fifteen days after the effective date of this Res. Such modifications will also include a summary of the final Total Service Long Run Incremental Costs (TSLRIC) for unbundled network elements, services and non recurring costs and will be filed as a supplement to AL 18434.

3) The modifications ordered herein and the TSLRIC summary are subject to approval of the Telecommunications Division.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on March 7, 1997. The following Commissioners approved it:

Wesley Franklin

Wesley M. Franklin
Executive Director

P. GREGORY CONLON
President
JESSIE J. KNIGHT, Jr.
HENRY M. DUQUE
JOSIAH L. NEEPER
RICHARD A. BILAS
Commissioners