Decision 84 04 016 APR 4 1984 ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of The Pacific Telephone and Telegraph Company, a corporation, for authority to establish a rate stability plan for Centrex and associated services and to expand Centrex service to smaller line size customers.	Application 83-05-45 (Filed May 20, 1983; amended October 14, 1983)

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Telephone Company, Hornitos Telephone Company, Kerman Telephone Co., Livingston Telephone Company, Mariposa County Telephone Company, Inc., Pinnacles Telephone Company, Sierra Telephone Company, Inc., The Ponderosa Telephone Co., The Siskiyou Telephone Company, The Volcano Telephone Company; and William Knecht, Attorney at Law, for California Association of Utility Shareholders; interested parties.

Rufus G. Thayer, Attorney at Law, and J. Douglas Dade, for the Commission staff.

I N D E X

O P I N I O N

By this application, The Pacific Telephone and Telegraph Company, now reorganized and operating under the name Pacific Bell (Pacific), seeks authority to adjust its Centrex and associated service offerings in a manner calculated to maintain the viability of these services in the face of drastic changes occurring in the telecommunications industry. As originally filed in April 1983 Pacific's application sought permission to establish a rate stability plan (RSP) for Centrex and associated services which would assure Centrex customers of retaining the bulk of their Centrex service features at present rates for three years in return for their agreement to retain at least 90% of their Centrex lines in service for that period. Pacific also sought permission to offer Centrex service, now available only to customers served by at least 100 access lines, to customers requiring only from 40 to 99 lines. In October 1983, responding to a Federal Communications Commission (FCC) order requiring that customer access line charges (CALCs) be applied, in the amount of at least $2 per access line, to all Centrex lines, Pacific amended this application to seek authority to lower the rates for Centrex and associated services to counterbalance the effects of the FCC-required CALCs.

Procedural History

A protest of Pacific's application was filed June 20, 1983 on behalf of ROLM Corporation (ROLM) and the California Interconnect Association (CIA) (referred to collectively as Protestants). Protestants asserted that the Commission lacked adequate information to determine whether Pacific's proposals were in the public interest and consistent with applicable law. They requested that the Commission set Pacific's application for hearing and deny the application.

A prehearing conference was held July 6, 1983 before Administrative Law Judge (ALJ) Martin A. Mattes. At that time the Commission staff moved that this application be consolidated for hearing with Pacific's current general rate increase application, Application (A.) 83-01-22, et al. Protestants supported the staff proposal, which was opposed by Pacific, the Cities of San Diego and Los Angeles, and the City and County of San Francisco. The staff motion to consolidate was denied, and hearings were scheduled to begin October 24, 1983, with a detailed calendar established for discovery and prefiling of proposed testimony and exhibits.

Delays in Pacific's responses to discovery requests led Protestants to file a motion for extension of time August 31, 1983, which they supplemented September 2. On September 8 staff filed a motion for consolidation, in effect renewing its oral motion of two months before and explaining that Pacific's failure to respond to staff data requests had disrupted the staff's schedule for working on this matter. On September 20, ALJ Mattes suspended the procedural schedule but deferred ruling on the motion for consolidation, which was subsequently denied.

After further communications among the parties and the ALJ, on October 14 Pacific amended its application and its evidentiary showing to account for the effects of the FCC's recent order establishing CALCs. On October 19 Pacific filed a motion to defer hearings until mid-December. That motion was granted by ALJ ruling issued October 24. On November 14 Pacific distributed "updates and refinements" to its previously filed testimony.

Seven days of hearing were held before ALJ Mattes in San Francisco in mid- to late December 1983. Four witnesses testified on behalf of Pacific, one on behalf of Protestants, and one on behalf of the U. S. Department of Defense and Federal Executive Agencies (DOD/FEA). In addition, representatives of the City of San Diego, the City of Los Angeles, the City and County of San Francisco, and the County of Los Angeles participated in the cross-examination of witnesses. Briefs were filed at the end of January 1984 by Pacific, Protestants CIA and ROLM, the City of San Diego and the City and County of San Francisco, the City of Los Angeles, and DOD/FEA. Oral replies to the briefs were heard February 3, 1984. The Commission staff did not participate in the hearings and did not file a brief.

Background

Pacific's application concerns the rates and conditions of service applicable to its Centrex-CO and Airport Intercommunicating Services. These services will be referred to collectively as Centrex service. Centrex service is an exchange telecommunications service intended for large business telephone customers. It provides the subscriber with many telephone lines which may be called individually, rather than through a switchboard; which may be used independently for outgoing calls; and which may be used for intercommunication (intercom) calling between stations on the subscriber's premises. Centrex provides station lines, attendant positions, direct inward dialing to individual stations, identification of outgoing calls, intercom usage with fewer than seven digits, call transferring and add-on within the sytem, access to the exchange and toll networks, and other optional features similar to those offered by a private branch exchange (PBX) system.

What primarily distinguishes Centrex from a PBX service is that Centrex employs the switching capacity of a telephone company central office to perform the switching otherwise provided by a PBX machine. The Centrex subscriber requires more access lines than a PBX user with comparable usage characteristics. This is because all calling, including intercom calling, must be routed off customer premises through the telephone company switching office. On the other hand, the customer need not devote office space to PBX equipment, but rather shares the use of the telephone company central office to meet internal call switching needs and can rely on the telephone company for spare capacity.

Clearly, PBX and Centrex are competing services. Pacific has offered Centrex service since 1964, but since the mid-1970s the Bell System preferred to market its Dimension PBX system, consequently neglecting to enhance its Centrex service offerings with state-of-the-art technology. Few new features were added to Centrex and the rates for Centrex service were increased, particularly by D.90309, issued May 22, 1979, in Pacific Tel. & Tel. Co. (1 PUC 2d 344). According to Pacific witness Malone, an independent industry consultant,

> "...in AT&T's zeal to sell the Dimension PBX in lieu of Centrex, what happened was Centrex customers began to feel that the company did not have a strong commitment to the product.
>
> "They did not see the number of new features being added to Centrex that they could get from a PBX. And they found that the Centrex rates, in their opinion, seemed to spiral upward.
>
> "So, therefore, the customers began to feel that Centrex was not what we referred to as a viable solution for them because as their businesses would grow and as their demands for communications products would change Centrex seemed to maintain a status quo in terms of what it offered to them."

Today Pacific's interest in Centrex service has changed. Divestiture from its parent American Telephone & Telegraph Company (AT&T) in accordance with an antitrust consent decree has deprived Pacific of its existing base of PBX equipment but has left Pacific with its Centrex customer base. Because Centrex plant is not customer premises equipment, the divestiture consent decree permits Pacific to continue providing Centrex service to its existing subscribers and to offer that service to new customers as well. Whether or not, prior to divestiture, Pacific stood to benefit from the migration of Centrex customers to AT&T's PBX product line, any benefit now clearly flows the other way. At least until Pacific develops its own PBX marketing operation anew, the movement of a Centrex customer to PBX service now means a significant loss of revenue to Pacific.

Position of Pacific

According to Pacific, Centrex service is one of only a few of its post-divestiture services that covers its fully allocated costs. Because Centrex provides a revenue contribution above and beyond its own investment, direct costs and overheads, Centrex helps to keep the rates for other services lower than they would otherwise be. By this application Pacific seeks to restore the viability of its Centrex service offerings and to maintain its existing Centrex customer base.

Pacific's Proposals

There are three main features to Pacific's application, each of which will be considered separately on its merits. These are the Centrex rate stability plan (RSP), the proposal to extend the Centrex offering to smaller line size customers, and the proposal to decrease Centrex rates to offset the effects of FCC-required CALCs.

The RSP is an optional plan which would guarantee Centrex customers against utility initiated increases in rates for the major portions of their Centrex service for a three-year period. The RSP would include all features included in Pacific's tariff schedules Cal. P.U.C. Nos. 117-T and 121-T, for Airport Intercommunicating Service and Centrex CO Service, respectively, which are subject to recurring monthly charges, with the exception of exchange access (sometimes referred to in the tariffs as the exchange access trunking charge), mileage charges, and dormitory rates. Nonrecurring charges for additions, moves, or changes would not be covered by the RSP. In return for the assurance against utility initiated rate increases for the three-year period, the Centrex customer would commit to retaining

90% of the Centrex lines in service at the time the RSP agreement becomes effective. The proposal includes a termination penalty, which would decline based on the number of months left to run in the agreement at the time of disconnection. The RSP election option would remain open only for nine months. Therefore, the RSP would be offered to existing customers and new customers placing orders during the nine-month window. The proposed RSP contract form, as it would be included in Pacific's tariff, is attached as Appendix A to this decision. The RSP itself would be set forth at Sheets 277-86 of Pacific's Tariff Schedule 121-T, attached as Appendix B.

Currently, Centrex customers must purchase a minimum of 100 Centrex lines. The second element of Pacific's application is a request to decrease the minimum line size required to 40 lines, so that Pacific may offer Centrex service to customers desiring systems in the range from 40 to 99 lines.

The FCC access charge decision on reconsideration (Memorandum Opinion and Order, released August 22, 1983, in CC Docket No. 78-72 Phase I) imposed monthly access charges beginning at $2 per month on each existing Centrex line and up to $6 per month on each Centrex line to be added in the future, as compared to a monthly charge of up to $6 for ordinary business lines, including PBX trunks. Because a typical Centrex customer is served by a number of Centrex lines greater by a factor of ten or more than the number of trunks required to serve the same customer using a PBX, the FCC decision imposes a substantial competitive disadvantage on Centrex service. Consequently, the October 1983 amendment to Pacific's application added a request to lower Centrex rates sufficiently to offset the differential impact on Centrex of the FCC-required CALCs. Pacific's request was intended to maintain the pre-existing price relationship between Centrex and PBX service offerings. By Pacific's calculations, the reduction in 1984 would be $1.51 per month per line on Centrex lines ordered on or before July 27, 1983 and $4.40 per month per line on new Centrex lines ordered after that date. In later years, the reductions on the older Centrex lines would increase up to the $4.40 level, paralleling the increase in interstate CALCs as currently required by the FCC.

Pacific's rationale for these three requests stems from its assertion that the proposals respond to the needs of existing and future customers and are necessary if Centrex service is to survive as a viable service offering of Pacific.

Pacific asserts that Centrex service is "imperiled" unless Pacific's proposals are instituted immediately. The record demonstrates that Centrex customers are anxious, restless, and uncertain about the future of Centrex service. They seek reassurance that Pacific is committed to maintaining the viability of Centrex. The FCC imposition of CALCs on a per line basis has heightened Centrex customers' concern.

According to Pacific, Centrex service is hindered not only with respect to price but also by its relative lack of modern features. Competitors can criticize Centrex as technologically outdated. Five particularly desirable features are lacking, including customer-controlled moves and changes, enhanced station message detail recording capability, traffic modeling, electronic telephone sets and data switching at a speed of 9.6 kilobits per second. Pacific is especially concerned because customers moving from Centrex will be purchasing competing systems for use over an extended period of time. Once gone, these customers will not return.

Pacific forecasts that without change in the Centrex offering 65% of Centrex lines will be discontinued within three years. For example, 13 of California's 15 largest Centrex customers are now circulating requests for proposals to replace their systems. These customers average nearly 10,000 lines each, totalling 126,000 Centrex lines in service, or 18% of all Pacific's Centrex lines.

Pacific's witness Malone verified that these developments mirror a nationwide trend, whereby some 2,000 to 3,000 Centrex lines are being taken out of service daily.

Pacific contends that Centrex is one of only a few of its services - and the only exchange access service - which covers its fully allocated costs. As noted above, because Centrex provides a revenue contribution beyond its own costs, it helps to keep rates for other services lower than they would otherwise be. Moreover, Pacific asserts that loss of Centrex customers would idle equipment and facilities much of which could take years to reuse, thus imposing stranded plant costs on the general body of ratepayers.

According to Pacific, a shift of Centrex customers to PBX service will not make up the lost revenue. Pacific cost studies show that even at the $9.25 PBX trunk charge proposed in A.83-01-22, revenues from this service will fall substantially short of costs.

Despite the gloomy present, Pacific sees potential for Centrex being viable for the long term. The advantages of Centrex include its ability to be increased in size without requiring a change of system, unlike PBXs which are often constrained by their design limits. Centrex also can be enhanced technologically as central office improvements occur, whereas most PBXs are technologically fixed. Centrex requires no customer premises switching equipment site and offers the inherent redundancy built into Pacific's central offices. If the economic attractiveness of Centrex can be maintained in the interim, Pacific plans to offer enhanced features in the future. Pacific also sees prospects for reducing the costs of providing Centrex service through greater use of electronic central office switching and the introduction of multi-channel technology. The latter, which will permit several communications paths to be used simultaneously over a single pair of wires, could profoundly benefit Centrex service, for which outside plant costs now comprise roughly two-thirds of total costs.

Pacific sees the RSP as giving it the breathing space to improve the feature capabilities and long-term attractiveness of Centrex. It will protect Centrex customers and Pacific from hasty decisions during a turbulent period. Pacific sees Commission precedent for programs similar in effect to the RSP, citing PT&T Variable Term Payment Plan, D.82-03-058 (March 16, 1982) and PT&T Two-Tier Payment Plan, (1975) 78 Cal. P.U.C. 1.

The offering of Centrex to smaller line size customers would allow reuse of facilities that otherwise might be idled by loss of larger Centrex customers. Pacific expects that smaller line size customers would tend to take more of the high profit optional Centrex features. Cost effectiveness would be assured by making Centrex available only to those 40-99 line size customers served out of electronic (ESS) central offices, which can provide Centrex service more efficiently than technologically antecedent facilities.

Finally, Pacific urges the necessity of its proposed offset to FCC-ordered access charges due to the close alignment of Pacific's Centrex rates with its PBX competition. According to Pacific,

> "If the end-user charges are allowed to be applied on a per-station basis, without some offsetting rate reductions, Centrex will no longer be price competitive."

Pacific witness Harris contends that the FCC "committed a serious economic fallacy" in applying the CALC on a uniform per line basis. Because Centrex lines are used for intercom calling as well as network access, the number of Centrex lines greatly overstates a Centrex user's relative use of the interexchange network. This justifies setting access charges for Centrex lines on a trunk-equivalency basis. Thus, Pacific's proposed access charge offset is intended to produce a net increase in charges per Centrex line (CALC minus intrastate offset) equal to 49¢, one-tenth the amount of the FCC CALC per PBX trunk, which Pacific projected to be $4.89. This result is indicated by the following tables drawn from the supplemental testimony of Pacific witness Ellis:

PACIFIC BELL

RATES FOR EXISTING CENTREX LINE

	1983	1984	1985	1986	1987
Line Rate*	$11.19	9.68	8.68	7.68	6.79
CALC**	-	2.00	3.00	4.00	4.89
Total Charges	11.19	11.68	11.68	11.68	11.68

RATES FOR NEW CENTREX LINE

	1983	1984	1985	1986	1987
Line Rate*	$11.19	6.79	6.79	6.79	6.79
CALC**	-	4.89	4.89	4.89	4.89
Total Charges	11.19	11.68	11.68	11.68	11.68

*Actual for 1983, proposed for subsequent years.

**Per FCC decisions in CC Docket No. 78-72, Phase I.

Actually Pacific's proposed rates would more than offset the FCC CALCs. This is because Pacific has failed to take account of the effects of the 5.4% and 10.32% surcharges which presently apply to Centrex station line rates and which would remain applicable under Pacific's proposal. Thus, for a new Centrex line the effective rate today is $11.19 x 1.054 x 1.1032 = $13.01 and the proposed rate is $6.79 x 1.054 x 1.1032 = $7.90, for a reduction of $5.11 rather than the intended $4.40. Also, by letter dated March 20, 1984, Pacific informed the Commission that its revised FCC tariff for access services filed March 19, 1984, changed the $4.89 charge to $4.78 per line. This slight revision is not, and need not be, incorporated in the discussion which follows.

Pacific's Evidence

Pacific's first witness, John Malone, is president of The Eastern Management Group, described as the largest communications industry consultant in the nation. Malone testified that Centrex is a viable service which, from a technical standpoint, can satisfy the communications demands of most businesses. However, Centrex customers see Centrex rates as having been allowed to spiral, and are looking for some sign that rates will be brought under control. They also are looking for the addition of modern optional features to their Centrex service, including cost-saving features which would enhance the competitiveness of Centrex vis-a-vis PBX service. Malone testified that momentum has been building against Centrex for several years, and that every day is important to Pacific's effort to reverse, or at least slow down, the trend toward abandonment of Centrex.

Pacific witness Carol Ellis is a product manager for Centrex services. She described Centrex as "a cost effective solution to customer communications needs across a broad range of system sizes." She testified that in the future Centrex will be one way for Pacific to serve as a gateway for sophisticated communications services including local area networks, relying on the powerful capabilities of electronic central offices and light guide fiber cable distribution systems. Ellis stressed the need to offer rate stability to Centrex customers, particularly in view of the guarantees of price stability which Pacific's PBX competitors can offer through fixed price leasing or direct sale. According to Ellis, approval of the RSP will demonstrate that the Commission recognizes Centrex users' needs, and may forestall decisions to abandon Centrex. It is a crucial first step in establishing Centrex as a strong business offering now and in the future.

Witness John Gueldner testified as to Pacific's costing studies for Centrex. He described the embedded costs of the present 100+ line Centrex service based on a "tops down" fully allocated disaggregation of average embedded costs, using Pacific's vertical category analysis model which disaggregates corporate financial results or budget data into service-specific investments, revenues, and costs. The cost study for the proposed 40-99 line service was also a fully allocated cost study, but necessarily a "bottoms up" study, using such inputs as materials cost, installation labor and engineering labor to compute a unit investment base. From this investment base, annual capital costs, maintenance, administrative and other expenses are developed. The "bottoms up" approach is necessary because the smaller customer segment is not represented in Pacific's current vertical category analysis model. Such a "bottoms up" approach is routinely used to price a new service.

The "tops down" study indicated that the existing service would generate $162 million in booked revenues at a cost (including capital cost) of $128 million in 1983, yielding net contribution of $34 million. On a 1983 basis the new 40-99 line service was calculated to produce $1.1 million in revenues at a cost of $0.8 million, producing a slight added contribution.

Gueldner supplemented his testimony to indicate that even with the proposed CALC offset Pacific's Centrex revenues would cover fully allocated costs throughout the three-year term of the RSP. Based on demand projections by Pacific's marketing department, Gueldner projected costs and net revenues for the alternatives of adoption or non-adoption of the proposed CALC offset. His calculations indicate that the CALC offset would help maintain a larger customer base, thus retaining a net revenue contribution over the three-year term totalling $65 million, as compared to a $16 million deficit without the CALC offset.

In further supplemental testimony, Gueldner factored in the effects of Pacific's study disaggregating local loop costs (performed for Pacific's general rate case A.83-01-22 in compliance with the Commission's "costing manual" decision, D.83-04-012) and of the prospective CALC revenues. These factors have the effect of increasing the indicated Centrex costs and revenues, respectively. The resultant net revenues from Centrex over three years with the CALC offset are shown as $66 million, but as a $40 million deficit without the offset. Thus, these final calculations indicate a $106 million net benefit to Pacific from adoption of the CALC offset. They indicate that with the RSP and the CALC offset, Centrex revenues will continue to cover its costs for at least the next three years. Gueldner's calculations also indicate that net revenues from the 40-99 line market segment will be positive by a small margin, with or without the CALC offset.

Pacific's rebuttal witness, Professor Robert Harris, is a professional economist who has advised Pacific on the pricing of telecommunications services. He testified that, if not offset, the CALCs may price Centrex out of the market. He testified that the RSP, including the CALC offset, would not only have an immediate, substantive effect on rates, but also would have "significant symbolic importance," reassuring Centrex customers that the Commission can manage the current period of change in an orderly fashion. Harris applied general principles of economics to validate witness Gueldner's calculations that rate reductions can produce higher net revenues where a service is subject to high elasticity of demand and declining incremental costs. He urged the Commission to act immediately to reduce and stabilize Centrex rates at competitive levels, thereby maintaining as much of the Centrex revenue contribution as competition will allow.

<u>Position of Protestants</u>

Protestants CIA and ROLM assert that Pacific's proposals are not cost-justified. They question Pacific's projection of continued contribution from Centrex service as based on insupportable assumptions about the level of demand for Centrex under the RSP. In any event, they challenge the RSP as an improper response to declining Centrex demand, which would merely postpone the problem, lead to continuing requests for "artificially lowered and frozen" Centrex rates, and cause excess investment to meet artificially stimulated demand. Moreover, Protestants assert that rate reductions alone will not hold the Centrex customer base; significant upgrading of features also is needed, which may be barred by the FCC's <u>Computer II</u> decisions. Protestants also challenge the proposal as anticompetitive and contrary to ratepayer interests.

Protestants focus on the extraordinary nature of the RSP proposal, by which Pacific has singled out one tariffed service to be insulated from all company initiated tariff increases for three years. No such guarantee is available for other services.

Protestants challenge the seriousness of the risk which Centrex abandonment poses for Pacific's ratepayers. They calculate that only about 228,000 Centrex lines, comprising about 2% of Pacific's total access lines, would be relegated to "temporary idleness" were Pacific denied the relief it seeks. They assert that this "will not affect California ratepayers greatly."

Protestants warn against maintaining Centrex service by below-cost pricing as merely postponing the problem of dealing with any abandoned Centrex plant. Protestants challenge Pacific's claim that once Centrex customers turn to PBX equipment, their business will be lost to Pacific forever. If Centrex reemerges with innovative features as a viable service offering, PBX users will return to Centrex in future years. According to Protestants, "there is no need for ratepayers to support the service now while the research and development goes on."

Protestants point out that Pacific bears the burden of providing cost justification for its proposals and of showing that they serve the public interest. They note that, although Pacific witness Harris criticized Protestants' showing as "hypothetical," Pacific's analysis is necessarily hypothetical as well, consisting as it does of predictions about the future. Protestants define the issue before the Commission as whether Pacific's analysis is

> "grounded in data and methodology that is sufficiently valid to warrant the Commission's reliance on it as a predictor of the future."

The core of Protestants' position is their challenge to Pacific's assertion that Centrex now is a profitable service and that Pacific's proposals will maximize future Centrex contribution toward supporting other services. Protestants criticize Pacific's analysis of both costs and demand.

On the cost side Protestants challenge Pacific's proposed Centrex rates as unduly discriminatory in relation to other business line rates. Protestants object to Pacific's efforts to deaverage local loop costs as between Centrex and other business lines. Protestants also point out apparent contradictions between Pacific's "tops down" study of Centrex service costs for the existing 100+ line size customer class and its "bottoms up" cost study for the proposed extension to 40-99 line size customers. Protestants further criticize the manner in which Pacific's cost witness accounted for the effects of inflation on Centrex costs.

Protestants point out the "extreme sensitivity" of Pacific's estimates of Centrex contribution to its demand projections. Those projections are criticized for being based on the subjective judgment of Pacific's marketing department, rather than on formalized survey procedures using representative samples. Protestants assert that the more reliable demand studies done by Eastern Management Group indicate a faster erosion of Pacific's Centrex customer base. Protestants see this as evidence that the RSP will fail to achieve its goal of preserving revenue contribution.

Protestants lodge the same sort of criticisms against Pacific's 40-99 line size Centrex service proposal as against the RSP. According to Protestants, Pacific has supplied little or no data as to the prospective demand in this customer class. In particular, two of Pacific's witnesses offered contradictory predictions as to the demand for optional features among smaller line size customers. Protestants also see little or no cost basis for the 40-99 line size proposal. They challenge the "bottoms up" costing methodology used for this proposal as "essentially inauditable" and inappropriate.

As to the proposed CALC offset, Protestants see no valid reason to offset the CALC just for Centrex customers. They note that Pacific has offered no demand projections specifically showing that this rate reduction will retain Centrex customers. They also criticize Pacific's use of a ten to one Centrex to PBX trunk equivalency ratio rather than a "sliding scale" reflecting the higher ratio appropriate for larger Centrex customers. According to Protestants, this amounts to a "functional rate increase" for large Centrex customers despite Pacific's claim that large Centrex users won't tolerate a rate increase.

Much of Protestants' criticism is based on the testimony of their witness, Dr. Nina Cornell, a professional economist who was formerly chief of the Office of Plans and Policy at the FCC. Cornell's testimony consisted in large part of sensitivity analysis, criticizing the assumptions on which Pacific's cost and revenue projections are based and calculating the very different results of applying different assumptions. Cornell also asserted that Pacific unduly discriminates in favor of Centrex and against other business line users by its differential pricing of Centrex lines and PBX trunks and by its failure to charge for Centrex intercom usage.

Cornell described Pacific's two cost studies, one of the 100+ line market and the other of the 40-99 line market, as flawed in methodology and assumptions and as mutually contradictory. She saw five major problems with Pacific's studies:

1. Failure to explain why the per line cost shown for 40-99 line market is lower than for the 100+ line market.

2. Failure to explain why it shows higher costs for a business line with no usage than for a Centrex line with intercom usage.

3. Miscalculation of the effects of inflation on investment costs.

4. Use of unsupported and unauditable estimates of demand and of plant reuse for calculating the impact of potentially idled plant.

5. Improper inclusion of CALC revenues in calculating "contribution."

Cornell challenged the "bottoms up" approach of the 40-99 line cost study as "essentially inauditable" and lacking closure to the company's total revenue requirement. She noted that the FCC has rejected the use of such "bottoms up" studies.

Cornell compared Pacific's $19.50 estimate of the monthly cost of a business access line with its $13.75 estimate for a Centrex line, noting that Pacific witness Gueldner identified only two primary sources for this cost difference: loop costs and commercial and administrative costs. The difference in loop cost, based on Pacific's disaggregated local loop study, is 11%, which could account for only about $1 per month in cost difference per line, leaving a $4.75 gap to be explained by the difference in commercial and administrative costs, which Cornell considered "extremely unlikely." She also challenged the cost difference based on the local loop study because it "merely reflects features of the loops that happen to be providing business or Centrex service at a point in time."

In calculating the cost of serving new Centrex customers, Gueldner factored in a higher incremental cost for new investment, 25 to 30% higher than embedded cost, to adjust for inflation. Cornell asserted that this incremental cost factor should also be used in calculating the cost of Centrex lines remaining in service due to the RSP. Cornell also challenged Pacific's assignment of "almost all the operating expenses" associated with idled Centrex plant to Centrex service. Such operating expenses should decline if Centrex plant is idled, thus diminishing the negative revenue impact of the loss of Centrex customers. Cornell also contended that Pacific overstated the prospective amount of idled Centrex plant, and criticized Pacific's demand projections as unscientific and subjective.

Finally, Cornell challenged Gueldner's inclusion of CALC revenues in his revised calculation of Centrex contribution. She noted that changes in revenue from Centrex tariffs directly affect how much revenue must be collected from other intrastate services, but that changes in CALC revenues will not have such an effect. Rather, reduced Centrex CALC revenues will increase the revenue required to be derived from another <u>interstate</u> access charge element, the carrier common line charge.

In supplemental testimony Cornell further criticized Pacific's demand assumptions, particularly as to demand under proposed rates. Based on different assumptions about demand and the reuse and cost of idled plant, Cornell calculated that Pacific's proposed Centrex rates would produce a <u>lower</u> net revenue contribution than existing rates, but for consideration of CALC revenues. She contended that no more than <u>net</u> CALC revenues, the difference between CALC revenues from Centrex usage and those from PBX usage, should be considered, and that adding in such net CALC revenues still would leave Pacific with a reduced net revenue contribution at proposed rates. She also calculated that different demand and cost assumptions would eliminate any net contribution from Centrex at either proposed or existing rates. Cornell reasserted her claim that Pacific's proposed pricing of Centrex would unfairly discriminate against other business line customers.

The essence of Protestants' case is that Pacific has failed to demonstrate that its proposals will benefit the general body of ratepayers. They assert that neither the RSP, the extension of Centrex to smaller line size customer, nor the CALC offset is cost-justified. Nor do Pacific's demand projections adequately assure that these measures would achieve the goal of maximizing whatever revenue contribution Centrex service might offer. In short, Protestants contend that Pacific has failed to bear the burden of proving that its proposals are in the public interest.

Pacific's Response

Pacific emphasizes the conservative assumptions made by witness Gueldner in his cost studies. These included the allocation of 50% of idle Centrex plant costs to remaining Centrex customers, the exclusion of consideration of new technology which may increase the efficiency of use of Centrex outside plant, and the assumption of higher incremental costs for 50% of new Centrex service additions. All of these assumptions tend to decrease the estimate of future contribution from Centrex service.

Pacific defends its inclusion of CALC revenues in calculating Centrex contribution, because imposition of the CALCs presents the first occasion in which interstate revenues will be collected from per-line rates charged to individual customers. Moreover, it is undisputed that Gueldner's analysis includes both interstate and intrastate costs of Centrex, so both interstate and intrastate revenues should be included as well. Pacific notes that a similar procedure has been followed in comparable cost studies for Pacific's general rate case, A.83-01-22.

Pacific explains the differences in costs indicated for the 100+ and 40-99 line size Centrex customer groups as simply due to the use of different mixes of plant facilities and central office equipment. The slightly lower cost per line calculated for the smaller line size customers is explained as probably due to the lower ratio of intercom calling characteristic of these customers. Pacific argues that any error in its cost calculations affects a much smaller proportion of costs than Protestants allege and has little effect on the net revenue improvement its proposals would generate. Pacific defends Gueldner's "bottoms up" cost study of the 40-99 line size service by distinguishing it from the very different studies rejected by the FCC. The lower cost per Centrex line as compared to other business lines shown by Gueldner's study is explained by various economies of scale benefiting Centrex, particularly the higher density of Centrex installations.

Pacific defends its demand projections, contending that in the current changing environment a detailed market study based on statistical methods would have been a waste of time and money. The Eastern Management Group studies which show more rapid loss of Centrex customers are distinguished as assuming that the operating companies including Pacific would be doing nothing to prevent the decline in demand for Centrex. Pacific notes that Protestants refused to provide any evidence from the market research of their own companies as to the demand for Centrex.

Pacific denies the need for such accuracy in its cost and revenue calculations as Protestants and their witness Cornell demand. According to Pacific,

> "such high accuracy is not needed when Centrex customers are leaving the service or have bids outstanding -- it is patently clear that many customers are on the verge of leaving Centrex (if they have not already left). A study accurate to the fourth or fifth decimal place is not necessary in such event."

Pacific responds to Protestants' calculation that "only" 2% of Pacific's total access lines would be idled absent approval of the proposals by noting such plant idling would lead to a loss of net revenues of about $20 million over three years - $20 million which would have to be borne by other ratepayers.

Pacific also notes the testimony of witness Harris that, according to economic theory, efficiency requires that prices move toward incremental economic costs, which are even less than the fully allocated costs calculated by Gueldner. Pacific's proposals are a modest step in that direction.

Positions of Other Parties

The only other party to present a witness was DOD/FEA. Its witness was Dr. Charlie McCormick, an economist with the Defense Communications Agency. McCormick testified in favor of Pacific's proposals because they would provide Centrex users some assurance of stable future rates after a recent history of rapid rate increases. He described the proposed RSP as

> "nothing more than an insurance policy which provides a degree of protection to [Pacific], Centrex users, and other ratepayers."

McCormick urged that Centrex prices be based on incremental or marginal costs in order to promote optimal resource allocation. He criticized the present Centrex rate structure as excessive because, based on Pacific's showing, it appears to contribute net revenues to the support of other services. Although Pacific witness Harris also testified in favor of basing rates on incremental costs, Pacific's proposals are based primarily on fully allocated embedded cost studies. Pacific's proposals do, however, tend in the direction in which rates apparently would move if based on incremental costs.

DOD/FEA supports all Pacific's proposals - the RSP, the extension of Centrex to smaller line size customers, and the CALC offset. It opposes Protestants' contention that Centrex lines should be tariffed at the same level as other business lines. DOD/FEA urges that future Centrex prices should not exceed "true economic or incremental costs" and that subsidies from Centrex to other services should be eliminated. It notes that plans comparable to the RSP "are being approved in other jurisdictions."

The City of San Diego and the City and County of San Francisco (Cities) filed a joint brief and were represented jointly in oral replies to the briefs. Cities note the substantial rate increases affecting Centrex services in California since 1979, increasing average monthly bills per Centrex line from $10.11 to $16.21 over a four-year period - roughly a 60% increase. Cities share the apparent frustration of Protestants' witness Cornell over the difficulty of analyzing Pacific's cost data for Centrex. Noting that Pacific requested no revenue increase during hearings in this proceeding, Cities urge the Commission to allow no general rate increase due to adoption of the RSP. The Commission also is urged "to maintain, in the future, an extremely watchful eye to ensure that Pacific does not price Centrex below cost."

On the other hand, Cities "are convinced that Centrex rates are far too high" at present, and so they support the RSP. They also see no reason to deprive Pacific of the ability to compete for the 40-99 line size market. They support the proposed CALC offset to correct for the effects of the FCC access charge decision.

A brief also was filed on behalf of the City of Los Angeles supporting the RSP and the CALC offset. Los Angeles takes no position on the proposal to offer Centrex to smaller line size customers. Los Angeles sees the RSP as providing a basis for it to minimize costs and to plan adequately for the future. The RSP will bring "sorely needed stability" to Centrex customers for a short period, enabling them "to wait until the dust from divestiture settles before having to confront difficult, expensive telecommunications decisions." The CALC offset will mitigate the "disastrous" impact of the FCC access charge decision. Los Angeles sees Pacific's cost study methodology as acceptable for purposes of this proceeding, and urges the Commission to approve the RSP and the CALC offset.

Discussion

Potential Viability of Centrex Service

The evidence is persuasive that the viability of Pacific's Centrex service is threatened. Testimony clearly indicates that substantial numbers of Centrex customers are abandoning that service or actively considering its abandonment. The participation of such interested parties as DOD/FEA and various cities and counties in this proceeding further substantiates this trend, as do letters submitted to the Commission in support of Pacific's application by various Centrex customers.

The threat to Centrex service is properly a subject of concern to this Commission. The primary grounds for concern are Pacific's assertions that Centrex remains today a profitable service contributing net revenues toward the support of basic telephone services and that substantial loss of Centrex customers would not only diminish that contribution but would leave Pacific with substantial stranded investment in outside plant and central office equipment. The validity of Pacific's analysis will be examined in detail below, but, if valid, it indicates a substantial ratepayer interest in the maintenance of Centrex as a viable service. A further reason for concern to maintain the viability of Centrex is its contribution toward diversity in Pacific's service offerings, presenting a wider choice of services to its business customers and extending the narrow range of the lines of business left to Pacific by the AT&T antitrust consent decree.

If Centrex should be preserved as a viable service, it must be determined whether Pacific's proposals will help to do so. Undisputed evidence indicates that both stable rates and enhancement of Centrex features are necessary to maintain the viability of the service. Pacific sees rate stability as the most urgent need, contending that this will stem the tide of customer attrition and provide "breathing space" necessary to develop new features to revitalize Centrex service. Protestants, on other hand, argue that Centrex is so unattractive as to be beyond saving. They assert that capping and even reducing Centrex rates will simply postpone the abandonment of a noncompetitive service, draining revenues and requiring uneconomic plant investments in the meantime.

We are impressed by Pacific's showing that Centrex service offers distinctive features which certain customers may prefer to the features offered by PBX services. We also consider it likely that technological advances can be incorporated into the development of new Centrex features which stand a good chance of maintaining and enhancing the technical viability of Centrex service. Protestants suggest that for Pacific to offer such features might violate the terms of the FCC's Second Computer Inquiry decisions, but fail to elaborate this possibility. Such vague speculation should not prevent Pacific from enhancing the competitiveness of its Centrex service. We conclude that Centrex can remain a viable and competitive service, if stabilized prices will cover its costs.

Fairness of Pacific's Proposals

We do not consider it unfair to single out Centrex service for assurances of rate stability, including an offset to the FCC CALCs, if the costs of the service justify such measures. Pacific alleges that Centrex is the only access line service which covers its cost and generates contribution toward the costs of other services. That, in itself, would justify special efforts to preserve the viability of Centrex service. Moreover, Centrex is a competitive service, competing with customer premises equipment (CPE) offerings priced on an unregulated basis with just the sort of price predictability which Pacific seeks for Centrex. Within the context of the competitive market in which Centrex is offered, there is nothing special about offering rate stability.

It is worth noting that the RSP would not guarantee Centrex customers against any rate increases whatsoever. Only certain recurring monthly charges are covered by the plan, and the customers would be protected only against utility initiated rate increases. If the Commission staff or even Protestants propose a Centrex rate increase in Pacific's next rate case, the RSP would not prevent this Commission from adopting such an increase. Tariffs including comparable guarantees against utility initiated rate increases have been approved before by this Commission in the similar context of CPE service offerings. See PT&T Variable Term Payment Plan, D.82-03-058, issued March 16, 1982, at 10 (mimeo.); cf. PT&T Two-Tier Payment Plan, (1975) 78 Cal. P.U.C. 1.

Consideration of Competitive Impacts

Protestants also assert that Pacific's proposals are anticompetitive. They do not support this assertion with any analysis of how competition or competitors would be adversely affected. In fact, Protestants refused to respond to Pacific's requests for data on the expected impact of Pacific's proposals on future sales of PBX equipment by ROLM and other CIA members and for other information regarding the activities of competitors in the PBX market. Pacific's motion to compel discovery as to these matters was denied by the ALJ on the grounds that it would be inappropriate to compel answers by a protestant as to its projection of its business and its members' business. The ALJ observed, however,

> "that the unwillingness of CIA and Rolm to divulge such information would cast some doubt upon contentions that they might make as to anticompetitive effects of the Pacific proposal."

We affirm the ALJ's ruling and note that Protestants have offered no evidence as to the prospective effects of approval of Pacific's proposals on PBX competitors. Nonetheless, we recognize it to be our duty to take into account, on our own initiative if necessary, the antitrust aspects of applications before us. As the California Supreme Court has ruled,

> "The Commission must place the important public policy in favor of free competition in the scale along with the other rights and interests of the general public." (Northern California Power Agency v Public Utilities Commission (1971) 5 Cal. 3d 370, 379.)

Amid the turmoil now affecting the telecommunications industry, it is often difficult to determine whether a particular action on our part will promote or hinder "free competition." This proceeding offers a good example. Vigorous competition clearly exists today between Pacific's Centrex service and the PBX equipment offerings of ROLM and the members of CIA. Pacific itself formerly offered and actively promoted Bell System PBX equipment to replace its Centrex service. That Bell System PBX equipment has now been transferred to and is being provided by AT&T as a further competitor with Pacific. It is clear to us that maintaining the viability of Centrex will enhance rather than impair competition in this market.

A key aspect of competition in the Centrex/PBX market is the fact that the offering of PBX equipment has been largely deregulated by the FCC's Second Computer Inquiry decisions, whereas Centrex remains a regulated, tariffed service. PBX competitors, with the partial exception of AT&T during the two-year course of its current price predictability program for embedded CPE, are free to adjust their prices up or down at a moment's notice. They are also free to offer price stability to their customers through firm sales prices or fixed rate leases. For Pacific to compete fairly and effectively it must be able to adjust its Centrex rates to meet competitive pressures as well as to offer some price stability to customers for whom that is an important consideration.

On the other hand, the free competition favored by public policy is not compatible with predatory pricing or cross-subsidization of a competitive service by revenues from monopoly operations. This brings us back to the question whether Centrex revenues cover the costs of Centrex operations, and whether under Pacific's proposals they will continue to do so. If so, and if these proposals will enhance the viability, i.e. the competitiveness, of Centrex, then approval of the proposals would be fully consistent with the public policy favoring free competition.

The Basic Issues: Costs and Revenues

The basic factual issues on which the disposition of this application turns come down to two questions of costs and revenues: (1) Is Centrex now a sufficiently profitable service to contribute net revenues for the support of other Pacific service offerings; and (2) Will approval of Pacific's proposals tend to maximize such contribution in the future? Resolution of these issues requires careful examination of Pacific's cost and revenue studies. In this review we recall that Pacific bears the burden of proving that the answers to the above questions are in the affirmative.

As discussed above, Pacific's cost and revenue studies indicate that Pacific's Centrex service currently is a profitable one, having generated in 1983 an estimated $162 million in revenues at a cost (including capital cost) of $128 million, for a net contribution toward other services of about $34 million. Pacific's studies further indicate that with the RSP, the extension of service to smaller customers, and the CALC offset, Centrex service will remain a net contributor of $66 million over the next three years. However, without the CALC offset Centrex is projected to operate at a $40 million deficit over that period. Thus, according to Pacific's studies, approval of Pacific's three proposals will enhance the viability of Centrex, benefit the general body of Pacific's ratepayers, and result in fair competition at rates fully covering the cost of service.

Evaluation of Objections to Pacific's Cost Estimates

The principal objections that Protestants lodge against Pacific's cost studies are (1) that the bottoms up study of the proposed 40-99 line size Centrex service is unreliable; (2) that the tops down study of the 100+ line size service indicates results inconsistent with those of the 40-99 line study; (3) that Pacific's study method discriminates improperly between Centrex lines and other business lines; and (4) that Pacific miscalculated the costs associated with idled plant and plant retained in service.

Protestants' challenge to Pacific's bottoms up study method is without merit. Pacific has justified its method of costing the proposed 40-99 line size Centrex service as the normal and the only practical approach to pricing a newly proposed service not represented in Pacific's vertical category analysis model. The FCC's rejection of bottoms up studies under different circumstances has not been shown to be relevant to this case.

In comparing the results of Pacific's tops down study of the costs of the present 100+ line Centrex service with those of the bottoms up study of the proposed 40-99 line size service, Protestants point out several alleged inconsistencies, which they contend indicate that Pacific's cost studies are unreliable. Indeed, several results of the two studies appear significantly disproportionate. However, Pacific has offered plausible explanations of the differences and, in view of the very different methods employed for the two studies, the differences do not appear so serious as to discredit the cost studies.

For example, much analysis was devoted to the costs of central office equipment devoted to Centrex because Pacific's studies showed a higher per line cost in this regard for the 100+ line customer class than for the 40-99 line size. Protestants criticized this result as contradicting Pacific's assertion that Centrex offers economies of scale. However, witness Gueldner's Exhibit 15 indicates that the entire cost differential, and more, is accounted for by the higher cost of intercom usage by 100+ line customers. This higher cost is fully consistent with the higher busy hour intercom usage Pacific projected for the larger line size customer class. The reason for higher intercom usage among customers with a larger number of lines was explained by witness Harris as being the logical result of having more persons available to call within the customer's Centrex system.

Protestants also established a 23% difference in cost per busy hour second of intercom calling between the two customer size classes. Pacific witness Gueldner saw this difference as logical because the lower per second cost was for the larger line size customers, which could benefit by economies of scale in the allocation of common or fixed costs. Protestants note that this 23% "error," applied to the total three-year projected costs of Centrex service under the RSP ($415 million), would exceed $96 million, possibly cancelling out the $66 million contribution Pacific calculates for Centrex. Pacific responds by denying that the 23% difference indicates an error in its cost studies, but that even if it does, the error would apply only to the cost of central office equipment devoted to 100+ line size Centrex, a projected $115 million, for a maximum error of $26 million. We conclude that some inconsistency between the two cost studies is apparent, but a significant portion of the difference is probably due to economies of scale.

In considering this and other criticisms of Pacific's studies raised by Protestants we must bear in mind that the purpose of the studies is not to predict Pacific's costs and revenues to a minute degree of accuracy. The purpose, quite simply, is to achieve a reasonable level of confidence that Pacific's Centrex service will provide a net revenue contribution, and that Pacific's proposals will enhance that contribution. Pacific's cost studies so indicate. We conclude that any inconsistencies between Pacific's two cost studies are not of such magnitude as to call that result into question.

Protestants' allegation of improper discrimination between Centrex lines and other business lines is also without merit. Pacific's studies include intercom usage costs in the calculation of Centrex line costs. Although the indicated monthly cost of a Centrex line ($13.75) exceeds the proposed rate ($11.68, including FCC CALC), the same is true of the projected monthly cost of a business line ($19.50) in relation to the rate proposed in A.83-01-22 ($15.89, since revised to $14.14, including FCC CALC). In the case of Centrex

Pacific's study indicates that the service as a whole generates revenues well exceeding costs.

Protestants complain that the $19.50 business line cost estimate is outdated. Pacific's disaggregated local loop study indicates that the cost may be slightly lower but the necessary calculations have not been made since that study did not have as its purpose the repricing of business lines. Such a reduction in the $19.50 cost estimate would eliminate much of the $4.75 gap which witness Cornell saw as unlikely to be due solely to commercial and administrative costs. Even with an adjustment equivalent to the indicated reduction in business line costs, the ratio of the business line rate to its cost remains roughly comparable to that between the Centrex line rate and its cost.

Protestants' argument that Centrex lines should not be distinguished from other business lines at all, because the same line could be used for either service, is invalid. As noted by Pacific, the two services are provided using different mixes of outside plant and central office equipment, resulting in different average costs. A primary reason is that Centrex lines tend to be concentrated in denser service areas; differences in vintage, dispersion, and planning horizon also are relevant. It is appropriate to recognize the resultant differences in average costs by setting the rate for a Centrex line lower than that for other business lines. Cf. Pacific Tel. & Tel., D.83-04-012, issued April 6, 1983, which prescribed "costing manuals" for CPE and private line services, including a requirement that future studies of local loop costs disaggregate loop costs for specific private line service offering groups. See especially id., Attachment B, p. 13.

On the subject of idled Centrex plant, Pacific's projection of idled plant and assignment of associated capital costs and expenses to Centrex service are generally reasonable. One exception is the level of assignment of operating expenses associated with idled Centrex plant. As witness Cornell argued, operating costs should decline when such plant is idled, thus diminishing the negative revenue impact of the loss of Centrex customers. On the other hand, Protestants also argue on brief that Pacific exaggerates the amount of plant which will be rendered idle by the loss of Centrex customers. These criticisms tend to cancel each other out.

Witness Cornell also criticized Pacific for failing to incorporate its 20 to 30% premium estimate of incremental as compared to embedded costs in calculating the cost of Centrex lines which will remain in service due to the RSP. This suggestion assumes that continuation of existing Centrex services will require new loop construction comparable to that required to meet incremental demand for Centrex service. The unrefuted evidence that loss of Centrex customers will result in substantial idling of plant indicates that Cornell's assumption is false. If the RSP results in continued service to a customer whose loss would have left idle plant, then the cost of that continued service is properly calculated on the basis of embedded, not incremental cost.

Evaluation of Objections to Pacific's Revenue Estimates

There is merit in Protestants' criticism that Pacific lacked hard, statistically reliable demand information, instead relying on informal projections of demand by its marketing personnel. This subjective approach makes it difficult to evaluate with any great accuracy Pacific's projections of the decline in demand for Centrex with or without approval of its proposals.

Protestants suggest, on the one hand, that Pacific should have obtained demand information through formalized procedures using representative samples, and on the other hand, that Pacific should have relied on the more reliable results of the several EMG studies of Centrex demand. Pacific contends that a detailed market study would have been a waste of time and money. While Pacific's marketing group considered the EMG studies in forecasting demand, it would have been misleading to rely solely on the EMG studies because they did not consider the effects of restraining increases in Centrex rates.

Pacific questions why Protestants did not offer demand studies of their own.

As indicated above, Pacific bears the burden of proving its case, and a central issue in that case is whether its proposals will enhance the revenue contribution from Centrex. Pacific's demand projections, assuming alternatively the approval or disapproval of its proposals, are critical to that determination. Although it would have been preferable to have had better substantiated demand projections, those which Pacific offers are plausible and consistent with testimony regarding the Centrex market by Pacific witnesses Malone, Ellis, and Harris. Protestants' criticisms suggest only that Pacific's proposals may be insufficient to stanch the flow of customers away from Centrex service. We will not require such certainty of success as a precondition to allowing Pacific to try restoring the viability of that service.

Protestants also criticize Pacific's failure to study the specific effects on demand of the proposed CALC offset. They suggest that the failure to apply a sliding scale trunk equivalency factor will produce an insufficient offset to protect the larger Centrex customers from increased bills. Here again Protestants are demanding greater exactness than we find necessary. The proposed Centrex rate reduction will precisely offset the CALC for a customer whose PBX trunk equivalency is 10:1. Exhibit 21 suggests that this ratio is applicable to a customer using about 250 Centrex lines, with the applicable ratio increasing for customers using more lines up to a maximum of about 18:1. Thus, the proposed rate reduction will fully offset the CALC for smaller Centrex users and will offset more than half the CALC for even the largest users of Centrex. Even if these large customers feel some impact of the CALC, its effect will be blunted and they will have to recognize Pacific's efforts to maintain the competitiveness of Centrex service. The same would be true of a partial CALC offset.

We also reject Protestants' objection to Pacific's inclusion of interstate CALC revenues in its Centrex revenue projections. Pacific's study approach is reasonable in that it includes the Centrex costs allocated to the interstate jurisdiction as well as the interstate revenues. The CALC is the first source of interstate revenues to be directly traceable to the provision of Centrex lines. Contrary to Protestants' argument, our direct concern is not with what other rates would be affected by the loss of Centrex customers, but rather with whether Centrex service covers the costs for which it is responsible.

Protestants also propose that only the net CALC revenues from Centrex customers, after deduction of the CALC revenues which would have been generated from a comparable PBX customer, should be factored into Pacific's cost studies. This, too, is inappropriate. The issues to which Pacific's cost studies are directed concern the total revenue which Centrex will generate. Total Centrex CALC revenues are properly included.

Conclusions

Pacific's cost and revenue projections indicate that Centrex service now generates a substantial contribution of net revenues in excess of its costs and that its proposals in this proceeding will tend to preserve that contribution in future years. Some of Protestants' criticisms of Pacific's studies are invalid; others call the accuracy of the studies into question, but only at a level of detail which is not essential to the purpose which the studies serve. Pacific's cost studies are, in general, well documented and reasonable. Its demand projections are less well substantiated, but they are plausible and consistent with both economic theory and common sense. On a more general level, Pacific's analysis of the problems of marketing a tariffed Centrex service in competition with unregulated PBX products and of the risk of substantial idling of outside plant and central office equipment reinforce the credibility of Pacific's demand and cost studies, respectively. We conclude that Pacific has met its burden of proving that Centrex service covers its costs and that Pacific's proposals will enhance that cost coverage.

Rate Stability Plan

In this light, we have no hesitation in approving the RSP. The RSP, is, after all, merely a contractual (i.e., tariff) commitment by Pacific not to propose an increase in certain Centrex rates during a three-year period. In effect, this means only that Pacific will not propose such an increase in its next general rate case. It is voluntary on the part of the customer. The RSP will encourage Centrex customers to remain with the service for sufficient time for Pacific to upgrade the features available with Centrex, which may restore its long-term viability.

We will provide for the RSP to be made available to customers on the effective date of this order. We will approve the nine-month window for subscribing to the RSP as proposed by Pacific, but the three-year term of the RSP will commence January 1, 1985.

Smaller Line Size Service

We also will approve the extension of the Centrex service offering to smaller line size customers on the effective date of our order. Priced, as the evidence shows, at levels which more than cover its prospective cost, this new service will offer greater choice to business customers of moderate size, will enhance the overall viability of Pacific's Centrex service, will help to minimize the idling of Centrex plant, and will diversify Pacific's service offerings. It will not unfairly undercut competitors but rather will tend to enhance competition in an already highly competitive market.

CALC Offset

The proposed CALC offset is more problematic. Although we have endorsed Pacific's inclusion of CALC revenues in its projections of the revenue contribution from Centrex, this does not necessarily imply that a CALC offset is warranted. As Protestants note, imposition of the CALC relieves interstate toll users from bearing a share of costs allocated to the interstate jurisdiction. A CALC offset would, at least in a static analysis, pass those costs on to some class of local ratepayers. However, in the competitive dynamic of the Centrex/PBX market, Pacific's studies indicate that a CALC offset will enhance, rather than diminish, the contribution of Centrex revenues to support other services.

Nonetheless, Pacific is asking us to ameliorate one of the many ill effects of FCC access charge policies. As we recognized in our recent decision on intrastate access charges,

> "It is clear to us that the FCC has committed a massive blunder in failing to treat Centrex lines on a trunk equivalency basis comparable to its treatment of PBX services." (Pacific Tel. & Tel., D.83-12-024, issued December 8, 1984, mimeo. at 118.)

The FCC claims to understand and account for the threat to Centrex' viability which the CALCs create. In the August 1983 access charge opinion on reconsideration, the FCC noted that if intrastate Centrex rates exceed intrastate costs,

> "the telephone companies would be deprived of a fair opportunity to compete and the customers and the economy as a whole would be deprived of any benefits that Centrex-CO service may be able to provide if we implemented our access charge plan in a manner that forced customers to abandon Centrex-CO service before the state commissions can reevaluate the rate structures they have adopted." (FCC, MTS & WATS Market Structure, CC Docket No. 78-72, Phase I, Memorandum Opinion & Order released August 22, 1983, para. 47.)

In its more recent opinion on further reconsideration, the FCC found it,

> "still premature to conclude that state commissions cannot respond appropriately to the challenge posed by our decision to require cost-based pricing for all subscriber loops, including those used for Centrex-CO service. For some Centrex-CO customers the charges they may now face arise from [a] rate structure imposed on the service at the state level that does not reflect intrastate costs and it is at the state level that this problem should be addressed." (FCC, MTS & WATS Market Structure, CC Docket No. 78-72, Phase I, Memorandum Opinion & Order released February 15, 1984, para. 44.)

The "challenge" facing this Commission would be less difficult if the FCC possessed the will and the ability to follow through on its "decision to require cost-based pricing for all subscriber loops." Unfortunately, the FCC has shown no interest in even learning, let alone applying, the costs of Centrex loops. This is clear from its most recent access charge order:

> "Some petitioners claim that a per line charge on Centrex-CO systems ignores the fact that the average unseparated cost per Centrex-CO line is less than the average unseparated cost of all subscriber lines. This may or may not be true...[T]he access rules are based on average loop costs for all categories of subscribers. There are an infinite number of subscribers who will be paying end user charges and who could also make the argument that they cause fewer costs to be assigned to the interstate jurisdiction than do other subscribers. There is simply no practical way for the Commission to break down average subscriber loop costs for Centrex service without doing the same for other categories of subscribers." (Id., para. 39.)

This Commission has required Pacific to perform a detailed study to disaggregate the costs of local loops by class of service. Pacific witness Gueldner has relied on the results of that study in offering testimony in this proceeding. Our record demonstrates that Pacific's per line net investment in Centrex loops is substantially less than that in other business lines. Also, as Pacific witness Harris testified, the FCC's application of access charges on a "literal line" basis improperly ignores the fact that a Centrex loop performs not only a network access function but also is used for intercom calls, so that a lesser portion of its costs should be assigned to access. The FCC finds it impractical to base access charges on such detailed studies, but expects state commissions to "respond appropriately" to its uninformed but nonetheless bold decisions.

We would not be responding appropriately to the FCC's actions were we simply to cancel out their impact by a dollar-for-dollar CALC offset. The result would be on overrecovery of costs in the interstate jurisdiction and an underrecovery of costs in our jurisdiction. Based on our record, total revenues still would exceed total costs, so no unfairness to competitors would result. However, we do not consider it our proper role to adjust intrastate rates below intrastate costs to accommodate the questionable actions of the FCC.

We discern a moderate approach which can be expected to maintain coverage of Centrex costs and which is consistent with our past reviews of Centrex rates. It will relieve Centrex customers of most of the burden of the FCC-ordered CALCs while not cutting so deeply into intrastate revenue generation as would a dollar-for-dollar CALC ofset. The approach we adopt will be to eliminate existing surcharges on Centrex rates, both the 5.4% surcharge imposed in August 1981 by D.93367 and the 10.32% surcharge imposed in December 1983 by D.83-12-025.

The 10.32% surcharge will be removed when that surcharge is replaced by a final rate design determined in the pending decision in Phase II of Pacific's general rate proceeding, A.83-01-22, et al. Elimination of that surcharge will constitute a 9.1% reduction in Centrex rates covered by the RSP (but only a 6.2% reduction from the 1983 rates on which Pacific's cost and revenue studies were based). It appears that the effect of this reduction will approximately offset the average effect of the FCC's 1984 CALCs on Centrex customers. We note that on March 20, 1984, the FCC "extended" the effective date for Pacific's interstate access tariff filings until June 13, 1984. Thus, we anticipate that the offsetting surcharge removal will nearly coincide with imposition of the FCC CALCs.

For subscribers to the RSP, the 5.4% surcharge also will be removed from rates subject to the RSP effective the date that the increase in FCC CALCs for the year 1985 takes effect. That surcharge should remain in effect for Centrex customers not subscribing to the RSP. Elimination of that surcharge will constitute a 5.1% rate reduction. The combined effect of removing both surcharges will be a

14.0% rate reduction. It appears that this reduction will approximately offset the average effect on Centrex customers of the FCC's 1985 CALCs which, under 47 C.F.R. § 69.202(a), are due to take effect June 1, 1985. This reduction will be given effect only if the FCC CALCs are actually implemented.

Removal of these surcharges from Centrex rates is consistent with Pacific's studies of the intrastate costs of Centrex service and is also consistent with the reasons for which those surcharges were imposed. The 10.32% surcharge imposed by D.83-12-025 was intended to be replaced by the rate design adopted in Phase II of A.83-01-22, et al.; no party proposed to increase Centrex rates subject to the RSP in that rate design proceeding. The 5.4% surcharge imposed by D.93367 was intended to assure "that all customers and services somehow share in a rate increase of this magnitude [$610.1 million]..." (6 Cal. P.U.C. 2d 441, 544.) Thus, neither of the surcharges was justified specifically based on the costs of Centrex service. Removal of the 5.4% surcharge is a fair _quid pro quo_ for agreement by Centrex customers to the terms of the RSP.

Removal of the service-wide surcharges is a more appropriate adjustment than a dollar-for-dollar offset to the Centrex station line rate. It would be misleading to single out Centrex station lines for substantial rate reductions at a time when the Commission is being urged to increase drastically the station line rates for residential and other business services. The adopted approach will tend to maintain the overall economic viability and competitiveness of Centrex service. It will not compensate for the heavy burden of the FCC CALC on new Centrex lines, and so Pacific's ability to market Centrex to new customers may be limited. This should encourage Pacific to redouble its efforts to obtain relief directly from the FCC.

We cannot now justify further rate adjustments to offset increases in the FCC CALCs beyond 1985. Pacific is free to propose rate reductions for Centrex subscribers to the RSP in its next general rate application. Beyond that, the remedy for the disruptive effects of CALC increases in 1986 and beyond must be sought from the FCC itself. Perhaps before that date the FCC will have reconsidered its ill-advised decision to have imposed the CALCs or will have been found lacking in authority to do so, as this Commission is urging in its pending appeal of the FCC access charge decisions on jurisdictional grounds, consolidated under the name National Ass'n of Regulatory Utility Commissioners v FCC, No. 83-1225, D.C. Cir., filed March 1983. If, by the time we reach our decision in Pacific's 1986 test year rate proceeding, the FCC CALCs for 1986 and 1987 appear destined to take effect as now planned, we will seriously consider further rate offsets to benefit Centrex subscribers to the RSP. We caution Pacific, however, that such action will be contingent on Pacific having made a vigorous and continuing effort to reverse the FCC's decision.

Compensatory Increases in Other Rates

Pacific has not proposed to increase any other rates, whether for Centrex or other services, to compensate for the RSP or the CALC offset. Cities have urged that no general rate increase should be allowed due to adoption of the RSP. Inasmuch as Pacific's revenue studies show increased revenue contribution from Centrex in the event of approval of its proposals, no such rate increase is warranted.

As contemplated by the procedures which the Commission has adopted for A.83-01-22, et al., Pacific's ongoing general rate increase proceeding, in D.83-04-021 and D.83-12-025, the current 10.32% surcharge on virtually all services, including Centrex, will be respread by a detailed rate design to be adopted in the Phase II decision in that proceeding. To that extent foregone Centrex revenues will be replaced by increased revenues from other services. No such rate adjustments will be authorized to replace any diminution in Centrex revenues due to elimination of the 5.4% surcharge on June 1, 1985. That rate change will be approximately equivalent to the second step of the CALC offset proposed by Pacific, for which Pacific proposed no compensatory rate increase. None is warranted.

Findings of Fact

1. By the RSP, Pacific proposes to offer Centrex customers the assurance that they can retain the bulk of Centrex service features without utility initiated rate increases for three years in return for the customer's agreement to retain at least 90% of Centrex lines in service for that period, subject to a termination penalty; a customer's participation in the RSP would be voluntary.

2. Pacific proposes to extend its offer of Centrex service to customers served by from 40 to 99 access lines, in addition to those served by 100 or more lines.

3. Pacific proposes to lower its monthly Centrex line rates to negate most of the effect of each increment in the interstate CALCs imposed by the FCC.

4. Seven days of evidentiary hearings were held for the evaluation of Pacific's proposals.

5. Centrex provides services and features comparable to those offered by PBX equipment, which constitutes the primary competition for Centrex service.

6. A Centrex subscriber requires more access lines than a PBX user with comparable usage.

7. Movement of a Centrex customer to PBX service causes a significant loss of revenue to Pacific.

8. The FCC access charge decisions have imposed monthly CALCs on all multiline business subscribers; for Pacific the CALC will begin at $2 and gradually rise to about $4.89 for each Centrex line ordered on or before July 27, 1983, and will be about $4.89 for new Centrex lines and other business lines. It is expected that the initial CALCs will take effect on or about June 13, 1984, and that the $2 CALC will be increased to $3 effective on or about June 1, 1985.

9. The FCC decision imposes a substantial competitive disadvantage on Centrex service.

10. Because Pacific failed to consider the effect of present rate surcharges, Pacific's proposed CALC offset would more than compensate for the differential impact on Centrex of the FCC CALCs.

11. The viability of Pacific's Centrex service is threatened; substantial numbers of Centrex customers are abandoning or actively considering abandoning the service.

12. There is a substantial ratepayer interest in the maintenance of Centrex as a viable service.

13. Centrex can remain a viable and competitive service if stabilized prices will cover its costs.

14. The competitive market in which Centrex is offered justifies singling out Centrex service for assurances of rate stability.

15. Maintaining the viability of Centrex will enhance rather than impair competition.

16. For Pacific to compete fairly and effectively it must be able to adjust its Centrex rates to meet competitive pressures as well as to offer some price stability to customers.

17. Pacific's bottoms up study of projected costs of a 40-99 line size Centrex service is appropriate for a newly proposed service.

18. Differences between the results of Pacific's cost studies for 40-99 line size and 100+ line size Centrex service are not so serious as to discredit the cost studies.

19. Pacific's cost studies properly distinguish between Centrex lines and other business lines.

20. Pacific's average cost of providing a Centrex line is significantly lower than its average cost of providing other business lines.

21. Pacific's projection of idled plant and assignment of associated costs to Centrex service are generally reasonable.

22. Pacific's revenue and cost projections include Centrex costs assigned to the interstate juridiction as well as interstate revenues flowing from the FCC CALCs.

23. Pacific's cost studies are, in general, well documented and reasonable.

24. Pacific's demand projections are plausible, consistent with economic theory, and supported by the testimony of several witnesses.

25. Pacific's Centrex service is now sufficiently profitable to contribute net revenues for the support of other Pacific service offerings.

26. Approval of Pacific's proposals would enhance the attractiveness of Centrex service and would tend to maximize net revenue contributions from Centrex service in the future.

27. The RSP will encourage Centrex customers to remain with the service for sufficient time for Pacific to upgrade the available Centrex features.

28. The three-year term of the RSP should commence January 1, 1985, so that its termination will coincide with the beginning of Pacific's 1988 test year.

29. The proposed Centrex service offering to smaller line size customers will cover its prospective cost and provide a variety of benefits to Pacific and its customers.

30. A CALC offset will enhance, rather than diminish, the contribution of net Centrex revenues to support other services.

31. It is not a proper role of this Commission to adjust intrastate rates below intrastate costs to accommodate questionable actions taken by the FCC.

32. Elimination of existing surcharges on Centrex rates will relieve Centrex customers of most of the burden of the FCC-ordered CALCs while not cutting deeply into intrastate revenue generation; if properly timed this action will approximately offset the average effect of the FCC CALCs in 1984 and 1985.

33. Adjustments to offset increases in the FCC CALCs beyond 1985 are not justified at this time.

34. Pacific has not proposed to increase any rates to compensate for the RSP or the CALC offset.

35. The risk of customer abandonment of Centrex service in the face of the impending imposition of the FCC CALCs warrants an early effective date for the following order.

<u>Conclusions of Law</u>

1. Pacific must bear the burden of proving that its proposals should be adopted.

2. Pacific's cost studies did not unduly discriminate between Centrex lines and other business lines; it is appropriate to

recognize differences in average costs for different services in the setting of rates.

3. In determining whether proposed rates for a service will cover its costs, if costs assigned to the interstate jurisdiction are considered, then revenues from interstate provision of the service should be considered as well.

4. Pacific has met its burden of proving that Centrex service covers its costs and that its proposals will enhance that cost coverage.

5. Pacific should be authorized to implement the RSP as proposed, except that the three-year term of the RSP should commence January 1, 1985.

6. Pacific should be authorized to offer Centrex service to smaller line size customers.

7. The present 10.32% surcharge should be removed from all Centrex rates when it is replaced by a final rate design determined in Phase II of A.83-01-22, et al.

8. The present 5.4% surcharge should be removed, effective the date that the increase in FCC CALCs for the year 1985 takes effect, from all Centrex rates for subscribers to the RSP, but should remain in effect for Centrex customers not subscribing to the RSP.

9. No rate increase is warranted to compensate for effects of the RSP or the elimination of present surcharges on Centrex rates.

O R D E R

IT IS ORDERED that:

1. Pacific Bell (Pacific) is authorized to file with this Commission, at least 10 days after the effective date of this order, in conformity with the provisions of General Order 96-A, revisions to its Tariff Schedules Cal. P.U.C. Nos. 36-T, 38-T, 117-T, and 121-T, as set forth in Exhibits 17 and 18 in this proceeding, to implement the proposed Rate Stability Plan for Centrex-CO and Airport Intercommunicating Service (Centrex) and to extend Centrex-CO service to 40 to 99 line size customers, except that such tariff revisions

shall not provide for the customer access line charge offsets proposed by Pacific and Sheet 277 of Tariff Schedule 121-T shall be revised by substituting the effective date of this order for the date January 1, 1984, wherever it appears, substituting the date nine months after the effective date of this order for the date October 1, 1984, wherever it appears in paragraph V.A.1. and in the second and seventh lines of paragraph V.A.3., substituting the date January 1, 1985, for the date October 1, 1984, in the fifth line of paragraph V.A.3, and substituting the date January 1, 1988, for the date October 1, 1987, in the last line of that paragraph. The effective date of the revised tariff sheets shall be five days after the date of filing. The revised tariff sheets shall apply to service rendered on and after their effective date.

2. If the Federal Communications Commission (FCC) shall have previously implemented customer access line charges applicable to Centrex customers, Pacific shall file a tariff revision to remove the present 10.32% billing surcharge from all Centrex rates concurrently with the effective date of tariffs implementing the rate design determined in Phase II of Pacific's A.83-01-22, et al.

3. If the FCC shall have previously implemented customer access line charges applicable to Centrex customers, Pacific shall remove the present 5.4% rate surcharge from all Centrex rates for subscribers to the RSP by a tariff revision filed no later than 14 days prior to the effective date of the step increase for the year 1985 in such customer access line charges.

4. Pacific shall promptly notify its Centrex customers of the rate changes effected by this order and by the decisions of the FCC in CC Docket No. 78-72, and of the availability of the RSP and the smaller line size Centrex service offering.

This order becomes effective 10 days from today.

Dated APR 4 1984, at San Francisco, California.

LEONARD M. GRIMES, JR.
President
VICTOR CALVO
PRISCILLA C. GREW
DONALD VIAL
Commissioners

Commissioner William T. Bagley being necessarily absent, did not participate.

I CERTIFY THAT THIS DECISION WAS APPROVED BY THE ABOVE COMMISSIONERS TODAY.

Joseph E. Bodovitz

Joseph E. Bodovitz, Executive Director

APPENDIX A
Page 1

Nevada Bell

Centrex CO Service
Airport Intercommunicating Service —
Mechanized Station Service
Rate Stability Plan

Letter Of Election

____
Date

______________________ (Customer) elects to subscribe to, and The PACIFIC TELEPHONE AND TELEGRAPH
Name of Customer
COMPANY (Utility) agrees to provide, the following specified Rate Stability Plan (RSP) as set forth in Schedule Cal. P.U.C. No. 121-T for (Centrex CO Service and/or Airport Intercommunicating Service — Mechanized Station Service (AIS—MSS)).

It is understood that the service items listed in the attached Exhibit A, which reflect Centrex CO Service and/or AIS—MSS on the first billing in __________ 1983, will be provided at the stated RSP stabilized monthly rates (SMR) for a period of three (3) years commencing on ______________________ (RSP effective date) and terminating on ______________________ (RSP termination date).

The total number of Centrex CO Primary, Semirestricted and Interior lines, hereinafter referred to as Centrex CO lines, and/or AIS—MSS Primary, Partially Restricted and Fully Restricted lines, hereinafter referred to as AIS—MSS lines installed on ______________________ (RSP effective date) is the total number of such lines for which billing is rendered on ______________________ (date of first __________ 1983 bill)

Customer and Utility agree that Exhibit A shall reflect the actual billing of USOC items for Centrex CO and/or AIS—MSS billed and such __________ 1983 billing or any adjustment thereof mutually agreed to by Customer and Utility.

This election is made subject to the following conditions:

1. All facilities other than those stated above are furnished in accordance with prevailing Tariff rates and charges. The RSP excludes exchange access trunking charges, Dormitory Centrex CO lines, mileage charges, and station terminal equipment.

2. A minimum ninety percent (90%) sustained level of Centrex CO and/or AIS—MSS lines must be maintained during the term of the RSP. If lines are disconnected below this minimum, the Customer may elect to continue paying for the lines up to the ninety percent (90%) minimum at the agreed to RSP rates or pay the line RSP termination charges stipulated in the RSP.

3. During the period of the RSP, all Centrex CO and/or AIS—MSS optional features, extension lines and private network and/or additional exchange access arrangement rates are stabilized. Reassociations, additions and/or deletions of these items are permitted without incurring any penalty or RSP termination charge.

4. Any additions of Centrex CO lines, AIS—MSS lines or Central Office features over such Centrex CO lines, AIS—MSS lines or Central Office features set forth in Exhibit A, will be covered under the RSP at RSP stabilized monthly rates until the termination of this Letter of Election. Any additions to attendant equipment subscribed to under the RSP will be billed at the tariffed prevailing monthly rates.

5. Customers of the RSP are subject to the nonrecurring charges as shown in Schedule Cal. P.U.C. No. 28-T, Schedule Cal. P.U.C. No. 117-T and Schedule Cal. P.U.C. No. 121-T, for additions, and/or moves and changes for those items included under this RSP.

6. The Customer may move their primary location within the same Central Office Service Area or any other location in the same Centrex CO Service and/or AIS-MSS within, into or outside of the same Central Office Service Area, and the provisions of the RSP shall apply. All lines involved in a relocation are subject to prevailing nonrecurring charges as defined in Schedule Cal. P.U.C. No. 28-T.

APPENDIX A
Page 2

7. If the RSP is cancelled in whole or in part by the Customer or is terminated for cause by the Utility prior to expiration of the agreed to payment period under the provisions of the Letter of Election, the Customer shall be required to pay a sum determined by the application of the appropriate following formula for the Centrex CO and/or AIS—MSS lines and Attendant Equipment:

Centrex CO and/or AIS—MSS Line RSP Termination Charge	=	# of Centrex CO and/or AIS—MSS Lines on Exhibit A Below the 90% Level of Commitment	X	Monthly Rate Stability Plan Rate	X	# of Months Remaining in Rate Stability Plan Commitment	X	50%

Attendant Equipment RSP Termination Charge	=	Monthly Rate Stability Plan Rate	X	# of Months Remaining In Rate Stability Plan Commitment	X	50%

8. With the written permission of the Utility; the obligation to pay the RSP rates for the remainder of the RSP period may be assigned to another customer at Multi-Element charges as defined in Schedule Cal. P.U.C. No. 28-T.

9. Any RSP Customer wishing to continue service beyond the end of the Rate Stability Plan period may elect:
   a. Prevailing Month-to-Month tariff rates.
   b. If offered, a renewal of the Rate Stability Plan.

10. The utility agrees not to seek increases in the charges and rates for the services provided hereunder for the period specified herein.

11. This election and the terms, conditions, rates and charges for the services provided hereunder shall at all times be subject to such changes or modifications by the Public Utilities Commission of the State of California as said Commission may from time to time direct in the exercise of its jurisdiction.

The rates, terms and conditions of the Rate Stability Plan are set forth in Schedule Cal. P.U.C. No. 121-T, Section V — Rate Stability Plan Centrex CO Service - Airport Intercommunicating Service - Mechanized Station Service are those rates and charges in effect as of the effective date of this Letter of Election as set forth in the applicable tariffs for the system subscribed to and which fully identifies the rights and obligations of The Pacific Telephone and Telegraph Company and ______________________ under this election.
(Customer billing name)

APPENDIX A
Page 3

____
(Customer billing name)

Signature: ______________________________
(Authorized by)

Printed Name: ______________________________

Title: ______________________________

Date: ______________________________

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY

Accepted: ______________________________
(Date)

Signature: ______________________________

Printed Name: ______________________________

Title: ______________________________

Exhibit A

Centrex CO Service
Airport Intercommunicating Service—
Mechanized Station Service
Rate Stability Plan
Letter Of Election

Service Item	USOC	SMR (each)	Quantity	SMR (total)
		$		$

Grand Totals ____________

(END OF APPENDIX A)

EXCHANGE TELEPHONE SERVICE

CENTREX SERVICE

SECTION V. - RATE STABILITY PLAN - CENTREX CO SERVICE - AIRPORT INTERCOMMUNICATING SERVICE - MECHANIZED STATION SERVICE (N)

A. GENERAL REGULATIONS - CONDITIONS OF OFFERING

Rate Stability Plan - RSP

1. Customers with Centrex CO Service and/or Airport Intercommunicating Service - Mechanized Station Service (AIS-MSS), effective January 1, 1984 , may subscribe to the Rate Stability Plan which will guarantee against Utility initiated rate increases in Section V., B. and C. of this Schedule for a term of three years subject to the following regulations. All equipment and services not covered by the Plan are subject to standard charges and rates.

2. A new customer eligible for the Rate Stability Plan is defined as a customer cutting over to service between January 1, 1984 and October 1, 1984 , or a customer whose letter of intent for Centrex CO Service and/or AIS-MSS is received by October 1, 1984 but who will not be in service until after October 1, 1984.

3. Subscription to the Plan must be made within the period of time which extends from January 1, 1984 to October 1, 1984 (subscription period). Additions to or reductions of the quantities of rate items covered by the customer's Rate Stability Plan are permitted prior to the effective date of the Rate Stability Plan. The Plan becomes effective on October 1, 1984 and terminates 36 months thereafter. Those new customers whose service commences after October 1, 1984 will have their RSP terminate on October 1, 1987.

4. The RSP customer assumes the obligation for a minimum of 90 percent of the Centrex CO Primary, Semirestricted and Interior Lines, hereinafter referred to as Centrex CO lines, and/or AIS-MSS Primary, Partially Restricted and Fully Restricted line, hereinafter referred to as AIS-MSS line, that are subscribed to at the time the Rate Stability Plan becomes effective unless as otherwise stated in Item 12. of this section.

5. All Centrex CO and/or AIS-MSS Primary, Semirestricted and Interior Lines, (excluding Dormitory Service Lines) in the same Centrex CO Service and/or AIS-MSS, regardless of location, must be covered by the Plan. (N)

<u>NOTE: ALL DATES SHOWN ARE ILLUSTRATIVE ONLY</u>

Continued

EXCHANGE TELEPHONE SERVICE

CENTREX SERVICE

SECTION V. - RATE STABILITY PLAN - CENTREX CO SERVICE - AIRPORT INTERCOMMUNICATING SERVICE - MECHANIZED STATION SERVICE - Continued (N)

A. GENERAL REGULATIONS - CONDITIONS OF OFFERING - Continued

Rate Stability Plan - RSP - Continued

6. Any reductions in the number of Centrex CO and/or AIS-MSS lines furnished under the Rate Stability Plan below the 90% commitment will not reduce the Rate Stability Plan payments for the duration of the term, unless RSP termination charges are applied in accordance with Item 12. of this Section.

7. Any RSP customer requested new Centrex CO and/or AIS-MSS line additions made during the subscription period of the Plan will be billed at the effective stabilized monthly rate for the remaining period of the Plan.

8. Centrex CO and/or AIS-MSS line rearrangements, reassociations, or moves are provided without incurring RSP termination charges.

9. Moves and changes, additions and/or deletions of Centrex Optional Features, Private Network and/or Additional Exchange Access arrangements are permitted without incurring any penalty or RSP termination charge.

10. The Rate Stability Plan requires that the customer's primary location continue to be located in the Central Office Service Area. An existing RSP customer who moves their primary location within the same Central Office Service Area or who moves any other location in the same Centrex CO Service and/or AIS-MSS within, into or outside of the same Central Office Service Area can retain the Rate Stability Plan. (N)

Continued

EXCHANGE TELEPHONE SERVICE

CENTREX SERVICE

SECTION V. - RATE STABILITY PLAN - CENTREX CO SERVICE - AIRPORT INTERCOMMUNICATING SERVICE - MECHANIZED STATION SERVICE - Continued (N)

A. GENERAL REGULATIONS - CONDITIONS OF OFFERING - Continued

Rate Stability Plan - RSP - Continued

11. Customers of the Rate Stability Plan are subject to the nonrecurring charges, as shown in Schedule Cal.P.U.C. No. 28-T, Schedule Cal.P.U.C. No. 117-T and Schedule Cal.P.U.C. No. 121-T, for additions and/or moves and changes for those items covered by this Plan.

12. If the Rate Stability Plan is cancelled in whole or in part by the customer or is terminated for cause by the Utility prior to expiration of the agreed to payment period, the customer shall be required to pay a sum determined by the application of the appropriate following formula for the Centrex CO and/or AIS-MSS lines and Attendant Equipment:

Centrex CO and/or AIS-MSS Line RSP Termination Charge	=	# of Centrex CO and/or AIS-MSS Lines Below the 90% Level Of Commitment Disconnected	X	Monthly Rate Stability Plan Rate	X	# of Months Remaining In Rate Stability Plan Commitment	X	50%

Attendant Equipment RSP Termination Charge	=	Monthly Rate Stability Plan Rate	X	# of Months Remaining In Rate Stability Plan Commitment	X	50%

13. With the written permission of the Utility, the obligation to pay the Rate Stability Plan charges for the remainder of the plan period may be assigned to another customer at Multi-Element Charges as shown in Schedule Cal.P.U.C. No. 28-T. This charge is payable by the superseding customer. In addition to assuming the responsibility to pay the rate for the remainder of the period, the superseding customer assumes the conditions applicable to the RSP offering at the time of assignment. (N)

Continued

EXCHANGE TELEPHONE SERVICE

CENTREX SERVICE

SECTION V. - RATE STABILITY PLAN - CENTREX CO SERVICE - AIRPORT INTERCOMMUNICATING SERVICE - MECHANIZED STATION SERVICE - Continued (N)

A. GENERAL REGULATIONS - CONDITIONS OF OFFERING - Continued

Rate Stability Plan - RSP - Continued

14. Any RSP customer wishing to continue service beyond the end of the Rate Stability Plan period may elect:

    a. Prevailing Month-to-Month tariff rates.

    b. If offered, a renewal of the Rate Stability Plan.

15. Customers electing to subscribe to the Rate Stability Plan will be provided with a Form No. M 1507, Letter of Election, as filed in Schedule Cal.P.U.C. No. 38-T, for review, completion and forwarding to the Utility. (N)

Continued

EXCHANGE TELEPHONE SERVICE

CENTREX SERVICE

SECTION V. - RATE STABILITY PLAN - CENTREX CO SERVICE - AIRPORT INTERCOMMUNICATING SERVICE - MECHANIZED STATION SERVICE - Continued (N)

B. AIRPORT INTERCOMMUNICATING SERVICE - MECHANIZED STATION SERVICE **

STABILIZED RATE OFFERINGS

	USOC	SMR	USOC	SMR	USOC	SMR
1. Attendant Equipment						
	RXX	$ 202.36	13D	$ 3.15	NKR	$ 6.75
	RXJ	236.08	FLL	8.43	P24AA	.32
	RXY	326.02	JNF	2.70	LER	26.14
	RXM	39.91	JPF	10.12	QER	91.06
	02D	18.83	NKP	6.75	RKT	74.65
2. Station and Extension Lines						
	RXR++	*	RX2N+	*	RUVNF	*
	RWR++	*	RS2NF	*	RX7	6.93
	RX2++	*	RX5++	*	RX8	6.93
	RX2MN	*	RUV++	*	RX8NF	6.93
	RSZ++	*				
3. Exchange and Toll Message Diverting						
	RXL	29.23	RJL	11.80		
4. Supplemental Services						
	TLS	33.00	1LMEP	8.43		
	S71	28.67	UVE	26.14		
	41V	26.14				

* See Primary Line Rates on Sheet 282-A.
** See Schedule Cal.P.U.C. No. 117-T for item descriptions. (N)

Continued

EXCHANGE TELEPHONE SERVICE

CENTREX SERVICE

SECTION V. - RATE STABILITY PLAN - CENTREX CO SERVICE - AIRPORT INTERCOMMUNICATING SERVICE - MECHANIZED STATION SERVICE - Continued (N)

B. AIRPORT INTERCOMMUNICATING SERVICE - MECHANIZED STATION SERVICE * - Continued

STABILIZED RATE OFFERINGS - Continued

5. Optional Features

USOC	SMR	USOC	SMR	USOC	SMR
B24	$ 28.67	EHL	$ 116.75	ACY	$ 62.56
EAN	64.92	EHAXP	4.67	SAK	.90
E6G	15.50	E3P	21.00	DRR	46.09
E6G	.62	E3P	.84	BRT	1.52
E9G	33.75	P40	13.38	ODT	.90
E9G	1.35	DPB	16.02	CCN	.90
EAT	21.00	DPG	.79	SFY	18.89
EAT	.84	DMA1E	19.75	SFF	6.80
EAY	141.65	DMA1E	.79	B3A	21.08
EAP	5.17	ESM	80.00	A1B	3.65
EAB	32.25	ESM	3.20	EAN	64.92
EAB	1.29	E6CCS	67.50	E6G	15.50
E2G	32.25	E6CCS	2.70	E6G	.62
E2G	1.29	E6N	26.75	E9G	33.75
E3G	32.25	E6N	1.07	E9G	1.35
E3G	1.29	ESZ	26.75		
E8A	15.50	ESZ	1.07		
E8A	.62				

* See Schedule Cal.P.U.C. No. 117-T for item descriptions. (N)

Continued

Issued by

Advice Letter No.

Decision No.

Robert B. Roche
Assistant Vice President

Date Filed:

Effective:

Resolution No.

EXCHANGE TELEPHONE SERVICE

CENTREX SERVICE

SECTION V. - RATE STABILITY PLAN - CENTREX CO SERVICE - AIRPORT INTERCOMMUNICATING SERVICE - MECHANIZED STATION SERVICE - Continued (N)

B. AIRPORT INTERCOMMUNICATING SERVICE - MECHANIZED STATION SERVICE * - Continued

STABILIZED RATE OFFERINGS - Continued

6. Primary Line Rates

USOC Service Ordered on or before 7-27-83	MR 1-1-84 Thru 12-31-84	MR 1-1-85 Thru 12-31-85	MR 1-1-86 Thru 12-31-86
RXRS+	$9.96	$ 8.96	$ 7.96
RWRS+	9.96	8.96	7.96
RX2S+	9.96	8.96	7.96
RSZS+	9.96	8.96	7.96
RX2MN	11.47	11.47	11.47
RX2N+	9.96	8.96	7.96
RSZNF	9.96	8.96	7.96
RX5S+	9.51	8.51	7.51
RUVS+	9.51	8.51	7.51
RUVNF	9.51	8.51	7.51

USOC Service Ordered after 7-27-83	MR 1-1-84 Thru 12-31-84	MR 1-1-85 Thru 12-31-85	MR 1-1-86 Thru 12-31-86
RXRB+	$7.07	$ 7.07	$ 7.07
RWRB+	7.07	7.07	7.07
RX2B+	7.07	7.07	7.07
RSZB+	7.07	7.07	7.07
RX2MN	11.47	11.47	11.47
RSZPF	7.07	7.07	7.07
RX5B+	6.62	6.62	6.62
RUVB+	6.62	6.62	6.62
RUBPF	6.62	6.62	6.62

* See Schedule Cal.P.U.C. No. 117-T for item descriptions. (N)

Continued

EXCHANGE TELEPHONE SERVICE

CENTREX SERVICE

SECTION V. - RATE STABILITY PLAN - CENTREX CO SERVICE - AIRPORT INTERCOMMUNICATING SERVICE - MECHANIZED STATION SERVICE - Continued (N)

C. CENTREX CO SERVICE **

STABILIZED RATE OFFERINGS

	USOC	SMR	USOC	SMR	USOC	SMR
1. Private Network Access	RXN	$ 98.93	PLS	$ 98.93	ESO	$ 43.84
2. Additional Exchange Access Trunk Terminations	ESQ	60.71				
3. Station and Lines	RXR++	*	RUVN+	*	PPJ	.34
	RXRMN	*	RX5	*	PS9	.34
	RX2++	*	RUV	*	PPJNF	.34
	RX2N+	*	RX7++	.34	RVY	5.51
			RX8	.34	RQR	5.51
			RX8NF	.34	RQRNF	5.51
4. Station Controlled Features	ACY	62.56	EAB	.56	BRT	1.52
	SAK	.90	E3N	21.64	ODT	.90
	E6G	.56	E3P	.56	CCN	.90
	E6GNC	.56	E8A	1.12	SFY	18.89
	E6GUR	.56	E6CCS	2.25	SFF	6.80
	E9G	.56	E6N	.90	E3G	1.69
	E9GNC	.56	ESZ	.90	ESHC6	1.69
	E9GUR	.56	EAN	77.57	E2G	1.80
	EAT	.56	53A	58.46	ESHC3	1.91
	ESMCS	.56	DPG	21.64	B24	9.27
	EAY	141.65	DMALE	.56	B3A	20.30
	EAP	5.17	DRR	46.09	RXNAA	24.06

* See Primary Line Rates on Sheet 286.
** See Section III. for item descriptions. (N)

Continued

EXCHANGE TELEPHONE SERVICE

CENTREX SERVICE

SECTION V. - RATE STABILITY PLAN - CENTREX CO SERVICE - AIRPORT INTERCOMMUNICATING SERVICE - MECHANIZED STATION SERVICE - Continued (N)

C. CENTREX CO SERVICE * - Continued

STABILIZED RATE OFFERINGS - Continued

	USOC	SMR	USOC	SMR	USOC	SMR
5. Administrative Services - Attendant Equipment	53B	$ 421.57	53N20	$ 5.62	CXJ	$ 6.46
	53C	376.61	53N10	4.95	ECB++	297.91
	53D	65.20	53P	7.59	ECC++	314.77
	53E	438.44	53Q	12.93	ECH++	191.11
	53F	376.61	53T	5.90	ECP	16.86
	53G	66.33	EAD4X	174.25	ECU	73.07
	EDD	432.82	53O	26.70	ECL	13.49
	EAX	432.82	53U	14.90	ECJ	47.89
	EAD	146.15	53V	24.17	CXFPT	17.14
	53H	370.98	CLF	65.20	CXJPT	10.12
	53J	12.37	CLH	38.22	CTC	56.21
	53K	5.17	CLK	9.27	CTE	11.52
	53L	252.94	CLZ	27.54	MP7	14.33
	EDD4X	33.16	CXK	26.42	MP8	.45
	EAX4X	51.71	CXD	52.84	MP9	15.74
	EAD4X	174.25	CXY	52.84	KR2	6.46
	ED7	20.80	CXX	62.95	LER	78.69
	54D	21.08	CWX	64.08	QER	157.39
	ED4	23.89	CX4	7.03	RKT	134.90
	54E	23.61	53W	12.37	P4C	112.42
	53M	370.98	CXF	16.30	P24	35.41
	RXY4X	573.34	53X	224.84	P4S	9.56
	RXS4X	438.44	53Y	6.46	C58	4.38

* See Section III. for item descriptions. (N)

Continued

EXCHANGE TELEPHONE SERVICE

CENTREX SERVICE

SECTION V. - RATE STABILITY PLAN - CENTREX CO SERVICE - AIRPORT INTERCOMMUNICATING SERVICE - MECHANIZED STATION SERVICE - Continued (N)

C. CENTREX CO SERVICE * - Continued

STABILIZED RATE OFFERINGS - Continued

	USOC	SMR	USOC	SMR	USOC	SMR
6. Administrative Services - Other	CMD	$ 39.00	EC4	$101.18	A6Y	$ 15.46
	CMDMN	39.00	ECM	134.90	A6Z	51.71
	CMD	.39	ECO	196.73	A9A	2.59
	CMDMN	.39	RXL	90.50	A6G	2.59
	ZZYQ2	168.63	RJL	45.25	A66CE	4.16
	90D	67.45	RJU	13.58	A8GCE	71.95
	90P	30.35	SBC	1.35	A8GAT	12.65
	MRBAA	66.33	A6V	.34	A8GST	1.57
	MRBAB	.28	A8A	3.49	ZZBYB	44.41
	MRLAA	62.95	A82	1.57	ZZBYC	7.87
	MRLAB	.34	A83RA	1.01	ZZBYD	7.87
	CE1	101.18	A6W	36.26		
	CE8	1.57				
	CEN	61.83				
	CEP	101.18				
7. Automatic Call Processing Features	ART	275.43	ARH	9.27	MERND	207.98
	ARQES	264.19	ECT	7.31	MERCD	207.98
	EC3X8	8.43	ARQ	47.78	MES32	24.45
	EC332	19.67	ASG	163.01	MES64	26.42
	EC364	39.35	EAO	3.37	MEV	40.47

* See Section III. for item descriptions. (N)

EXCHANGE TELEPHONE SERVICE

CENTREX SERVICE

SECTION V. - RATE STABILITY PLAN - CENTREX CO SERVICE - AIRPORT INTERCOMMUNICATING SERVICE - MECHANIZED STATION SERVICE - Continued (N)

C. CENTREX CO SERVICE *

STABILIZED RATE OFFERINGS

8. Primary Line Rates

USOC Service Ordered on or before 7-27-83	SMR 1-1-84 Thru 12-31-84	SMR 1-1-85 Thru 12-31-85	SMR 1-1-86 Thru 12-31-86
RXRS+	$ 9.68	$ 8.68	$ 7.68
RX2S+	9.68	8.68	7.68
RX2N+	9.68	8.68	7.68
RXRMN	11.19	11.19	11.19
RUVN+	9.34	8.34	7.34
RX5S+	9.34	8.34	7.34
RUVS+	9.34	8.34	7.34

USOC Service Ordered after 7-27-83	SMR 1-1-84 Thru 12-31-84	SMR 1-1-85 Thru 12-31-85	SMR 1-1-86 Thru 12-31-86
RXRB+	$6.79	$6.79	$6.79
RX2B+	6.79	6.79	6.79
RX2P+	6.79	6.79	6.79
RXRMN	11.19	11.19	11.19
RUVB+	6.45	6.45	6.45
RX5B+	6.45	6.45	6.45
RUVP+	6.45	6.45	6.45

* See Section III. for item descriptions. (N)

Continued

(END OF APPENDIX B)

the interstate jurisdiction and an underrecovery of costs in our jurisdiction. Based on our record, total revenues still would exceed total costs, so no unfairness to competitors would result. However, we do not consider it our proper role to adjust intrastate rates below intrastate costs to accommodate the questionable ~~careless~~ actions of the FCC.

We discern a moderate approach which can be expected to maintain coverage of Centrex costs and which is consistent with our past reviews of Centrex rates. It will relieve Centrex customers of most of the burden of the FCC-ordered CALCs while not cutting so deeply into intrastate revenue generation as would a dollar-for-dollar CALC ofset. The approach we adopt will be to eliminate existing surcharges on Centrex rates, both the 5.4% surcharge imposed in August 1981 by D.93367 and the 10.32% surcharge imposed in December 1983 by D.83-12-025.

The 10.32% surcharge will be removed when that surcharge is replaced by a final rate design determined in the pending decision in Phase II of Pacific's general rate proceeding, A.83-01-22, et al. Elimination of that surcharge will constitute a 9.1% reduction in Centrex rates covered by the RSP (but only a 6.2% reduction from the 1983 rates on which Pacific's cost and revenue studies were based). It appears that the effect of this reduction will approximately offset the average effect of the FCC's 1984 CALCs on Centrex customers. We note that on March 20, 1984, the FCC "extended" the effective date for Pacific's interstate access tariff filings until June 13, 1984. Thus, we anticipate that the offsetting surcharge removal will nearly coincide with imposition of the FCC CALCs.

For subscribers to the RSP, the 5.4% surcharge also will be removed from rates subject to the RSP effective the date that the increase in FCC CALCs for the year 1985 takes effect. That surcharge should remain in effect for Centrex customers not subscribing to the RSP. Elimination of that surcharge will constitute a 5.1% rate reduction. The combined effect of removing both surcharges will be a

26. Approval of Pacific's proposals would enhance the attractiveness of Centrex service and would tend to maximize net revenue contributions from Centrex service in the future.

27. The RSP will encourage Centrex customers to remain with the service for sufficient time for Pacific to upgrade the available Centrex features.

28. The three-year term of the RSP should commence January 1, 1985, so that its termination will coincide with the beginning of Pacific's 1988 test year.

29. The proposed Centrex service offering to smaller line size customers will cover its prospective cost and provide a variety of benefits to Pacific and its customers.

30. A CALC offset will enhance, rather than diminish, the contribution of net Centrex revenues to support other services.

31. It is not a proper role of this Commission to adjust intrastate rates below intrastate costs to accommodate questionable K ~~careless~~ actions taken by the FCC.

32. Elimination of existing surcharges on Centrex rates will relieve Centrex customers of most of the burden of the FCC-ordered CALCs while not cutting deeply into intrastate revenue generation; if properly timed this action will approximately offset the average effect of the FCC CALCs in 1984 and 1985.

33. Adjustments to offset increases in the FCC CALCs beyond 1985 are not justified at this time.

34. Pacific has not proposed to increase any rates to compensate for the RSP or the CALC offset.

35. The risk of customer abandonment of Centrex service in the face of the impending imposition of the FCC CALCs warrants an early effective date for the following order.

Conclusions of Law

1. Pacific must bear the burden of proving that its proposals should be adopted.

2. Pacific's cost studies did not unduly discriminate between Centrex lines and other business lines; it is appropriate to