

ASSEMBLY BILL

No. 2898

Introduced by Assembly Member Pescetti

February 25, 2002

An act to add and repeal Article 1.5 (commencing with Section 2880) of Part 2 of Division 1 of the Public Utilities Code, relating to telephone corporations.

LEGISLATIVE COUNSEL'S DIGEST

AB 2898, as introduced, Pescetti. Telephone corporations: New Regulatory Framework.

(1) Under existing law, the Public Utilities Commission has regulatory authority over public utilities, including telephone corporations, and authorizes the commission to establish just and reasonable rates. Under that authority, the commission has adopted decisions adopting an incentive-based regulatory framework called the New Regulatory Framework.

This bill would require, up until January 1, 2007, that the commission (1) suspend the use of a price-cap index mechanism, and (2) suspend use of an earnings-sharing mechanism for those telephone corporations regulated under the New Regulatory Framework.

Because a violation of an order of the commission is a crime under existing law, the bill would impose a state-mandated local program by creating a new crime.

(2) The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement.

This bill would provide that no reimbursement is required by this act for a specified reason.

Vote: majority. Appropriation: no. Fiscal committee: yes.
State-mandated local program: yes.

The people of the State of California do enact as follows:

1 SECTION 1. The Legislature finds and declares all of the
2 following:

3 (a) For many decades, telephone corporations were regulated
4 solely under cost of service, or rate of return, regulation, under
5 which the California Public Utilities Commission set rates based
6 on a review of each utility's costs, investments, necessary return
7 and corresponding revenue requirement needs. The commission
8 has replaced cost-of-service regulation for four incumbent local
9 exchange carriers, two upon the commission's investigation and
10 rulemaking and two upon application by the utilities, with an
11 incentive-based regulation known as the New Regulatory
12 Framework.

13 (b) The New Regulatory Framework combines financial
14 incentives, streamlined regulation, safeguards for corporate
15 shareholders and ratepayers, and commission monitoring through
16 triennial reviews.

17 (c) The goals for the New Regulatory Framework are: (1)
18 universal service; (2) economic efficiency; (3) technological
19 advance; (4) financial rate stability; (5) full utilization of the local
20 exchange network; (6) avoidance of cross subsidies and
21 anticompetitive behavior; and (7) low-cost, efficient regulation.

22 (d) Under the original New Regulatory Framework, rates were
23 based on the prior year's rates, adjusted annually for inflation as
24 measured by the gross national product price index, productivity,
25 and exogenous adjustments found reasonable and necessary by the
26 commission. Services were classified into three categories. Basic
27 monopoly services were classified as Category 1 services.
28 Discretionary or partially competitive services were classified as
29 Category 2 services. Fully competitive services were classified as
30 Category 3 services.

31 (e) Under the original New Regulatory Framework, prices for
32 basic monopoly services (Category 1) and price ceilings for
33 discretionary and partially competitive services (Category 2) were



1 revised annually in accordance with a ‘price-cap index’ equal to
2 inflation less productivity. In Decision 95-12-052, the commission
3 set the productivity factor in the price adjustment formula equal to
4 the inflation factor. The act of setting the productivity factor equal
5 to the inflation factor operated as a suspension of the price
6 adjustment formula. This had the effect of capping prices for
7 Category 1 services, and capping the price ceiling for Category 2
8 services, except for the exogenous adjustments found reasonable
9 and necessary by the commission. In Decisions 96-12-054,
10 96-12-074, 98-10-026, 00-03-040, and 01-06-077 the commission
11 suspended, and continued the suspension of, the price-cap index.
12 Decision 98-10-026 declared its expectation that the price-cap
13 index would be eliminated in the next New Regulatory Framework
14 triennial review. In Rulemaking 01-09-001, the commission is
15 considering whether to reinstate the price-cap index mechanism,
16 continue the suspension of the mechanism, or to eliminate the
17 price-cap mechanism altogether.

18 (f) The original New Regulatory Framework included an
19 earnings-sharing mechanism that included a market-based rate of
20 return, a benchmark rate of return, a ceiling rate of return, and a
21 floor rate of return. The telephone corporations retained 100
22 percent of earnings up to the benchmark rate of return and either
23 shared or returned earnings over the benchmark and ceiling rates
24 with ratepayers. In Decision 98-10-026, the commission
25 suspended the earnings sharing mechanism for Pacific Bell
26 Telephone Company and GTE California Incorporated, now
27 known as Verizon California Incorporated. Decision 98-10-026
28 declared its expectation that the sharing mechanism would be
29 eliminated in the next New Regulatory Framework triennial
30 review. In Decisions 01-06-077 and 01-12-024, the commission
31 ordered the retention of Roseville Telephone Company’s sharing
32 mechanism. In Decision 00-03-040, the commission approved a
33 settlement agreement between Citizens Telecommunications
34 Company of California, Inc. and the commission’s Office of
35 Ratepayer Advocates, that ordered the retention of a sharing
36 mechanism. In Rulemaking 01-09-001, the commission is
37 considering whether to eliminate the sharing mechanism, continue
38 the suspension of the sharing mechanism, or to reinstate the
39 sharing mechanism.



(g) The telecommunications industry is in a state of transition, with a convergence of technology and increasing competition. The commission's New Regulatory Framework has allowed consumers to benefit from low, stable prices, as well as from the fast deployment of important new technologies, including modernized networks, deployment of fiber optics, advanced switches, and an abundance of convenience features. The New Regulatory Framework has resulted in billions of dollars in investment and the creation of thousands of new jobs for the California economy. Maintaining the investment incentives created by the commission's New Regulatory Framework, while at the same time protecting consumers and promoting competition, is vital to the state's economy.

(h) The New Regulatory Framework's incentive-based regulation has proven to be the most effective regulatory means to increase efficiency and reduce cost in the telecommunications market.

(i) Telephone corporations regulated under the New Regulatory Framework's incentive-based or price-cap mechanism require predictability with respect to the provisions of the New Regulatory Framework that will apply to them.

(j) It is the intent of the Legislature to maintain the progress created by the commission's New Regulatory Framework, which includes the creation of an atmosphere in which telephone corporations have incentives to operate efficiently, introduce new products, and provide better service.

SEC. 2. Article 1.5 (commencing with Section 2880) is added to Part 2 of Division 1 of the Public Utilities Code, to read:

Article 1.5. New Regulatory Framework

2880. (a) Any price-cap index mechanism whereby inflation is adjusted by a productivity factor, and its related components and elements, previously suspended by the commission in regulating a telephone corporation under the New Regulatory Framework, shall be suspended from use with respect to that telephone corporation, until January 1, 2007. Nothing in this section shall impair the commission's power to eliminate the price-cap index mechanism from its New Regulatory Framework, for any telephone corporation. Nothing in this section shall impair the

1 commission's power to retain or suspend the price-cap index
2 mechanism for its New Regulatory Framework, for telephone
3 corporations where the commission has not previously suspended
4 their use for that corporation.

5 (b) Any sharing mechanism, and its related components and
6 elements, shall be suspended from use with respect to telephone
7 corporations regulated under the New Regulatory Framework,
8 until January 1, 2007. Nothing in this section shall impair the
9 commission's power to eliminate the sharing mechanism from its
10 New Regulatory Framework, for any telephone corporation.
11 Nothing in this section shall impair the commission's power to
12 retain or suspend the sharing mechanism from its New Regulatory
13 Framework, for telephone corporations not previously regulated
14 under the New Regulatory Framework.

15 (c) Nothing in this section shall impair the commission's power
16 to regulate rates and charges, price ceilings and price floors for
17 services of telephone corporations subject to its jurisdiction, or to
18 impair the commission's power to reclassify services to a different
19 pricing category under the New Regulatory Framework, except as
20 provided in subdivisions (a) and (b).

21 (d) Nothing in this section shall impair the commission's power
22 to regulate the quality of service provided by telephone
23 corporations subject to its jurisdiction.

24 (e) This section shall apply to each telephone corporation
25 regulated pursuant to the New Regulatory Framework.

26 (f) This section shall remain in effect only until January 1,
27 2007, and as of that date is repealed, unless a later enacted statute,
28 which is chaptered before January 1, 2007, deletes or extends that
29 date.

30 SEC. 3. No reimbursement is required by this act pursuant to
31 Section 6 of Article XIII B of the California Constitution because
32 the only costs that may be incurred by a local agency or school
33 district will be incurred because this act creates a new crime or
34 infraction, eliminates a crime or infraction, or changes the penalty
35 for a crime or infraction, within the meaning of Section 17556 of
36 the Government Code, or changes the definition of a crime within
37 the meaning of Section 6 of Article XIII B of the California
38 Constitution.

