

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion to Assess and Revise the New Regulatory Framework for Pacific Bell and Verizon California Incorporated.

FILED
PUBLIC UTILITIES COMMISSION
SEPTEMBER 6, 2001
SAN FRANCISCO, CALIFORNIA
RULEMAKING 01-09-001

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SAN FRANCISCO, CALIFORNIA
INVESTIGATION 01-09-002

**ORDER INSTITUTING RULEMAKING
AND ORDER INSTITUTING INVESTIGATION
FOR THE PURPOSE OF ASSESSING AND
REVISING THE NEW REGULATORY FRAMEWORK**

Summary of Order

This order institutes a rulemaking and a companion investigation to assess and possibly revise certain elements of the New Regulatory Framework (NRF) for Pacific Bell Telephone Company (Pacific) and Verizon California Incorporated (Verizon). The proceeding instituted by today's order is the fourth triennial review of NRF. The specific issues the Commission will consider in this proceeding are listed and described in Appendix A of this order. The preliminary schedule for conducting this proceeding is set forth in Appendix B.

A primary goal of this proceeding is to assess how service quality has fared under NRF. To begin the process of establishing a record on service quality, Appendix C of this order contains summary information on informal complaints

filed at the Commission regarding Pacific and Verizon. To further develop the record, this order requires Pacific and Verizon to submit service quality information identified in Appendix D.

Background

In Decision (D.) 89-10-031, the Commission replaced cost-of-service regulation for Pacific and Verizon with incentive-based regulation known as NRF.¹ NRF combines financial incentives, streamlined regulation, safeguards for shareholders and ratepayers, and Commission monitoring of Pacific and Verizon. The Commission's regulatory goals for NRF are: (1) universal service; (2) economic efficiency; (3) technological advance; (4) financial and rate stability; (5) full utilization of the local exchange network; (6) avoidance of cross subsidies and anticompetitive behavior; and (7) low-cost, efficient regulation.²

Under the original NRF adopted in D.89-10-031, rates were adjusted annually based on the formula $R(t) = R(t-1) * (1 + I - X) +/- Z$, where $R(t)$ is the rate to be set for the current year, $R(t-1)$ is the rate in the prior year, I is inflation as measured by the gross national product price index (GNP-PI), X is productivity,³ and Z is other exogenous adjustments found reasonable and necessary. Price changes beyond those allowed by the annual price formula required separate Commission approval. Additionally, Pacific and Verizon were permitted to

¹ D.89-10-031, 33 CPUC2d 43.

² D.95-12-052, 63 CPUC 2d 377, 381 and Fn. 2 at 411; and D.89-11-031, 33 CPUC 2d 43, 92-115.)

³ The productivity factor "X" was based on the difference in productivity growth between the national telecommunications market and the national economy, plus a stretch factor.

petition for reconsideration of the adopted inflation or productivity factors if their earnings fell below a rate of return of 8.25% for two years in a row.

Pacific and Verizon were given the opportunity under NRF to earn rates of return above market-based returns. An earnings sharing mechanism was also established that employed several rates of return: a market-based rate of return (initially set at 11.50%), a benchmark rate of return 150 basis points higher than the market-based rate of return, a cap (ceiling) rate of return 500 basis points higher than the market-based rate of return, and a floor rate of return 325 basis points below the market-based rate of return. Pacific and Verizon each retained 100% of its earnings between the market-based and benchmark rates of return, shared 50% of earnings between the benchmark and ceiling rates of return, and returned to ratepayers 100% of earnings over the ceiling rate of return.

Services were classified into three categories under NRF. Basic monopoly services were classified as Category 1 services. Discretionary or partially competitive services were classified as Category 2 services. Fully competitive services were classified as Category 3 services. The price for each Category 1 service was fixed except for the annual adjustment made in accordance with the formula $R(t) = R(t-1) * (1 + I - X) +/- Z$. The price for each Category 2 service could vary within a price ceiling and price floor. The price floor was increased annually by inflation, and the price ceiling was revised annually in accordance with the previously described formula. Prices for Category 3 services were provided the maximum flexibility allowed by law.

In D.89-10-031, the Commission stated that it would review NRF every three years. The first triennial review resulted in several significant changes to NRF. In D.93-09-038, the Commission eliminated the 50% sharing band for Verizon, reduced Verizon's rates, and increased the productivity factor in the price

adjustment formula applicable to Verizon.⁴ In D.94-06-011, the Commission (1) adopted an increased productivity factor for Pacific, (2) replaced GNP-PI in the price adjustment formula applicable to Pacific with the gross domestic product price index, (3) reduced Pacific's benchmark rate of return, and (4) allowed Pacific to retain 70% of its earnings above the ceiling rate of return, with the remaining 30% returned to ratepayers.⁵

The second triennial review resulted in another significant revision to NRF. In D.95-12-052, the Commission set the productivity factor in the price adjustment formula equal to the inflation factor.⁶ This had the effect of capping (1) prices for Category 1 services, and (2) price ceilings for Category 2 services, except for Z factor adjustments.

The third triennial review modified some elements of NRF and retained others.⁷ In D.98-10-026, the Commission (1) continued the price caps adopted in the second triennial review; (2) retained most of the rules and procedures for revising Category 1 rates and Category 2 ceilings and floors; (3) suspended sharing; (4) phased out then-existing Z-factor adjustments; (5) replaced Z-factor adjustments with a streamlined advice letter process for a limited set of exogenous costs; and (7) invited parties to submit information by September 1, 2000, to facilitate the commencement of the next NRF triennial review.

⁴ 50 CPUC 2d 684.

⁵ 55 CPUC 2d 1.

⁶ D.95-12-052, 63 CPUC 2d 377. The act of setting the productivity factor equal to the inflation factor has sometimes been referred to as a "suspension" of the price adjustment formula.

⁷ D.98-10-026.

Pursuant to D.98-10-026, several parties submitted comments and reply comments in September 2000 regarding the scope of the fourth triennial NRF review.⁸ These comments have been reflected, as appropriate, in the scope of this proceeding set forth in Appendix A of today's order. We note that while the parties had many good suggestions regarding the scope of this proceeding, we lack the resources to consider every issue recommended by the parties.⁹ As in prior triennial reviews, this proceeding will necessarily focus on those elements of NRF that we believe are in the most need of review and/or revision.¹⁰

Preliminary Scoping Memo

By this order, we commence the fourth triennial review of NRF. The triennial review shall be conducted in accordance with Article 2.5 of the Commission's Rules of Practice and Procedure (Rules).¹¹ Pacific and Verizon are

⁸ The following parties submitted comments regarding the scope of the fourth triennial NRF review: The Office of Ratepayer Advocates (ORA), Pacific, The Utility Reform Network, and Verizon.

⁹ We decline to consider in this proceeding those issues proposed by the parties that the Commission has or will consider in other proceedings. For example, we decline to adopt ORA's proposal to consider affordability studies in this proceeding, since we intend to consider affordability studies in a future proceeding that we plan to open regarding universal service. Similarly, we decline to adopt Pacific's proposal to consider in this proceeding whether to revise the rules that Pacific must follow to introduce new services, since we are already addressing the procedures governing the introduction of new services in Rulemaking (R.) 98-07-038.

¹⁰ For example, due to constraints on our resources, we decline to adopt Verizon's proposal to consider in this proceeding whether Pacific and Verizon should be exempt from Pub. Util. Code § 851.

¹¹ The Rules of Practice and Procedure are posted on the Commission's web site at www.cpuc.ca.gov.

designated as respondents to this order. As required by Rule 6(c)(2), this order includes a preliminary scoping memo¹² as set forth below.

The scope of this rulemaking is to review and revise, as necessary, those elements of NRF listed and described in Appendix A. The final scope of the issues will be determined in one or more scoping rulings issued by the assigned Commissioner pursuant to Rules 6(c)(2) and 6.3.

Pursuant to Rule 6(c)(2), we preliminarily determine that (1) the category of this proceeding is “ratesetting” as that term is defined in Rule 5(c),¹³ and (2) there is need for evidentiary hearings. Among the issues that may be addressed in evidentiary hearings are the Pacific and Verizon audits, the quality of service provided by Pacific and Verizon, linkages between service quality and NRF, and other matters identified by the parties. The time, place, and scope of the evidentiary hearings will be set in one or more rulings issued by the assigned Commissioner or the assigned Administrative Law Judge (ALJ).¹⁴

The preliminary schedule for this proceeding is set forth in Appendix B of this order. As shown in Appendix B, this proceeding will be conducted in three

¹² Rule 5(m) defines “scoping memo” as an order or ruling describing the issues to be considered in a proceeding and the timetable for resolving the proceeding.

¹³ Rule 5(c) defines “ratesetting” proceedings as proceedings in which the Commission sets or investigates rates or establishes a mechanism that in turn sets the rates for a specifically named utility or utilities.

¹⁴ In a ratesetting proceeding, the assigned Commissioner designates the principal hearing officer prior to the first hearing in the proceeding. If the assigned Commissioner is acting as the principal hearing officer, the assigned ALJ shall act as the presiding officer in the assigned Commissioner’s absence. (Rule 5(k)(2)) “Principal hearing officer” means the assigned Commissioner in a ratesetting proceeding, or the assigned ALJ in a ratesetting proceeding if, prior to the first

Footnote continued on next page

phases. The first phase will focus on factual issues regarding the audit of Verizon that was completed by ORA in April 2001. The second phase will address factual issues regarding (1) service quality, and (2) the audit of Pacific that is currently being conducted by the Telecommunications Division (TD).¹⁵ The final phase will review and revise, as necessary, those elements of NRF identified in Appendix A of this order. Parties will also have an opportunity in Phase 3 to recommend revisions to NRF based on the record developed in Phases 1 and 2 regarding the Pacific audit, the Verizon audit, and service quality.

Parties will have an opportunity during each phase to submit written comments and to request an evidentiary hearing. Appendix B contains a preliminary schedule for conducting each phase. We anticipate that because of the number and complexity of the issues in this proceeding, it may be necessary to revise the schedule as the proceeding progresses. Accordingly, the assigned Commissioner and the assigned ALJ may issue rulings to revise the schedule.

Parties may file and serve opening comments regarding Phase 1 issues no later than 30 days from the effective date of today's order, and reply comments no later than 45 days from the effective date of today's order. As required by Rule 6(c)(2), parties shall also include in their opening comments any objections they may have regarding (1) the categorization of this proceeding as "ratesetting,"

hearing in the proceeding, the ALJ has been designated by the assigned Commissioner as the principal hearing officer for that proceeding. (Rule 5(l))

¹⁵ TD's audit of Pacific has been hindered by discovery disputes. We expect Pacific to fulfill its obligation under §§ 314(a), 314(b), 314.5, 581, 582, and 584 to timely provide TD with such information that TD may need to complete its audit in accordance with the schedule set forth in Appendix B of this order.

(2) the preliminary determination that evidentiary hearings are required, and
(3) the preliminary scope and timetable for this proceeding as set forth in Appendices A and B of this order. Any party who believes that an evidentiary hearing is required regarding Phase 1 issues should file a motion requesting such a hearing no later than 50 days from the effective date of today's order. Any such motion must identify and describe (1) the material issues of fact, (2) the adjudicative evidence the party proposes to introduce at the requested hearing, and (3) a proposed schedule for the hearing. Any right that a party may otherwise have to an evidentiary hearing regarding Phase 1 issues will be waived if the party does not file a timely motion requesting an evidentiary hearing.

Following the receipt of Phase 1 comments and any motions requesting an evidentiary hearing, the assigned Commissioner will issue a ruling pursuant to Rules 6(c)(2) and 6.3. The ruling will address the scope of the proceeding, particularly in regard to Phase 1 issues. The ruling will also finalize the category of this proceeding, the need for evidentiary hearings regarding Phase 1 issues, and the schedule for resolution of Phase 1 issues. The ruling will also designate a principal hearing officer as required by Rule 6(c)(2). The ruling may also provide a revised scope and schedule for Phases 2 and 3. After the ruling is issued, parties may submit an appeal to the full Commission pursuant to Rule 6.4 regarding the assigned Commissioner's ruling on category.

Service and Availability of this Order

This order shall be served on the service lists for R.98-03-040, the proceeding for the third triennial review, and R.95-04-043/I.95-04-044, the proceeding for matters related to local exchange competition. These service lists include the respondent utilities Pacific and Verizon.

This order will be available to the public on the Commission's web site (www.cpuc.ca.gov). A copy of this order may also be obtained from the Commission's Central Files Office in San Francisco [(415) 703-2045]; and from the Commission's Public Advisor Offices in Los Angeles [(213) 897-3544]; and San Francisco [(415) 703-2074].

Participation and Service List

The Commission's practice is to require any party who wishes to formally participate in a proceeding to submit an appearance form at a prehearing conference (PHC) or evidentiary hearing. This practice may discourage formal participation in this proceeding, since individuals and small organizations may find it burdensome to travel to a PHC or evidentiary hearing.

To facilitate broad public participation in this proceeding, we will allow parties to formally participate by mailing a notice of participation to the Commission's Process Office. The address of the Commission's Process Office is Room 2000, 505 Van Ness Avenue, San Francisco, CA 94102. The notice of participation must include all of the following information:

- The proceeding numbers shown on the first page of this order.
- The name, address, and telephone number of each person to be placed on the service list. Parties are encouraged to provide an e-mail address. Any party that provides an e-mail address will be required to (1) serve their pleadings by e-mail on other parties that provide an e-mail address, and (2) receive the pleadings of other parties by e-mail.
- The person, entity, or organization for which the notice is being filed.
- The category of participation. There are three categories of participation: Appearance, State Service, and Information Only. Those in the Appearance category are parties with all attendant

rights and obligations. Appearances receive exhibits, testimony, and all formally filed documents, including pleadings, motions, rulings, proposed decisions, and Commission decisions. Appearances must serve their pleadings on all other Appearances and those in the State Service category. Persons should not indicate that they are an Appearance unless they intend to actively participate in this proceeding by filing comments or testimony. Any Appearance that fails to actively participate may be moved to the Information Only portion of the service list. The State Service category consists of persons employed by the State of California. Those in the State Service category receive the same documents as appearances, but they are not parties to the proceeding and cannot file pleadings. Those in the Information Only category receive all Commission-generated documents at no charge, such as notices of hearings, rulings, proposed decisions, and Commission decisions. Appearances are not required to serve their pleadings on those in the Information Only category.

Parties may also seek to formally participate in this proceeding by filing a notice of party/non-party status at a PHC or evidentiary hearing. Any person interested in participating in this rulemaking but unfamiliar with the Commission's procedures should contact the Commission's Public Advisor Offices in Los Angeles [(213) 897-3544] or San Francisco [(415) 703-2074].

Parties should note that it is not necessary to formally participate in this proceeding in order to monitor major developments. Significant documents in this proceeding (e.g., rulings and decisions) will be posted on the Commission's web site. There is no need to mail the previously described notice of participation to the Process Office to monitor in this fashion.

The Process Office will compile an initial service list based on the notices that it receives on or before August 30, 2001.¹⁶ The service list for this proceeding may be obtained from the Commission's web site (www.cpuc.ca.gov) or the Process Office [(415) 703-2021].

The assigned Commissioner and the assigned ALJ shall have ongoing oversight regarding the procedures governing parties' participation and the service list. They may revise these procedures and the service list, as necessary.

Electronic Service

Any Appearance that provides an e-mail address shall serve and receive all pleadings by e-mail in Microsoft Word format. There is no need to serve hard copies of pleadings on any party listed in the Appearance and State Service categories of the service list if that party has provided an e-mail address.

However, if a party in the Appearance or State Service categories has not provided an e-mail address, then that party must be served with a hard copy.¹⁷

Ex Parte Communications

This proceeding is subject to Rule 7, which specifies standards for engaging in ex parte communications and the reporting of such communications. Pursuant to Rules 7(a)(3) and 7(a)(4), ex parte communications will be allowed in this proceeding consistent with the restrictions and reporting requirements set forth in Rules 7(c) and 7.1. The restrictions and reporting requirements in Rule 7(c) and 7.1

¹⁶ The Process Office periodically updates service lists to correct errors and to make changes at the request of the parties on the list or the assigned ALJ.

¹⁷ This order does not affect the Commission's Rules regarding the filing of documents at the Commission. All documents filed at the Commission must be tendered in paper form as described in Rule 2 et seq.

shall remain in effect until the assigned Commissioner makes an appealable determination of category. Following the Commissioner's determination, the applicable ex parte communication and reporting requirements shall depend on such determination unless and until the determination is modified by the Commission pursuant to Rule 6.4 or 6.5.

IT IS ORDERED that:

1. A rulemaking and investigation is instituted on the Commission's own motion for the purpose of assessing and possibly revising certain elements of the New Regulatory Framework (NRF) applicable to Pacific Bell Telephone Company (Pacific) and Verizon California Incorporated (Verizon).
2. Pacific and Verizon are made respondents to this proceeding.
3. The specific issues to be considered in this proceeding are listed and described in Appendix A of this order. These issues constitute the general scope of this proceeding. The exact scope of this proceeding will be determined in one or more scoping rulings issued by the assigned Commissioner.
4. The preliminary schedule for conducting this proceeding is set forth in Appendix B. The assigned Commissioner and the assigned Administrative Law Judge (ALJ) may revise the schedule of this proceeding.
5. The category of this rulemaking is preliminarily determined to be "ratesetting" as this term is defined in Rule 5(c) of the Commission's Rules of Practice and Procedure (Rule).
6. It is preliminarily determined that there is a need for evidentiary hearings. The final determination on the need for evidentiary hearings will be made in one or more rulings issued by the assigned Commissioner. The time, place, and scope

for evidentiary hearings, if any, shall be set in one or more rulings issued by the assigned Commissioner or the assigned ALJ.

7. Parties that seek to participate in this proceeding should mail a notice of participation to the Commission's Process Office. The address of the Process Office is Room 2000, 505 Van Ness Avenue, San Francisco, CA 94102. The notice must include all the information identified in the body of this order.

8. The Process Office shall create an initial service list based on notices of participation received by the Process Office on or before August 30, 2001. Parties may obtain the service list from the Commission's web site (www.cpuc.ca.gov) or by contacting the Process Office [(415) 703-2021].

9. The assigned Commissioner and the assigned ALJ shall have ongoing oversight regarding the procedures governing participation in this proceeding. They may revise these procedures, as necessary. The assigned Commissioner and the assigned ALJ shall also have ongoing oversight of the service list. They may revise the service list or the procedures governing the list, as necessary.

10. Any party listed in the "Appearance" category on the service list that provides an e-mail address shall serve and receive all pleadings by e-mail in Microsoft Word format. There is no need to serve hard copies of pleadings on any party listed in the Appearance and State Service categories of the service list if that party has provided an e-mail address. However, if a party in the Appearance or State Service categories has not provided an e-mail address, then that party must be served with a hard copy.

11. All documents filed at the Commission must be tendered in paper form as described in Rule 2 et seq.

12. Opening comments regarding Phase 1 issues identified in Appendix A shall be filed and served no later than 30 days from the effective date of today's order.

Reply comments shall be filed and served no later than 45 days from the effective date of today's order. In addition, as required by Rule 6(c)(2), parties shall include in their opening comments any objections they may have regarding (i) the categorization of this proceeding as "ratesetting," (ii) the preliminary determination that evidentiary hearings are required, and (iii) the preliminary scope and schedule for this proceeding as set forth in Appendices A and B.

13. Any party who believes that an evidentiary hearing is required regarding Phase 1 issues should file a motion requesting such a hearing no later than 50 days from the effective date of today's order. Any such motion must identify and describe (i) the material issues of fact, (ii) the evidence the party proposes to introduce at the requested hearing, and (iii) the schedule for conducting the hearing. Any right that a party may otherwise have to an evidentiary hearing regarding Phase 1 issues will be waived if the party does not submit a timely motion requesting an evidentiary hearing.

14. Pacific and Verizon shall each file a compliance report containing the information specified in Appendix D of this Order. The schedule for filing the compliance reports is set forth in Appendix B. Pacific and Verizon shall each promptly provide a copy of its compliance report to any party in this proceeding requesting a copy of the report. The assigned Commissioner and the assigned ALJ may issue rulings that modify the information that Pacific and Verizon are required to include in their compliance report.

15. This order shall be served on the service lists for Rulemaking 98-03-040 and Rulemaking 95-04-043/Investigation 95-04-044.

This order is effective today.

Dated September 6, 2001, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
RICHARD A. BILAS
CARL W. WOOD
GEOFFREY F. BROWN
Commissioners

I will file a concurrence.

/s/ HENRY M. DUQUE
Commissioner

Appendix A

Scope of Proceeding

The scope of this proceeding consists of those issues identified and described below. The scope of this proceeding may be revised and refined by the assigned Commissioner. Any issue not identified in this Appendix or a subsequent ruling by the assigned Commissioner is beyond the scope of this proceeding.

Phase 1 Issues

Phase 1 will focus on the resolution of factual issues related to the audit of Verizon conducted by ORA pursuant to Pub. Util. Code § 314.5, D.94-06-011, D.96-05-036, D.98-10-019, and D.98-10-026. The scope of ORA's audit was as follows:

(1) analyze Verizon's NRF monitoring reports; (2) analyze Verizon's cost allocations and accounting practices and procedures that were established to protect against cross subsidization and anticompetitive behavior; (3) determine whether Verizon and its affiliates are following the Commission's rules for affiliate transactions; (4) determine whether Verizon is properly tracking and allocating costs related to non-regulated activities; and (5) determine whether non-structural safeguards adequately protect ratepayer and competitor interests with respect to non-regulated activities. (D.96-05-036, 66 CPUC 2d 274, 278, and OPs 3 and 4; and Executive Director letter dated September 18, 1998)

ORA released its audit report on April 30, 2001. Verizon submitted a response on July 11, 2001. ORA shall promptly provide a copy of its audit report to any party that requests a copy. Verizon shall promptly provide a copy of its response to any party that requests a copy. Any party requesting a copy of the audit report should sign a non-disclosure agreement, as appropriate.

In Phase 1, parties should address what corrective measures, if any, the Commission should implement at the conclusion of Phase 1 in response to the Verizon audit. Parties may also present other recommendations they believe the Commission should adopt at the conclusion of Phase 1. In addition, parties should identify findings of fact regarding the Verizon audit that are relevant to Phase 3 issues. If necessary, an evidentiary hearing will be held in Phase 1 to allow parties to present testimony regarding issues of fact pertaining to the Verizon audit. If appropriate, the Commission will issue a decision at the conclusion of Phase 1 that (1) adopts corrective measures in response to the audit, (2) makes factual findings relevant to Phase 3 issues, and/or (3) takes such other actions as the Commission deems necessary or appropriate.

In Phase 3, the Commission will consider the audit results as a factor in determining whether and how NRF should be revised. Parties will also have an opportunity in Phase 3 to recommend specific revisions to NRF that should be considered by the Commission in light of the audit report. Accordingly, parties should not recommend revisions to NRF in Phase 1 (unless the revisions are remedial actions that should be implemented expeditiously). Parties will not have an opportunity in Phase 3 to litigate issues of fact regarding the audit. All litigation of factual issues pertaining to the audit must occur in Phase 1.

Phase 2 Issues

Phase 2 will focus on two topics. First, Phase 2 will address factual issues related to the audit of Pacific Bell currently being conducted by the Commission's Telecommunications Division (TD) pursuant to Pub. Util. Code § 314.5, D.94-06-011, D.96-05-036, D.98-10-019, and D.98-10-026. Second, Phase 2 will address factual issues regarding how service quality has fared under NRF. Each of these topics is addressed in more detail below.

1. Pacific Bell Audit

TD is currently conducting an audit of Pacific Bell. The scope of the audit is as follows: (1) analyze Pacific's NRF monitoring reports; (2) analyze Pacific's cost allocations and accounting practices and procedures that were established to protect against cross subsidization and anticompetitive behavior; (3) determine whether Pacific and its affiliates are following the Commission's rules for affiliate transactions; (4) determine whether Pacific is properly tracking and allocating costs related to non-regulated activities; and (5) determine whether non-structural safeguards adequately protect ratepayer and competitor interests with respect to non-regulated activities. (D.96-05-036, 66 CPUC 2d 274, 278, and OPs 3 and 4; and Executive Director letter dated September 18, 1998)

TD's audit of Pacific should be complete sometime during Fall 2001. After TD has completed its audit, TD shall file and serve a notice of availability of the audit report on the service list for this proceeding. TD shall also provide a copy of its audit report to the assigned Commissioner, the assigned ALJ, ORA, and Pacific. Pacific shall file a response to the audit report no later than 15 days after TD serves notice that the audit report is available. TD shall provide a copy of its audit report to any party that requests a copy. Pacific shall likewise provide a copy of its response to any party that requests a copy. Any party requesting a copy of the

audit report and/or response should sign a non-disclosure agreement, as appropriate.

In Phase 2, parties should address what corrective measures, if any, the Commission should implement at the conclusion of Phase 2 in response to the Pacific audit. Parties may also present other recommendations they believe the Commission should adopt at the conclusion of Phase 2. In addition, parties should identify findings of fact regarding the Pacific audit that are relevant to Phase 3 issues. If necessary, an evidentiary hearing will be held in Phase 2 to allow parties to present testimony regarding issues of fact pertaining to the Pacific audit. If appropriate, the Commission will issue a decision at the conclusion of Phase 2 that (1) adopts corrective measures in response to the audit, (2) makes factual findings relevant to Phase 3 issues, and/or (3) takes such other actions as the Commission deems necessary or appropriate.

In Phase 3, the Commission will consider the audit results as a factor in determining whether and how NRF should be revised. Parties will also have an opportunity in Phase 3 to recommend specific revisions to NRF that should be considered by the Commission in light of TD's audit report. Accordingly, parties should not recommend revisions to NRF in Phase 2 (unless the revisions are remedial actions that should be implemented expeditiously). Parties will not have an opportunity in Phase 3 to litigate issues of fact regarding the audit. All litigation of factual issues pertaining to the audit must occur in Phase 2.

2. Service Quality

The availability of high quality service is one of the Commission's primary goals for NRF. (D.89-10-031, 33 CPUC 2d 43, 92, 197) In Phase 2 of this proceeding, the Commission will assess how service quality has fared under NRF. This assessment will focus on the quality of service provided to end users by Pacific and Verizon. Issues that are beyond the scope of this proceeding include the following: (1) the quality of service provided by Pacific and Verizon to other carriers; (2) requests for relief that are better addressed in complaint proceedings or enforcement OIIs; and (3) issues regarding universal service.

To begin the process of establishing a record regarding how service quality has fared under NRF, Appendix C of this order contains summary information regarding the number of informal complaints filed at the Commission pertaining to Pacific and Verizon. To develop the record further, Pacific and Verizon shall each file a compliance report that contains the information pertaining to service quality identified in Appendix D of this order. Pacific and Verizon shall file their

reports no later than January 15, 2002. Pacific and Verizon shall promptly provide a copy of their reports to any party requesting the report.

Parties may submit information in Phase 2 regarding service quality, including customer surveys. Parties that conduct surveys are encouraged to adhere to the following principles. First, in developing the survey, the party should use as a starting point the surveys of Pacific and Verizon customers conducted by Commission staff in previous proceedings. Second, the survey should include a statistically valid sample of consumers. Finally, the survey should encompass, to the extent possible, a broad cross section of residential and small business customers, including customers in rural, suburban, and urban areas. Any party that conducts a survey must file and serve the results of its survey no later than January 15, 2002. If Commission staff (including ORA) conducts a survey, Pacific and Verizon shall cooperate with Commission staff in conducting the survey. Pacific and Verizon shall also provide full and timely responses to staff requests for information regarding service quality.

Parties may address in their Phase 2 comments the information regarding consumer complaints contained in Appendix C of this order, the information regarding service quality identified in Appendix D that Pacific and Verizon are required to submit pursuant to this order, and any surveys submitted by the parties. Parties may also present other information in their Phase 2 comments that they believe is relevant to assessing how service quality has fared under NRF. If necessary, an evidentiary hearing will be held in Phase 2 to allow parties to present testimony regarding issues of fact pertaining to service quality. If appropriate, the Commission will issue a decision at the conclusion of Phase 2 that will resolve issues of fact pertaining to service quality.

In Phase 3, the Commission will consider whether and how NRF should be revised to achieve the Commission's goal of high-quality service. Parties will have an opportunity in Phase 3 to recommend specific revisions to NRF that should be considered by the Commission in light of the record developed in Phase 2 regarding how service quality has fared under NRF. There will not be an opportunity in Phase 3 to litigate issues of fact regarding service quality. All litigation of factual issues pertaining to service quality must occur in Phase 2.

Phase 3 Issues

In Phase 3, the Commission will consider whether to revise those elements of NRF that are identified and described below. If necessary, an evidentiary hearing will

be held in Phase 3 to allow parties to present testimony regarding factual issues that are within the scope of Phase 3.

1. Price-Cap Index

Under the original NRF established by D.89-10-031, prices for basic monopoly services (Category 1 services) and price ceilings for discretionary and partially competitive services (Category 2 services) were revised annually in accordance with a “price-cap index” equal to inflation less productivity. The inflation component of the index was equal to the Gross National Product Price Index (GNP-PI), and the productivity component was equal to 4.5%. In D.93-09-038, the Commission made two revisions to the price-cap index with respect to Verizon. First, the Commission replaced the GNP-PI with the Gross Domestic Product Price Index (GDP-PI). Second, the Commission adopted a productivity factor of 4.6%. In D.94-06-011, the Commission made two revisions to the price-cap index with respect to Pacific. First, the Commission replaced the GNP-PI with GDP-PI. Second, the Commission adopted a productivity factor of 5%. In D.95-12-052, the Commission suspended the price-cap index for Pacific and Verizon. In D.98-10-026, the Commission continued the suspension of the price-cap index mechanism.

In Phase 3 of this proceeding, the Commission will consider whether to reinstate the price-cap index mechanism, continue the suspension of the mechanism, or eliminate it altogether. Parties should address what criteria (e.g., the state of competition in the relevant markets) the Commission should use to determine which course of action to take. Any party that recommends a specific course of action should provide adequate information for the Commission to adopt the recommendation. For example, any party that recommends the reinstatement of the price-cap index mechanism should provide information regarding the appropriate inflation and productivity components of the index. Similarly, any party that recommends the elimination of the price-cap index should demonstrate that the price-cap index is unnecessary (e.g., competitive conditions warrant its elimination), and that adoption of the recommendation would ultimately lead to rates that are just and reasonable for all customers.

2. Exogenous Factors

Under the original NRF established by D.89-10-031, prices for Category 1 and 2 services could be adjusted (via a surcredit or surcharge) for exogenous cost changes called “Z-factors.” The Z-factor was designed to adjust rates for positive

or negative changes in costs that were (1) material, (2) beyond the utility's control, and (3) not reflected in the economy-wide index of inflation used in the price index. (33 CPUC 2d 33, 161 - 162, 228) In D.94-06-011, the Commission held that a change in costs could be reflected in rates as a Z-factor only if it met all nine of the following criteria: (1) the event causing the cost must be exogenous; (2) the event causing the cost must occur after the establishment of NRF in D.89-10-031; (3) the cost is clearly beyond management's control; (4) the cost is not a normal cost of doing business; (5) the event has a disproportionate impact on local exchange carriers; (6) the cost is not reflected in the economy-wide inflation factor used in the price index; (7) the event has a major impact on the utility's overall costs; (8) the actual cost can be determined with reasonable certainty and minimal controversy; and (9) the cost is reasonable. (55 CPUC 2d 1, 36 - 41). In D.98-10-026, the Commission replaced Z-factors with "limited exogenous factors" (LE factors). Under the LE factor mechanism, the only types of costs that could be reflected in rates were (1) changes in total intrastate cost recovery resulting from changes between federal and state jurisdictions, and (2) costs associated with regulatory requirements imposed by the Commission, provided that such costs also met the nine criteria for Z-factors set forth in D.94-06-011. Decision 98-10-026 also retained existing Z-factors until they were fully recovered in rates. (D.98-10-026, *mimeo.* pp. 59 - 69)

In Phase 3 of this proceeding, the Commission will consider whether to retain the LE factor mechanism adopted in D.98-10-026, modify the mechanism, or eliminate it on a prospective basis. The Commission's focus will be on the formulation of policy regarding the regulatory treatment for "exogenous costs," and not whether any particular cost should be included or excluded in rates. Accordingly, the Commission will not consider in this proceeding the addition of any new LE factors. Nor will the Commission consider the elimination of any existing LE factors or Z-factors. Parties are invited to address whether and how the LE factor mechanism should be revised to provide an opportunity for parties other than the utilities to propose LE factors. In addressing this matter, parties should identify who should be eligible to propose an LE factor and the procedure they would use to do so.

3. Sharing Mechanism

The original NRF established by D.89-10-031 included an earnings-sharing mechanism. The sharing mechanism included several rates of return (RORs): a market-based ROR of 11.50%, a benchmark ROR of 13%, a ceiling ROR of 16.5%,

and a floor ROR of 8.25%. Pacific and Verizon retained 100% of earnings up to the benchmark ROR, shared with ratepayers 50% of earnings between the benchmark and ceiling RORs, and returned to ratepayers 100% of earnings over the ceiling ROR. Ratepayers received their portion of sharable earnings via a reduction in prices for Category 1 services, excluding low-speed special access and other services normally excluded from surcredits. If earnings fell below the floor ROR for two consecutive years, Pacific and Verizon could petition the Commission for reconsideration of the adopted inflation or productivity factors. (33 CPUC 2d 43, 138 - 141, and 162 - 189) In D.93-09-038, the sharing mechanism for Verizon was revised to (1) eliminate the 50% sharing band, (2) lower the ceiling ROR from 16.5% to 15.5%, and (3) lower the floor ROR from 8.25% to 7.75%. (50 CPUC 2d 684, 689) Verizon was allowed to retain all earnings up to the ceiling ROR, while ratepayers continued to receive all earnings above the ceiling ROR. In D.94-06-011, the sharing mechanism for Pacific was revised to (1) reduce the market-based ROR from 11.50% to 10%, (2) reduce the benchmark ROR from 13% to 11.5%, (3) reduce the ceiling ROR 16.5% to 15%, and (4) reduce the floor ROR from 8.25% to 6.75%. The decision retained the 50/50 sharing of earnings between the benchmark ROR and ceiling ROR, and adopted 30/70 sharing between ratepayers and shareholders, respectively, for earnings in excess of the ceiling ROR. (55 CPUC 2d 1, 31 - 33) In D.98-10-026, the Commission suspended the earnings sharing mechanism for both Pacific and Verizon. (D.98-10-026, *mimeo.*, pp. 27 - 50)

The Commission will consider in Phase 3 of this proceeding whether to eliminate the sharing mechanism, continue the suspension of the sharing mechanism, or reinstate the sharing mechanism. Parties should address what criteria (e.g., the state of competition in the relevant markets) should be used to determine whether sharing should be eliminated, suspended, or reinstated. Any party that recommends the reinstatement of sharing should describe in detail the sharing mechanism that should be reinstated, including (1) the appropriate benchmark ROR; (2) the appropriate sharing formula (e.g., 50/50 sharing above the benchmark ROR); (3) the specific costs and revenues included and/or excluded from the sharing mechanism; (4) which services should have their prices adjusted to reflect sharable earnings; and (5) whether it is appropriate to have graduated sharing like that adopted in D.94-06-011. Any party that recommends the elimination of the sharing mechanism should describe in detail whether the relevant markets are sufficiently competitive so as to obviate the need for the sharing mechanism.

4. Gain on Sale

Under NRF, the Commission has repeatedly allocated directly to ratepayers via rate reductions at least some of the gains from the sale or transfer of utility property. (Resolution T-16481, issued on January 18, 2001; Resolution T-16375, issued on January 20, 2000; D.95-10-035, 62 CPUC 2d 116, 177, 188; D.95-02-017, 58 CPUC 2d 614, 615; D.94-06-011, 55 CPUC 2d 1, 43 - 45, 61; D.94-04-083, 54 CPUC 2d 268, 294, 295, 312; D.93-09-038, 50 CPUC 2d 684, 690, 691, 695; and D.92-07-072, 45 CPUC 2d 109, 131, 138) The Commission has also determined on two occasions that gains from the sale of telephone exchanges should be subject to the NRF earnings sharing mechanism instead of allocating some or all of the gains directly to shareholders or ratepayers. (D.94-09-080, 56 CPUC 2d 539, 545 - 547; D.01-06-007, *mimeo.*, pp. 90 - 95).

In Phase 3 of this proceeding, the Commission will consider how gains from the sale of utility assets should be treated under NRF. Any party that recommends that ratepayers receive some or all of the gains from the sale of utility assets should specify the mechanism for doing so. The Commission will not address in this proceeding issues regarding the Commission's authority to allocate gains to ratepayers, since the Commission's authority to do so is well established.

5. Timing of Price Cap Advice Letter

Under NRF, Pacific and Verizon are required to file an annual "price cap" advice letter by October 1st. Any new rates established by the advice letter are supposed to go into effect on January 1st of the following year. (D.89-10-031, 33 CPUC 2d 43, 229, 234) The current purpose of the price cap advice letter is to (1) adjust Category 2 price floors by inflation, and (2) request recovery of LE factors. (D.98-10-026, *mimeo.*, p. 76 and OP 1.g.; D.94-09-065, 56 CPPUC 2d 117, 290) It has become increasingly difficult to implement new rates by January 1st due to the requirement to provide parties with an opportunity to (1) file responses the advice letter, and (2) file comments on the draft resolution regarding the advice letter.

The Commission will consider in Phase 3 of this proceeding whether to require Pacific and Verizon to file their annual price cap advice letters on September 1st instead of October 1st as is currently the case. The purpose of requiring the advice letters to be filed one month earlier is to provide Commission staff with adequate time to process the advice letters prior to the implementation of new rates on January 1st of the following year.

6. Criteria and Procedures for Revising Prices

Under NRF, services are classified into three categories. Category 1 is for basic monopoly services. In D.89-10-031, prices for Category 1 services were fixed, except for the annual price-cap index adjustment, Z-factor adjustments, and Commission-approved rate changes. Pacific and Verizon could seek to change prices for Category 1 services by filing an application. In D.95-12-052, the Commission suspended the use of the inflation and productivity components of the price-cap index to adjust Category 1 prices. In D.98-10-026, the Commission replaced the Z-factor mechanism for revising Category 1 prices with the LE factor mechanism. Category 2 is for discretionary or partially competitive services. Pursuant to D.89-10-031, prices for Category 2 services could vary within the confines of Commission-established ceilings and floors. Pacific and Verizon could revise Category 2 prices by filing an advice letter. Price reductions that did not drop below the price floor become effective on five days' notice (65 CPUC 2d 156, 196, 213); and price increases up to the ceiling become effective on 30 days' notice. (56 CPUC 2d 117, 264) Price floors were increased each year for inflation, and price ceilings were revised each year in accordance with the price-cap index. Category 2 prices could also be revised to reflect Z-factors and Commission-approved rate changes. In addition, Pacific and Verizon could file advice letters to revise price floors on 40 days' notice (56 CPUC 2d 117, 264, 290); and file applications to revise price ceilings. In D.95-12-052, the Commission suspended the use of the inflation and productivity components of the price-cap index to adjust Category 2 price ceilings. (63 CPUC 2d 377, 406) In D.98-10-026, the Commission replaced the Z-factor mechanism for revising Category 2 prices with the LE factor mechanism. Category 3 is for competitive services. The criteria and procedures for revising Category 3 prices are set forth in Resolution T-15139, dated March 24, 1993. In general, Pacific and Verizon may change prices for Category 3 services after providing notice in accordance with the provisions of Resolution T-15139. Revisions to some of the procedures for NRF price changes are under consideration in R.98-07-038, which is addressing revisions to General Order 96-A.

The Commission will consider in Phase 3 what criteria and procedures (other than those resolved in R.98-07-038) should be used to revise (1) prices for services in Categories 1,2 and 3; and (2) price floors and ceilings for Category 2 services. Topics that are within the scope of this proceeding include the criteria and procedures (other than those resolved in R.98-07-038) that should be used to set and revise prices for (1) promotional offerings, (2) bundled offerings, and (3) customer-specific contracts. Parties should address whether the current criteria and procedures are adequate, or if the criteria and procedures need to be

refined or replaced. Parties are also encouraged to address whether and how parties besides Pacific and Verizon may propose price changes. Issues that are beyond the scope of this proceeding include the following: (1) changes to the existing definitions of Category 1, 2, and 3; (2) changes to the existing categorization of services; (3) changes to existing prices, price caps, and price floors; and (4) changes to Commission review procedures resolved in R.98-07-038.

7. Audit Findings and Recommendations

The Commission will consider in this proceeding the audits of Pacific and Verizon that were undertaken pursuant to § 314.5, D.94-06-011, D.96-05-036, D.98-10-019, and D.98-10-026. The scope of these audits was as follows: (1) analyze the company's NRF monitoring reports; (2) analyze the company's cost allocations and accounting practices and procedures that were established to protect against cross subsidization and anticompetitive behavior; (3) determine whether the company and its affiliates are following the Commission's rules for affiliate transactions; (4) determine whether the company is properly tracking and allocating costs related to non-regulated activities; and (5) determine whether non-structural safeguards adequately protect ratepayer and competitor interests with respect to non-regulated activities. (D.96-05-036, 66 CPUC 2d 274, 278, and OPs 3 and 4; and Executive Director letter dated September 18, 1998.)

Parties will have an opportunity in Phase 3 of this proceeding to propose changes to NRF based on the results of the Pacific and Verizon audits. Any party that proposes a revision to NRF based on the audits must demonstrate a connection between the proposed revision and the results of the audits. Parties will not have an opportunity in Phase 3 to litigate issues of fact regarding the audits. All litigation of factual issues pertaining to the audits must occur in earlier Phases.

8. Revisions to NRF Monitoring Reports

In D.89-10-031, the Commission established the following seven goals for NRF: (1) universal service; (2) economic efficiency; (3) encouragement of technological advance; (4) financial and rate stability; (5) full utilization of the local exchange network; (6) avoidance of cross subsidies and anticompetitive behavior; and (7) low-cost, efficient regulation. (33 CPUC 2d 43, 92-115.) The Commission also established a monitoring program to determine if NRF is achieving these goals. (Ibid., pp. 152, 197) To implement the monitoring program, the Commission in

D.91-07-056 ordered Pacific and Verizon to submit various reports regarding each of the seven goals. (41 CPUC 2d 89).

In Phase 3 of this proceeding, the Commission will consider whether, and to what extent, the NRF monitoring reports should be revised. Any party that proposes new or revised monitoring reports should demonstrate how its proposal would enhance the Commission's ability to monitor the seven NRF goals. Any party that proposes to eliminate a monitoring report should demonstrate why its proposal would not detract from the Commission's ability to monitor the seven NRF goals.

9. Service Quality

In D.89-10-031, the Commission stated that the availability of high quality service was one of the central goals of NRF. (33 CPUC 2d 43, 92, 197) Accordingly, the Commission in D.89-10-031 adopted a program to monitor service quality to ensure that service quality did not deteriorate under NRF. (Ibid., pp. 152, 197) The Commission stated that if the monitoring efforts revealed that ratepayers were being harmed through deteriorating service quality, the Commission would take immediate steps to rescind or alter NRF. (Ibid., p. 153)

In Phase 3, the Commission will consider whether and how NRF should be revised to achieve the Commission's goal of high-quality service. Parties will have an opportunity in Phase 3 to recommend revisions to NRF that should be considered by the Commission in light of the record developed in Phase 2 regarding how service quality has fared under NRF. Parties may also offer recommendations in Phase 3 regarding how NRF should be revised to promote the availability of high quality services, such as a system of financial carrots and sticks tied to measurements of service quality. There will not be an opportunity in Phase 3 to litigate issues of fact regarding the quality of service provided by Pacific and Verizon. All litigation of factual issues pertaining to service quality must occur in Phase 2.

10. Next NRF Review

In previous decisions regarding the NRF triennial review, the Commission has provided guidance regarding the issues that should be addressed in the next triennial review. The Commission has also established procedures for parties to provide comments on the scope for the next triennial review. (D.94-06-011, 55 CPUC 2d 1, 56, 57; D.98-10-026. *mimeo.*, pp. 75 - 78)

Parties may provide recommendations in Phase 3 regarding (1) what guidance the Commission should provide regarding the issues that should be addressed in the next triennial review, and (2) the procedures that should be established to provide parties with an opportunity to offer input regarding the scope of the next triennial review.

(End of Appendix A)

Appendix B

Preliminary Schedule for the Proceeding

Date	Event
September 2001	Commission issues order instituting rulemaking (OIR) and order instituting investigation (OII).
September – October 2001	ORA provides its Verizon audit report to those who request it. Verizon provides its response to the audit report to those who request it. Any party requesting a copy of the audit report should sign a non-disclosure agreement, as appropriate.
October 2001	Opening comments regarding Phase 1 issues filed 30 days after the effective date of the OIR/OII. Comments should include any objections to (1) the categorization of the proceeding, (2) the preliminary determination to hold evidentiary hearings, and (3) the preliminary scoping memo. (Rule 6(c)(2))
October 2001	Reply comments regarding Phase 1 issues due 45 days after the effective date of the OIR/OII.
November 2001	Motions for evidentiary hearings regarding Phase 1 issues due 50 days after the effective date of the OIR/OII.
November 2001	Replies to motion(s) due. (Rules 45(f) and 45(g))
November – December 2001	Assigned Commissioner ruling (ACR) regarding the scope, schedule, need for hearing, and categorization of this proceeding. (Rule 6.3) Appeals of categorization may be filed no later than ten days after the ACR. (Rule 6.4(a)) Response to appeals may be filed no later than fifteen days after the ACR. (Rule 6.4(b))
December 2001 – January 2002	Written testimony and evidentiary hearings regarding Phase 1 issues.

Date	Event
December 2001 - January 2002	Telecommunications Division (TD) files its Pacific Bell audit report. Pacific Bell files its response to TD's audit report 15 days after TD files its report. TD provides its audit report to those who request it. Pacific provides its response to the audit report to those who request it. Any party requesting a copy of the audit report and/or response should sign non-disclosure agreements, as appropriate.
January 2002	Briefs regarding Phase 1 hearing issues.
January 15, 2002	Pacific Bell and Verizon file compliance reports containing information pertaining to service quality identified in Appendix D of this order.
January 15, 2002	Parties submit consumer surveys on service quality.
February 2002	Opening and reply comments regarding Phase 2 issues.
March 2002	Draft interim decision regarding Phase 1 issues.
March 2002	Motions for evidentiary hearings regarding Phase 2 issues.
March 2002	Replies to motion(s) due. (Rules 45(f) and 45(g))
March - April 2002	Ruling regarding need for an evidentiary hearing on Phase 2 issues.
April 2002	Written testimony and evidentiary hearings regarding Phase 2 issues.
May 2002	Briefs regarding Phase 2 hearing issues.
July 2002	Draft interim decision regarding Phase 2 issues.
August 2002	Opening and reply comments regarding Phase 3 issues.
July 2002	Motions for evidentiary hearings regarding Phase 3 issues.
August 2002	Replies to motion(s) due. (Rules 45(f) and 45(g))
August 2002	Ruling regarding need for an evidentiary hearing on Phase 3 issues.
September 2002	Written testimony and evidentiary hearings regarding Phase 3 issues.
October 2002	Briefs regarding Phase 3 hearing issues.

Date	Event
October 2002	Requests for final oral arguments before the Commission due. (Rule 8(d))
November 2002	Opportunity for parties to present final oral arguments. (Rule 8(d).) Proceeding submitted. (Rule 8.1(a))
November 2002	Draft final decision issued for comment. (Rule 8.1(b))
December 2002	Comments filed on draft decision. (Rules 77.1-77-6)
January 2003	Commission issues final decision. (Rule 8.1(c))

(End of Appendix B)

Appendix C

Number of Informal Complaints Filed at the Commission

January 1, 1995, through July 12, 2001

Pacific Bell

Category of Complaint	1995	1996	1997	1998	1999	2000	2001
1 Delayed Orders & Missed Appoint.	71	259	644	650	409	623	157
2 Quality of Service (e.g., static, crossed lines, intermittent service, etc.)	947	1,416	1,780	1,639	1,095	1,324	380
3 Disputed Bill	1,334	1,733	2,171	2,113	1,404	2,365	1,249
4 Disconnections	93	186	286	441	306	500	173
5 Deposits	111	100	191	176	128	104	43
6 Disputed Customer of Record	166	121	206	239	238	134	55
7 No Notice	39	65	104	125	127	15	0
8 Late Payment Charge	12	6	10	10	13	0	0
9 Rate Design	175	62	82	150	39	20	11
10 Rules	363	272	465	249	78	152	82
11 Directory	143	89	144	123	109	13	0
12 Company Practice	459	376	319	303	131	498	249
13 Miscellaneous	286	317	262	272	273	294	120
14 Baseline	0	0	1	1	0	0	0
15 Surcharges/Taxes	13	17	73	47	145	55	36
16 Number/Area Code	2	31	48	48	46	18	8
17 Rate Protest	8	24	6	105	11	3	6
18 Master/Sub Meters	0	0	0	2	0	0	0
19 Bill Format	5	5	18	4	10	1	0
20 Commission Policy/Practices	2	1	1	1	4	0	0
21 Operator Services	1	11	12	29	35	2	0
22 Annoyance Calls	18	26	37	53	58	3	0
23 Payment Arrangements	223	295	609	420	124	10	20
24 Commitment	7	52	923	301	100	55	6
25 Pay Per Call Service	65	44	94	26	17	3	1
26 Refusal to Serve	40	53	141	70	10	1	2
27 Estimated Billing	0	1	0	1	0	0	1
28 Deaf Program	0	1	1	2	7	2	2
29 Balance/Level Pay Plan	0	0	0	1	0	0	0
30 Illegal Activities	0	0	0	1	0	6	0
31 COPT	9	12	8	9	3	2	1
32 Custom Calling Features	160	426	129	294	271	472	42
33 Inside Wiring	98	54	70	100	62	28	6
34 Abusive Marketing	41	41	48	53	93	86	26
35 Backbilling	0	0	8	12	21	7	1
36 Centralized Credit Check System	21	7	4	29	59	7	0
37 Female/Minority Business Enterprise	0	1	4	2	0	0	0
38 Mergers	0	5	0	0	1	0	0
39 Low Income Programs	17	9	11	2	18	10	10
40 New Incentive Regulatory	274	7	6	7	13	5	2
41 Safety	0	5	9	10	4	11	3
42 Electromagnetic	0	0	0	1	0	0	0
43 Landline to Cellular	0	0	0	2	4	0	0
44 Improper Advertising	0	0	0	13	8	1	0
45 Cramming	0	0	1	30	27	77	75
46 Outages	0	0	0	4	7	64	15

Pacific Bell

Category of Complaint		1995	1996	1997	1998	1999	2000	2001
47	Anonymous Call Rejection	0	0	0	21	5	0	0
48	Prepaid Phone Card	0	0	0	0	2	3	2
TOTALS		5,203	6,130	8,926	8,191	5,515	6,974	2,784

Verizon

	Category of Complaint	1995	1996	1997	1998	1999	2000	2001
1	Delayed Orders & Missed Appoint.	20	7	44	94	44	80	44
2	Quality of Service (e.g., static, crossed lines, intermittent service, etc.)	183	250	243	217	193	188	77
3	Disputed Bill	502	655	767	807	489	692	365
4	Disconnections	29	56	61	106	61	59	35
5	Deposits	39	44	47	21	23	22	7
6	Disputed Customer of Record	27	21	53	59	67	37	12
7	No Notice	14	31	22	19	26	0	0
8	Late Payment Charge	3	3	5	7	4	0	0
9	Rate Design	300	28	47	67	9	9	6
10	Rules	20	52	74	69	16	20	21
11	Directory	25	31	47	107	39	0	0
12	Company Practice	26	79	54	58	21	60	44
13	Miscellaneous	76	54	47	77	61	57	25
14	Baseline	0	0	0	0	0	24	0
15	Surcharges/Taxes	15	2	18	36	28	8	14
16	Number/Area Code	1	0	15	14	22	0	1
17	Rate Protest	1	0	2	3	2	0	0
18	Master/Sub Meters	0	0	0	0	0	0	0
19	Bill Format	5	1	3	2	1	0	0
20	Commission Policy/Practices	0	1	1	0	0	0	0
21	Operator Services	0	2	8	6	9	0	0
22	Annoyance Calls	6	5	10	6	14	0	0
23	Payment Arrangements	30	17	38	73	28	5	3
24	Commitment	0	1	9	16	12	2	1
25	Pay Per Call Service	16	19	15	13	5	0	0
26	Refusal to Serve	11	2	14	12	2	1	1
27	Estimated Billing	0	0	0	1	0	0	0
28	Deaf Program	0	2	0	0	2	1	0
29	Balance/Level Pay Plan	0	0	1	1	0	0	0
30	Illegal Activities	0	0	0	0	0	2	0
31	COPT	2	0	5	3	0	0	0
32	Custom Calling Features	21	93	45	42	44	21	0
33	Inside Wiring	13	1	12	13	16	6	3
34	Abusive Marketing	10	35	31	36	19	22	21
35	Backbilling	2	0	3	2	2	1	1
36	Centralized Credit Check System	50	28	43	24	20	1	0
37	Female/Minority Business Enterprise	0	0	0	0	0	0	0
38	Mergers	0	0	0	0	0	0	0
39	Low Income Programs	14	3	18	0	5	8	2
40	New Incentive Regulatory	265	1	1	4	3	0	0
41	Safety	0	0	0	1	1	0	1
42	Electromagnetic	0	0	0	0	0	0	0
43	Landline to Cellular	0	0	0	0	1	0	0
44	Improper Advertising	0	0	0	0	3	0	0
45	Cramming	0	0	0	16	10	6	7
46	Outages	0	0	0	0	0	3	9
47	Anonymous Call Rejection	0	0	0	0	0	0	1

R.01-09-001, I.01-09-002 ALJ/TIM/tcg

48 Prepaid Phone Card	0	0	0	1	1	1	0
TOTALS	1,726	1,524	1,803	2,033	1,303	1,336	701

Appendix D
Information Regarding Service Quality
to be Submitted by Pacific Bell and Verizon California Inc.

Pacific and Verizon shall each file a compliance report that contains the following information for the period of January 1, 1990, through June 30, 2001.

- a. Each automated Reporting Management Information System (ARMIS) Service Quality Report 43-05 provided to the Federal Communications Commission (FCC); and
- b. Each ARMIS Customer Satisfaction Report 43-06 provided to the FCC.

(End of Appendix D)

Commissioner Henry M. Duque, concurring:

NRF is over ten years old and perhaps not deserving of the accolade-laden term of 'new'. It made sense to call it 'new' in 1990 when it replaced the old rate-of-return regulation. Today, having matured and then grown old, NRF is nearing its retirement phase. The proposed OIR appears to gloss-over NRF's waning years and its place in the changing telecommunications market to embark on re-testing certain proven assumptions about service quality.

That price-cap regulation neither undermines service quality nor retards technological growth has been known for sometime. To the contrary, since its inception in 1984 for the British Telecom and as it spread, in one form or another, into over thirty-six states in the U.S., incentive-based regulation has proven to be the most effective regulatory means to increase efficiency and reduce cost in the telecommunications market. NRF, as practiced in California, has produced these results with no perceptible service quality degradation. In fact, experience shows modernized networks, deployment of fiber optics, advanced switches, and an abundance of convenience features, are the direct results of price-cap regulation. Why then do we initiate a grand investigation of NRF when we should be working to align disparate regulatory regimes to the evolving and converging telecommunications market? Frankly, we don't need to commission a three-year formal and expensive investigation to find out how service quality has fared under price cap regulation.

The elaborate and overly ambitious scheme of review in this proposed OIR will drag on for several years. As outlined, the fourth-triennial review is made up of three phases, two of which will focus on service quality of Verizon and Pacific Bell. These two phases will culminate into the third big phase where, having studied service quality, NRF will be analyzed to decide if any changes should be made. My guess is that this process will probably take three years to complete, by which time the Commission might wisely kick off the fifth triennial review in the final decision of the third phase.

I don't intend to disparage the NRF review process. Scoped properly, this review can be an opportunity to align existing regulatory framework with prevailing and imminent market reality, an area the proposed OIR nearly misses. I do appreciate Commissioner Lynch's Office for their willingness to include an issue related to market competitiveness. However, I must say that this proposed grand review of service quality is simply too much for a single proceeding and may be so overloaded with many, but not necessarily all the right issues that it might buckle due to its sheer weight. For example, much focus is given to service quality issues. Appendices of complaints are attached to the decision to kick off an investigation

into service quality as a precursor to the policy making phase of the OIR, creating the impression that service quality, above all other matters, will play a crucial role in formulating regulatory framework. In so doing, the draft OIR gives the impression that only service quality matters in reviewing price-cap regulation. This is not to say that service quality is not important. A review of service quality and standards by which it is measured for incumbent carriers as well as competitors **is** an important issue for consumers. But there is no policy reason for the Commission to focus on the service quality of incumbent carriers to the exclusion of others. Competition among telephone carriers is increasing and will only intensify from hereon. Ignoring the reality of competition in communications services, convergence of technology, and relevant market conditions can be a recipe for a regulatory disaster.

For all these reasons, while I vote to open this OIR, I express serious reservations and concerns about the direction and scope of this review and what it will accomplish.

Henry M. Duque

Commissioner

September 6, 2001

San Francisco, California