



ities and levels of service.

-A newly created Regional Development and Infrastructure Agency, located in each of the state's air basins, would eliminate the artificial lines dividing functionally separate single-purpose regional agencies. This entity would not be a new layer of government but a merger of existing efforts that are now ineffective because of a functional bias toward single goals.

-The report recommends elimination of the geographic division of air pollution control efforts within the air basins established by the Air Resources Board. This approach reflects a simple recognition that air flows freely within each of the basins without regard to legal jurisdictional boundaries.

-The report recommends the elimination of fiscal incentives which encourage sprawling land development requiring public investment in inefficient infrastructure and which deny needed services and infrastructure to poorer communities.

## SENATE OFFICE OF RESEARCH

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Established and directed by the Senate Committee on Rules, the Senate Office of Research (SOR) serves as the bipartisan, strategic research and planning unit for the Senate. SOR produces major policy reports, issue briefs, background information on legislation and, occasionally, sponsors symposia and conferences.

Any Senator or Senate committee may request SOR's research, briefing and consulting services. Resulting reports are not always released to the public.

### MAJOR PROJECTS:

A *Summary of California's Alcohol and Drug Abuse Laws (June 1989)* was released to the public by SOR and Senator John Seymour in December 1989. The report was the result of SB 2599 (Seymour) (Chapter 983, Statutes of 1988), which established a Five-Year Master Plan to Reduce Drug and Alcohol Abuse in California. The report sets forth a compilation and consolidated overview of California laws pertaining to drug and alcohol abuse. The report presents brief summaries of applicable statutes in non-technical language,

and is intended to be an only an introduction to these statutes.

As background information, the report noted that a recent finding by the California Department of Alcohol and Drug Programs indicates that approximately 2.2 million Californians have a problem with alcohol abuse and 2.1 million persons in the state use illicit drugs or use drugs inappropriately. During 1987, 2,488 people died in California as a direct result of alcohol abuse and 2,000 died as a result of drug abuse. Problems caused by substance abuse cost the state approximately \$17.7 billion per year in lost worker productivity, health and medical costs, motor vehicle accidents, violent crimes, social responses, and fire losses.

The report discussed the six major statutes that provide the statutory authority governing the regulation and enforcement of alcohol and controlled substances in California, including the Alcoholic Beverage Control Act, the Uniform Controlled Substances Act, the California Control of Profits of Organized Crime Act, the California Major Narcotic Vendors Prosecution Law, the California Imitation Controlled Substance Act, and the Sherman Food, Drug, and Cosmetic Law.

The report then listed various categories of laws relating to alcohol and drug abuse, including laws relating to use, possession, and soliciting; driving under the influence; sale, dispensing, and administering; adulterating/poisoning food, drink, or water; labeling and advertising; professions and employment; education; the administration of justice; treatment and prevention; and alcoholic beverage licensing and taxation.

*Changes in Our Telephone Regulation: Competition at the Crossroads (September 1989).* In response to a request by Senator Herschel Rosenthal, Chair of the Senate Energy and Public Utilities Committee, the SOR released this report, which provides a comprehensive review of the growth of competition in the telecommunications industry and discusses the response of the California Public Utilities Commission (PUC) to the regulatory challenge it faces.

The traditional system of telecommunications regulation, commonly referred to as rate of return regulation, is intended to assure that four important goals are met: assuring just and reasonable rates; preserving the ability of the utility

enterprise to attract capital on reasonable terms; assuring high quality service and adequate facilities; and preventing abuse of monopoly power and undue discrimination among customers. Rate of return regulation consists of four basic steps: determining the rate base (the stock of capital facilities that the company uses to provide services); determining the firm's cost of capital; adding the operating expenses and depreciation to the rate base; and determining customer rates so as to provide utility stockholders with a fair rate of return on their investment. According to the report, the benefits of this type of regulation include the provision of below-cost basic telephone service while allowing the development of an extremely high quality telecommunications system. Also, the traditional regulatory scheme has allowed for vigorous oversight of the local exchange carriers (LECs) and provided opportunities for customer protection. However, because of ongoing changes in both technology and government policies, both of which have fostered competition in a variety of services, the PUC is examining the desirability and feasibility of establishing an alternative regulatory framework for regulating LECs.

In the past several years, three major proposals for dramatic regulatory change have been submitted for the PUC's consideration by Pacific Bell, GTE California, and the PUC's Division of Ratepayer Advocates (DRA). Although each proposal is different, each entails a significant change in regulation, and each offers increased freedom and flexibility to LECs to enter competitive business. Under each plan, traditional rate of return regulation would be abandoned for incentive regulation, which encourages the utility to act more like an unregulated business and vigorously seek methods to improve productivity and also allows the utility the freedom to enter new markets. The danger of such a system, according to the report, is that the utility still maintains monopoly power in some areas, which could result in anticompetitive behavior. Competitors and consumer groups have opposed the plans offered by Pacific Bell and GTE California, citing the lack of safeguards and the unprecedented flexibility that has increasingly been given the two telephone companies.

In late 1987, the PUC commenced what Senator Rosenthal characterized as



"expedited proceedings" to, in essence, restructure the entire regulatory structure of local telephone companies in California. Concerned that these proceedings could dramatically lessen the opportunity for greater telecommunication competition, and in light of the fact that the Senate Committee on Energy and Public Utilities anticipated lengthy debate on these issues, Senator Rosenthal requested SOR to review and evaluate the proposed options and report back so that the committee could proceed on a more informed basis.

In addition to describing the three submitted proposals, the SOR's report also considered a then-pending August 17, 1989 recommendation of a PUC administrative law judge (ALJ), which proposed replacing the present rate of return regulation with an incentive system based on price caps. These caps would limit rate increases to an inflation factor, and reduce rates based on the phone company's gains in productivity. The telephone company would have new flexibility to enter competitive markets. [EDITOR'S NOTE: The August recommended decision was subsequently adopted by the PUC on October 12, 1989; see *infra* agency report on PUC and CRLR Vol. 9, No. 4 (Fall 1989) p. 133 for further information.]

After reviewing the proposals of Pacific Bell, GTE California, the DRA, and the recommendation of the ALJ, and in light of the PUC's ongoing investigation into changing telecommunications regulation, SOR's report made a number of general conclusions and recommendations, including the following:

-In order to provide the proper framework for the LEC and its competitors to compete, changes must be made to the regulatory system. Part of that regulatory change is the need to give the telephone companies new flexibility in competitive markets.

-Competitive safeguards need to be adopted to prevent anticompetitive behavior on the part of the monopoly side of the LEC business.

-The PUC must reaffirm the importance of the DRA and establish a role for DRA in the new regulatory framework.

-Enactment of a profit sharing mechanism is desirable. According to the report, profit sharing provides an incentive to the LEC while protecting ratepayers. The disadvantage of profit sharing is that it creates the incentive in certain circumstances for the LEC to

incur costs to reduce or avoid profit sharing. Therefore, the use of profit sharing implies that an appropriate level of regulatory oversight is necessary to prevent the LEC from carrying out activities that reduce profit sharing.

-The PUC must retain strict oversight over monopoly services.

-The PUC should adopt comprehensive ex parte rules for the Commission's routine use. According to the report, competitors are concerned about the lack of rules because of the resources that LECs can devote to discussing issues with Commissioners and staff.

-The PUC should streamline its complaint procedure in order to facilitate the rapid and fair handling of complaints and reduce the barriers to filing complaints.

-The legislature should consider allowing appeals of PUC decisions to be taken to a court other than the California Supreme Court, as it, as a matter of practice, reviews very few PUC decisions. Expanded judicial review is desirable as the number of disputes grows due to the increased competition.

-The legislature should consider establishing an independent DRA and ALJs. Representatives of consumer groups and competitors are concerned that being under the direct control of the Commission limits the independence of these two parties.

-The legislature should also require the PUC to define "competition". According to the report, such a definition is important if regulation for competitive services will be different than that for monopoly services.

