ALJ/jt

Decision 84 06 111 June 13, 1984

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a corporation, for authority to increase certain intrastate rates and charges applicable to telephone services furnished within the State of California due to increased depreciation expense.

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(Filed November 4, 1982)

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And Related Matters.

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(I&S) Case 83-11-06
led November 22, 1983)

I&S) Case 83-11-07
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CORRECTION

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(See Decision 83-12-025 for appearances and Appendix A for additional appearances.)

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INTERIM OPINION

I. SUMMARY

In this Phase II of these combined proceedings estimated 1984 intrastate revenue requirements are determined for the successors to The Pacific Telephone and Telegraph Company's (PT&T) intrastate telephone operations, namely Pacific Bell (PacBell) and AT&T Communications (AT&T-C). Rates necessary to produce these revenue requirements are then prescribed. The 1984 revenue requirements are obtained from the 1983 intrastate revenue requirements for PT&T authorized in D.83-12-024, which were based on an extensive examination of PT&T's 1983 rate case request. The 1983 authorizations are updated in two respects to obtain the 1984 revenue requirements: an attrition mechanism recognizes cost increases due to inflation and system growth; and a "divestiture overlay" identifies cost increases due to divestiture and separates the total intrastate operations among PacBell, AT&T-C, and AT&T Information Systems.

The revenue requirements determined for PacBell indicate an intrastate revenue increase of $130.9 million, and for AT&T-C, a revenue decrease of $73.5 million.

PacBell is ordered to establish 1986 goals for Female and Minority Business Enterprise contracting as part of its next general rate case and to report progress toward these goals on a semi-annual basis.

The authorized 1984 intrastate revenue requirements for PacBell are $133 million less than the staff recommendation, and $267 million below PacBell's request. The predominant difference between the amount authorized and the staff position lies in the adopted attrition mechanism, which reflects lower inflation expectations and does not provide for expense increases beyond levels attributable to inflation and system growth. Additional hearings are ordered for further consideration of attrition issues for 1984 and 1985.

A rate design is adopted for PacBell calculated to produce a $565.2 million increase in annual revenues, comprising the $434.3 million interim increase granted in December 1983 plus the $136.6 million additional increase found reasonable by this decision, reduced by $5.7 million to reflect new sources of revenue and other necessary adjustments.

The major rate design changes made to meet the increased revenue requirement are in the areas of private line services, directory assistance charges, service connection charges, long distance charges, local usage charges, local coin service, and basic exchange services. At the same time these charges are revised, a

current 10.32% billing surcharge and a further 5.4% surcharge on certain rates will be discontinued.

Based on detailed analysis of voluminous studies of PacBell's service costs, recurring charges for unswitched private line services are increased by up to 80%, and nonrecurring private line charges are set up to 150% above current levels. Local area directory assistance (DA) charges are increased from 15¢ to 25¢ and free DA calling allowances are substantially reduced. Service connection charges are increased substantially, including a 50% increase in the typical residence service installation charge from $23 to $34.50.

Message toll rates for long distance service within PacBell's serving areas are increased slightly for calls up to 50 miles, but elimination of the current 10.32% surcharge means a decrease in toll charges overall. Charges for heavily discounted optional toll calling plans are increased significantly, but two new discount plans are created, one for high-volume users and another for users of telecommunications devices for the deaf (TDDs). Rates for foreign exchange service also are increased substantially, to bring them more closely in line with the costs of the service.

PacBell is required to continue expanding the availability of measured local service, which is optional for residence customers but mandatory for business subscribers. Local calling areas are reconfigured in San Diego, Orange, and part of eastern Los Angeles Counties to conform to current calling patterns and communities of interest. The Zone Usage Measurement (ZUM) charging plan for metropolitan area calling is extended to the San Diego, Orange County, and Sacramento areas. The initial minute rate for ZUM calling is increased by up to 2¢ per call.

The rate for local coin service is increased from 10¢ to 20¢ per call, the first increase in that rate since 1952. This will

bring the local coin rate more closely into line with the cost of pay telephone service.

All rates for basic exchange service, to both residence and business subscribers, are increased by about 18%, or about 8% above the current surcharged level. Thus, the residence flat rate is set at $8.25, in comparison to the current rate of $7 ($7.72 including the 10.32% surcharge). The residence measured rate is increased from $3.75 ($4.14 with the surcharge) to $4.45 per month, including an allowance of $3 worth of free local calls.

Rate design changes also are approved for AT&T-C in order to effect the required $73.5 million reduction in its annual revenues from operations within California and to bring its rates more closely in line with service costs. The latter consideration is very important, because over 80% of AT&T-C's costs consist of access charges which it must pay to PacBell and other local exchange carriers for access to their local networks to initiate or complete long distance calls between the local serving areas.

The major rate changes for AT&T-C are in its message toll rates for long distance service. Because access charges do not vary with the distance called, it is necessary to increase AT&T-C's toll rates for short-haul calls which are currently priced well below cost. Rates for calls over 50 miles are substantially reduced, particularly on distances over 150 miles, the bulk of AT&T-C traffic. Discount plans also are approved for off-peak usage, high-volume customers, and users of TDDs. The overall impact of the toll rate increases and decreases will be a $100 million cut in AT&T-C revenues, balanced by a $1 million revenue increase from charges under the discount calling plans.

The other major rate change authorized for AT&T-C is a new 35¢ per call charge for long-distance directory assistance. This charge is necessary because, as a result of the Bell System divestiture, AT&T-C must pay PacBell and other local carriers for the

use of their directory assistance services. The 35¢ charge recovers only a portion of AT&T-C's cost of providing this service for its customers (and for customers of its long-distance competitors).

II. INTRODUCTION

Scope and Procedural History

This decision deals with issues raised in the second phase of these consolidated proceedings. The Commission, by Decision (D.) 83-04-004, issued April 6, 1983, bifurcated the case and established a schedule that was an acceleration of the Commission's Rate Case Plan (RCP)[1] schedule to accommodate the exigencies of the case. The first phase was to consider The Pacific Telephone and Telegraph Company's (PT&T) 1983 results of operations, an attrition mechanism, and an interim surcharge design. The second phase was to consider 1984 attrition, access charges, the effects of divestiture of PT&T by American Telephone and Telegraph Company (AT&T), and final rate design.

On December 7, 1983, the Commission issued D.83-12-024 and D.83-12-025, interim decisions called for by the accelerated schedule to dispose of the issues specified for consideration in the first phase. In D.83-12-025, the Commission granted, effective January 1, 1984, an interim increase in rates of $445.4 million.[2] A 12.7% return on the California intrastate rate base was found to be reasonable. The Commission authorized PT&T to impose a surcharge on its then effective rates to collect the increased revenue requirement during the interim period pending a scheduled final order in these proceedings.

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[1] The RCP is the Commission's standing plan and schedule for processing major utility general rate cases.

[2] PT&T sought $837.9 million.

The establishment of an attrition mechanism, and also an appraisal of PT&T's Female and Minority Business Enterprise (F/MBE) program activities program as contemplated by the Commission's D.82-12-101 was deferred from the first phase into the second phase.

As explained in D.83-12-025, because AT&T would, after the impending divestiture of PT&T, be providing a form of intrastate toll service, AT&T was named a respondent in Order Instituting Investigation (OII) 83-04-02, one of the proceedings combined into this consolidated case.

Subsequent to the issuance of D.83-12-025 on December 7, 1983, AT&T spun off PT&T in accordance with the "Modified Final Judgment" (MFJ) in the AT&T antitrust case. United States v American Telephone and Telegraph Co., 552 F. Supp. 131 (D.D.C., 1982). At midnight of December 31, 1983, PT&T became a separate, independent corporation, for which it selected the name Pacific Telesis Group (Telesis). Those public utility communications operations of the former PT&T that were assigned to local operating companies by the MFJ are being carried out by a wholly-owned subsidiary of Telesis, Pacific Bell (PacBell).

Pursuant to the MFJ, AT&T formed a national subsidiary, AT&T Communications, Inc. (AT&T-C) to conduct the United States interLATA and the overseas telecommunications services retained by AT&T under the MFJ. In turn, AT&T-C formed various jurisdictional subsidiaries, the name of the California interexchange company being "AT&T Communications of California, Inc." (AT&T-CC). The latter corporation appears to have been essentially a paper entity established for jurisdictional reasons only and there does not seem be any real world operating distinction between AT&T-C and AT&T-CC. During the compilation of the record, little distinction was made between the two and therefore references in this decision to either or both will be to "AT&T-C." The final results, of course, must be on a separated California intrastate jurisdictional basis and will pertain to AT&T-CC.

The scope of operations retained by AT&T-C,[3] formerly known as "toll" are now called "interLATA" and are described in D.83-12-024, the decision in these proceedings that established the California intrastate "access charges" to be collected by PT&T (and now, PacBell) for the provision of exchange access services to long-distance carriers for the origination and termination of intrastate toll calls.

The first phase of the proceedings was submitted for decision with the presentation of oral replies to briefs on August 5, 1983.

As with Phase I, two Administrative Law Judges (ALJ) were assigned to Phase II, one to consider results of operations and one for rate design issues. Of the 65 days of hearings in Phase II, 17 were devoted to consideration of results of operations and closely related items. The remaining 48 days were for public hearings and hearings on rate design issues.

Hearings on the results of operation portion of Phase II commenced on October 11, 1983, and were generally concluded on January 13, 1984. A one-day hearing on M/FBE issues was held on February 21, 1984 and the results of operations issues were submitted for decision at the conclusion of a hearing for oral replies to briefs that was held before the Commission en banc on March 2, 1984.

On April 18, 1984, the Commission, by D.84-04-104, modified D.83-12-025 to require PT&T (and therefore PacBell) to impute a 6% cost to $82 million of PT&T's common equity. D.83-12-025 had discontinued the imputation. Although the evidentiary record in Phase II had been concluded on January 13, 1984, D.84-04-104

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[3] Before divestiture and its actual formation, the contemplated AT&T-C was designated successively as "Bell System Interexchange Organization" (BSIO) and "American Telephone and Telegraph Company Interexchange Company" (ATTIX).

contemplates a reconsideration of the imputation in Phase II. The quantitative evidence in this record is all based on the 12.70% rate of return found reasonable in D.83-12-025. To preserve continuity the Commission will discuss the evidence based on the 12.70% rate of return as presented in the record and then convert the final revenue requirements as determined at 12.70% to those determined at 12.64%, the rate of return based on imputation of the 6% common equity. Since the evidentiary portion of Phase II is long closed and these consolidated proceedings are being concluded, any reconsideration of the imputation of 6% common equity must await some future proceeding.

Divestiture Framework

D.83-12-025 recites organizational developments transpiring prior to the submission of Phase I, including the deregulation of terminal equipment according to the Federal Communications Commission's (FCC) order in its D.80-628, in Docket 20828, the so-called "Computer Inquiry II" (CI II) decision.

Divestiture effects, as explained earlier, were deferred until Phase II. The divestiture process is being carried out according to a four-part "Plan of Reorganization" (POR) which was prepared by AT&T and the "Bell Operating Companies" (BOCs) and approved by the court in the antitrust case.

Part I of the POR covers the division of BOC facilities, personnel, and books of account. It contains subsections on BOC facilities, systems, and other assets; BOC liabilities, reserves and equity, inventory, assignment and audit procedures; and assignment of personnel.

Part II describes augmentation of BOCs' facilities to enable their provision of service independently of AT&T and the establishment of a "Central Services Organization" (CSO) to be owned by the BOCs for the purpose of providing engineering, administration, and other services on a centralized basis. The MFJ requires that BOCs "shall provide, through a centralized organization, a single

point of contact for coordination of BOCs to meet the requirements of national security and emergency preparedness" and the CSO meets that mandated function.

Part III of the POR pertains to cancellation of contracts. It covers the major areas of license contracts, standard supply contracts, cost sharing agreements, Bell Information System (BIS) agreements, other operational agreements, division of revenues contracts and general provisions, and overall dispute resolution.

Part IV covers AT&T's divestiture of the Bell System's exchange operations to the seven BOCs, arrangements to facilitate servicing of regional company stock, and the schedule of reorganization.

Since divestiture, each BOC is providing service only within local access and transport areas (LATA) as designated by the modified POR. California is divided into 10 LATAs. The BOC connects to interLATA carriers at designated points identified as points of presence (POPs). At these POPs locations much of the equipment and facilities to provide inter and intraLATA services initially is being shared. In such cases the BOC or interLATA carrier is assigned a role as a predominant user.

The divestiture process separated the operating company facilities and employees and the books of account into those used to provide interLATA service and customer premises equipment (CPE), and those used to provide intraLATA service. AT&T-C and other interLATA carriers provide interLATA service. IntraLATA service will be provided by PacBell.

Primary Issues of Phase II

The results of operations portion of Phase II involved, as can be appreciated from the foregoing recitation of procedural history, two parallel but separate and distinct rate cases, one concerning PacBell and the other AT&T-C.

For PacBell, the primary issues are:

1. The determination of a reasonable post-divestiture revenue requirement for year 1984.
2. The establishment and implementation of an appropriate attrition mechanism for year 1985.
3. An appraisal of the adequacy of PacBell's M/FBE program activities.

For AT&T-C, the only primary issue is the establishment of a reasonable 1984 revenue requirement. AT&T did, however, by its mere participation in the case, become associated with the 1985 attrition and M/FBE questions although it did not involve itself in the hearings concerning those issues.

III. PACBELL - 1984 REVENUE REQUIREMENT

Format of Estimates and Tables - PacBell

The RCP as established by D.83-04-021 contemplated the evaluation of PT&T's results of operations as filed in its rate increase application Application (A.) 83-01-22, leading to the establishment, in the first phase, of a 1983 rate base and revenue requirement. Adjustments to the adopted results could then be made, in the second phase, for the effects of divestiture that would prevail in 1984.

In D.83-12-025 (pp. 16-18), the Commission explained how regulatory events transpiring between the preparation of estimates for PT&T's Notice of Intention before that document was filed in August 1982, and the final showing in the first phase of the proceeding could have required a continuing complex and confusing set of revisions to the data originally submitted. PT&T and the staff overcame this difficulty by retaining the original estimates and "recasting" them three times before submission of the first phase. The results that were adopted by the Commission were thus on a

"Recast 3" basis. Updating revisions were not made during the course of the second phase of PacBell showings and therefore the PacBell results considered and adopted in this decision are all consistently on a Recast 3 basis.[4]

Updated Revenue Requirement

Only PacBell and the Commission staff presented Phase II revenue requirement evidence. PacBell claims a need for increased annual revenues of $403 million over and above these authorized by the Commission in the Phase I decision. The staff recommends that any increase be held to $269 million.

Comparisons of the overall PacBell and staff estimates of 1984 California intrastate jurisdictional revenue requirements, based on D.83-12-025 adopted results are shown in the following table:

[4] A detailed description of the Phase I sequence of revisions, or "recasts" can be found on pages 16 to 18 of D.83-12-025.

Table 1

PACIFIC BELL

California Intrastate
Revenue Increase Requirement Comparison
Based on D.83-12-025 Adopted Results

Recast 3

(Dollars in Millions)

Phase I 1983 Adopted Results	PacBell	Staff
Adopted Net Revenue Increase Amount — Phase I	$445	$445
Phase II Divestiture Overlay		
Impact of Divestiture on 1983 Adopted Results	219	209
Impact of 1984 Attrition and Depreciation Rate Technical Update	184	60
Net Amount Pending in Phase II	403	269

Combined Phase I and Phase II Revenue Increase Requirements	PacBell	Staff	Diff.
Phase I Adopted	$445	$445	0
Phase II Pending	403	269	$134
Total	$848	$714	$134

The 1984 revenue requirements as developed by PacBell and the staff are on a Recast 3 basis and reflect the $445 million rate award granted by the Commission in D.83-12-025. The Commission reduced the effective value of that award by $61 million pending the extinguishing of the accrued refund liability arising from D.83-08-031. No such adjustment should be applied to the 1984 proposed values. This is because the D.83-08-031 refund liability will be eliminated prior to any additional awards being authorized based on the results of Phase II proceedings.

A more detailed breakdown of the differences between the PacBell and staff California intrastate jurisdictional results is shown in the next table:

Table 2

PACIFIC BELL

Results of California Intrastate Operations
and Revenue Requirement Calculation

Year 1984 Estimated Based on D.83-12-025
Adopted 1983 FT&T Results

	PacBell	Staff ($000)	PacBell Exceeds Staff
RESULTS OF OPERATIONS			
Revenues	$ 6,000,666	$ 6,085,678	$ (85,012)
Expenses and Taxes			
Depreciation	823,624	751,817	71,807
Relief and Pensions	517,652	523,072	(5,420)
All Other Expenses	2,946,687	2,904,306	42,381
Taxes - FIT	416,160	482,131	(65,971)
Taxes - CCFT	88,168	96,299	(8,131)
Taxes - Soc. Sec.	121,695	122,614	(919)
Taxes - Other	115,873	112,206	3,667
Total	5,029,859	$ 4,992,445	37,414
Balance Net Revenues	$ 970,807	$ 1,093,233	$ (122,426)
Rate Base			
Plant in Service	$13,158,305	$13,326,419	$ (168,114)
Plant Held for Future Use	41,211	40,967	244
Working Cash	209,601	209,601	-
Materials & Supplies	66,515	59,895	6,620
Less: Depreciation Reserve	2,434,963	2,422,517	12,446
Less: Deferred Tax Reserve	1,707,810	1,715,729	(7,919)
Total Intrastate Rate Base	$ 9,332,859	$ 9,498,636	$ (165,777)
Realized Rate of Return	10.40%	11.51%	(1.11%)
REVENUE REQUIREMENT CALCULATION			
Intrastate Rate Base	$ 9,332,859	$ 9,498,636	$ (165,777)
Times: Adopted Rate of Return	.1270	.1270	-
Equals: Net Revenue Reqt.	1,185,273	1,206,327	(21,054)
Minus: Balance Net Revenues	970,807	1,093,233	(122,426)
Equals: Increase in Net Rev. Reqt.	214,466	113,094	101,372
Times: Div. Net-to-Gross Multiplier	2.0734	2.0734	-
Equals: Increase in Gross Rev. Reqt.	444,674	234,489	210,185
Underutilized Plant Adjustment	(41,737)	(41,737)	-
Technical Update of Depr. Rates	*	76,409	(76,409)
Proposed Gross Revenue Increase	$ 402,937	$ 269,161	$ 133,776

( ) Denotes negative amount.

* PacBell "Technical Update of Depr. Rates" in an amount of $93.002 million in overall results.

Unfortunately, a strict comparison of results is not possible because PacBell included its "Technical Update of Depreciation Rates" estimate of $93,002,000 in its overall results whereas the staff grouped its $76,409,000 estimate into one item.

PacBell, although not contesting the quantitative effect of the results adopted in D.83-12-025, stated in its brief that it did not agree with all of them. PacBell did not, in Phase II, contest any of the Commission's judgments as made in the Phase I results of operation decision.

A portion of PacBell's operations, after divestiture, continue to be attributable to interstate service, and thus subject to FCC jurisdiction. PacBell, as did PT&T, functions as an integrated system, and it is only the total integrated systems that the Commission can actually examine. It is necessary, therefore, to continue to allocate, or "separate" the results of its examinations between the two jurisdictions, federal and state. In this decision, as in D.83-12-025, the Commission will, where data permit, discuss and resolve the differences in total California operations and then separate out the California intrastate results.

D.83-12-025 Adopted Results of Operations as Adjusted for Divestiture

PacBell and Commission staff determinations of total California and separated California intrastate test year results of operations are shown in Tables 3 and 4 following:

Table 3

PACIFIC BELL

Adopted 1983 Results of Total California Operations
Based on D.83-12-025 & Adjusted for Divestiture

Recast 3

	PacBell	Staff ($000)	PacBell Exceeds Staff
Revenues			
Local Service Revenues	$ 2,070,854	$ 2,071,193	$ (339)
Toll Service Revenues	1,401,511	1,401,511	0
Miscellaneous Revenues	3,609,429	3,714,332	(104,903)
Less: Uncollectibles	58,090	59,624	(1,534)
Total Revenues	7,023,704	7,127,412	(103,708)
Expenses and Taxes			
Current Maintenance	1,604,342	1,609,048	(4,706)
Depreciation & Amortization	930,478	948,558	(18,080)
Traffic Expenses	238,896	238,493	403
Commercial Expenses	630,091	664,686	(34,595)
Gen. Office Salaries & Expenses	484,520	495,204	(10,684)
Operating Rents	228,800	222,273	6,527
Balance Other Oper. Expenses	808,946	831,306	(22,360)
Total Expenses	4,926,073	5,009,568	(83,495)
Taxes - Federal Income	490,756	497,221	(6,465)
Cal. Corp. Franch.	98,926	103,157	(4,231)
Social Security	154,088	155,909	(1,821)
Other	147,716	141,048	6,668
Total Exp. & Taxes	5,817,559	5,906,903	(89,344)
Balance Net Revenues	1,206,145	1,220,509	(14,364)
Rate Base			
Telephone Plant in Service	15,790,282	16,005,900	(215,618)
Property Held For Fut. Tel. Use	55,100	55,100	
Working Cash	260,320	260,320	
Materials & Supplies	77,948	77,948	
Less: Depreciation Reserve	2,866,189	2,902,244	(36,055)
Less: Deferred Tax Reserve	1,790,232	1,782,742	7,490
Total Rate Base	11,527,229	11,714,282	(187,053)
Rate of Return	10.46%	10.42%	.04%

( ) Denotes negative amount.

Table 4

PACIFIC BELL

Adopted 1983 Results of California Intrastate Operations
Based On D.83-12-025 & Adjusted For Divestiture
Recast 3

	PacBell	Staff ($000)	PacBell Exceeds Staff
Revenues			
Local Service Revenues	$ 2,070,854	$ 2,071,193	$ (339)
Toll Service Revenues	1,401,511	1,401,511	0
Miscellaneous Revenues	1,580,431	1,685,334	(104,903)
Less: Uncollectibles	50,409	51,943	(1,534)
Total Revenues	5,002,387	5,106,095	(103,708)
Expenses and Taxes			
Current Maintenance	1,148,709	1,152,078	(3,369)
Depreciation & Amortization	658,685	671,484	(12,799)
Traffic Expenses	212,952	212,593	359
Commercial Expenses	544,588	574,488	(29,900)
Gen. Office Salaries & Expenses	360,059	368,182	(8,123)
Operating Rents	214,523	208,403	6,120
Balance Other Oper. Expenses	612,017	629,096	(17,079)
Total Expenses	3,751,533	3,816,324	(64,791)
Taxes - Federal Income	237,067	251,699	(14,632)
Cal. Corp. Franch.	44,549	49,911	(5,362)
Social Security	116,922	118,304	(1,382)
Other	108,822	103,910	4,912
Total Exp. & Taxes	4,258,893	4,340,148	(81,255)
Balance Net Revenues	743,494	765,947	(22,453)
Rate Base			
Telephone Plant in Service	11,795,341	11,956,407	(161,066)
Property Held For Fut. Tel. Use	40,967	40,967	
Working Cash	201,436	201,592	(156)
Materials & Supplies	59,911	59,911	
Less: Depreciation Reserve	2,174,291	2,201,642	(27,351)
Less: Deferred Tax Reserve	1,388,683	1,382,873	5,810
Total Rate Base	8,534,681	8,674,362	(139,681)
Rate of Return	8.71%	8.83%	(.12%)

(...) Denotes negative amount.

Reasons for Differences in PacBell's Intrastate Divestiture Impact Determinations

Although there were some estimating differences, the $10 million difference between the divestiture impact on PacBell 1983 divested intrastate results of $219 million and the staff figure of $209 million, as shown in Table 1, comes principally from four fundamental policy issues which PacBell is contesting.

Since the operations of PacBell must be studied as a whole company and then separated, the effects of the four policy issues were examined on a total California basis, as follows:

1. The staff placed "above the line" the revenue, expense, and plant effects of contracts for "Shared Multifunctional Facilities" leased by PacBell to AT&T. The net effect was to lower total revenue requirement by only $142 thousand.[5]
2. The staff imputed $8 million of revenues to reflect a reimbursement to PacBell by AT&T for preoperational CPE start-up cost.
3. The staff determined lower costs in the Commercial Expense category for some of PacBell's sales and marketing activities in an amount of $12.3 million. These lower costs were concentrated in two accounts:

   Ac. 640, General Commercial Administration: $6.7 million.

   Ac. 642, Advertising: $5.6 million.
4. The staff did not allow for the costs of the "small stockholder clearinghouse" function

[5] I.e., revenues, expense, and plant associated with these facilities were included in the revenue requirements calculation.

being performed by AT&T for the BOCs,[6] an amount of $4.0 million.

Each of these differences will be considered and resolved in the sections which follow and then the total impact of divestiture will be determined on a separated California intrastate basis.

It should be noted that, while PacBell contested elements of the staff expense determinations, the staff determinations for the individual expense categories, as shown in Tables 3 and 4, are higher than those of PacBell's. The higher expense estimates are offset, however, by higher revenue determinations.

Determination of the Impact of Divestiture on 1983 Adopted Intrastate Results

Table 5 shows the determination of the $219 million and $209 million impacts of divestiture on the adopted 1983 California intrastate results of operations that were first set out in Table 1.

[6] The clearinghouse was established pursuant to the POR to provide a means by which the smaller stockholders of AT&T could designate which of the divested regional companies' stock they wished to receive in the course of the divestiture process.

Table 5

PACIFIC BELL

Impact of Divestiture on Adopted 1983
Results of California Intrastate Operations
Recast 3

	PacBell	Staff ($000)	PacBell Exceeds Staff
Results of Operations			
Revenues	$5,002,387	$5,106,095	$(103,708)
Expenses and Taxes	4,258,893	4,340,148	(21,255)
Balance Net Revenues	743,494	765,947	(22,453)
Rate Base	8,534,681	8,674,362	(139,681)
Rate of Return	8.71%	8.83%	(.12%)
Revenue Requirement Calculation			
1983 Rate Base	8,534,681	8,674,362	(139,681)
Times Requested Rate of Return	.1270	.1270	-
Equals Net Revenues Required	1,083,904	1,101,644	(17,740)
Minus 1983 Net Revenues	743,494	765,947	(22,453)
Equals Increase in Net Revenues Required	340,410	335,697	4,713
Times Net-to-Gross Multiplier	2.0734	2.0734	-
Equals Increase in Gross Rev. Required	705,806	696,034	9,772
Impact of Divestiture Calculation			
Underutilized Plant Effect	(41,737)	(41,737)	
Proposed Gross Revenue Inc.	664,069	654,297	9,772
Minus D.83-12-025 Rev. Inc.	445,450	445,450	-
Impact of Divestiture Rev. Inc.	218,619	208,847	9,772

(-) Denotes negative amount.

Revenue Determinations

The PacBell and staff revenue determinations, based on adopted 1983 results adjusted for divestiture, are shown in Table 6.

Table 6

PACIFIC BELL

Adopted 1983 Total California
Revenues Adjusted for Divestiture
Recast 3

	PacBell	Staff ($000)	PacBell Exceeds Staff
Local	$2,070,854	$2,071,193	$ (339)
Toll	1,401,511	1,401,511	-
Miscellaneous	3,609,429	3,714,332	(104,903)
Uncollectibles	(58.090)	(59.624)	1,534
Total	$7,023,704	$7,127,412	$(103,708)

Reasons for Differences

1. Staff determination reflects rentals from shared multifunctional facility contracts treated as a regulated ("above the line") activity, for a difference of $(102,737,000).
2. Staff determination includes an $8,000,000 imputation of revenues to reflect a reimbursement to PacBell from AT&T for preoperational CPE start-up costs.

Shared Multifunctional Facility Contracts - Summary of Issue

PacBell and AT&T-C interface at 185 POPs located at 57 major shared-use locations. Formerly the facilities at these locations were owned by either PT&T or AT&T Long Lines. Now that AT&T-C has assumed, as interLATA, many of the intrastate toll functions formerly conducted by PT&T, some means of sharing responsibility for these facilities must be devised, since such

hardware cannot be effectively split in a short time.[7] The MFJ accommodates the sharing requirement by providing that the BOCs may lease a part of such multifunctional facilities from AT&T, providing that the BOC "is ensured control over the exchange telecommunications and exchange access functions." Conversely, AT&T may lease multifunctional facilities from the BOC.

PacBell and AT&T-C have entered into multifunctional facility leasing contracts that are of limited duration and that provide for full separation as soon as practicable. The contracts provide for limited renewals and are intended to assure that PacBell will have control sufficient to met its MFJ obligations.

The POR includes a provision that allows the BOCs to recover all costs, including return on investment and working cash allowance, associated with the shared multifunctional facilities. The POR requires that the return on investment for the first two years be based on the FCC interstate authorized rate of return. Starting with the third year, the return on investment is to be based on the utility's then authorized intrastate rate of return.

The revenues from the shared multifunctional facilities are thus of a very high quality as contrasted with revenues obtained from normal service. Instead of merely being afforded the opportunity to recover its costs and a return, PacBell is guaranteed by the terms of the lease that it will receive payments from AT&T sufficient to recover all costs and recover a specifically designated return.

The current FCC interstate rate of return is 12.75%. In Phase I of this proceeding PacBell (then PT&T) requested 13.49% and the Commission authorized 12.70%, subsequently reduced by D.84-04-104 to 12.64%.

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[7] Examples of facilities used in common between AT&T-C and PacBell are switching machines and transmission facilities that at the present time handle both local and long distance calls.

The revenues to be received by PacBell for multifunctional facility rentals, on a 1983 total California divested basis are, for both PacBell and staff showings $102,737,000.

For situations where PacBell leases multifunctional facilities to AT&T-C, PacBell proposes that revenues, expenses, and investment all be recorded "below the line" as nonregulated items. Conversely, where PacBell leases the facilities from AT&T-C, the lease payments paid by PacBell are proposed to be recorded "above the line" as reasonable operating expenses properly allowed for regulatory purposes.

For the converse, where PacBell rents AT&T-C equipment, PacBell reasons that the facilities are being used by PacBell to provide public utility telephone service to its customers according to its filed tariffs and the Commission should recognize such service as properly being utility service.

Shared Multifunctional Facility Contracts - Arguments

As justification for its seemingly inconsistent regulatory proposals, PacBell reasons that the facilities rented out to AT&T-C are not being used by PacBell to serve PacBell's customer base, and therefore, they are only incidental to PacBell's operations. PacBell claimed that its treatment, as originally proposed in October, several months before the issuance of D.83-12-025, was the most beneficial to the ratepayer, since PacBell (then PT&T), was requesting a 13.49% rate of return and the leased equipment was to return only 12.75%. Had a 13.49% rate of return actually been granted, above the line treatment would have increased revenue requirements by $10 million.

In support of its position, the staff considered the following factors:

1. The MFJ restricts the contracting of multifunctional facilities to AT&T.

2. PacBell is required to maintain the contracted facilities.
3. Contracted facilities are predominantly used for utility purposes.
4. Contract terms are flexible, capacity needs can be either increased or decreased.
5. Contract facilities may revert back to PacBell for its utility use when final separation is accomplished.
6. Reconfiguration or modernization of utility property must recognize contract requirements.

Ac. 524, Rent Revenues, specifies that rent "from the rental or subrental to others of telephone plant constituting a part of the property used by the company in its telephone operations" be recorded as revenue, above the line.

According to PacBell's brief, the staff recommendation appears to be that the regulatory treatment to be accorded these contracts should depend solely on whether the contracts earn a return higher than authorized for utility operations. During cross-examination, before the issuance of D.83-12-025, the staff witness testified that, should the rate of return authorized on the multifunctional facility contracts be below that authorized by the Phase I decision, the shortfall should be made up by the stockholders.

PacBell argues that this anomalous result, where the ratepayers receive the benefit, if any, but the stockholders bear the burden, if any, is both inequitable and unlawful. See, e.g., Democratic Central Committee of D.C. v. Washington Metropolitan Area Transit Commission, 485 F.2d 786, 821 (D.C. Cir., 1973). Under Democratic Central Committee, the burden and the benefit must fall on the same party, either the stockholders or the ratepayers. This is, PacBell contends, the only equitable result as well. Should, as a matter of policy, the Commission decide to treat the shared facility contracts "above the line," PacBell urges that it should reject the staff's uneven approach.

Discussion of Regulatory Treatment of Shared Multifunctional Facility Contracts

Upon consideration of the above recited facts and arguments, the Commission concludes that the staff position is correct. The facilities in question were recognized by the antitrust court as essential links in the chain of nationwide and worldwide telephone service. Until separate discrete links can be forged, these links must be shared. The sharing and leasing are merely common sense accommodations to a problem obviously unanticipated when the equipment was designed and installed to fit into the old order of things. The facilities, continuously the property of PT&T and PacBell, were formerly part of PT&T's rate base and in the future, when the leasing arrangement ends, they again will be indisputedly in PacBell's rate base. It strains logic to contend that, during the transition period while they are leased out to AT&T, but performing their original function and serving the same telephone-using public, they somehow fall into a regulatory hiatus, subject to neither control of the FCC or this Commission.

PacBell's Democratic Central Committee argument, made in its brief filed February 24, 1984, is not compelling. With the issuance of D.83-12-025 on December 7, 1983, the adopted California intrastate rate of return became 12.70%, 0.05% below the FCC authorized 12.75% used for the multifunctional facilities leases. At that point the staff witness' opinion as to the treatment of an intrastate rate of return higher than the FCC rate of return became superfluous to the known facts. The Commission therefore sees no need to reject the staff's recommendation as to treatment of a higher intrastate rate of return since that matter is now moot. We express no opinion on the appropriate disposition under the hypothetical facts presented by PacBell.

As a practical matter, the Commission-adopted 12.70% rate of return is so close to the FCC's 12.75%, that, although rental revenues are estimated at $102,757,000, there is little quantitative effect of either regulatory treatment on overall revenue requirement, only $142,000. The staff's revenues are higher, but so are the

expenses associated with the multifunctional facilities and the cost of the facilities are in the staff's higher rate base.

The Commission finds that the shared multifunctional facilities are an integral part of PacBell's utility operations and are dedicated to public use. The Commission concludes that the proper regulatory treatment is to include the results of those operations "above the line."

Imputation of Revenue for Preoperational CPE Start-up Cost

In December 1982 and March 1983, PacBell was reimbursed, on an intrastate basis, approximately $25 million by AT&T for PacBell's share of the funding of the CPE development and formation expense incurred prior to the commencement of operations of AT&T's CPE subsidiary. The CPE subsidiary was established in compliance with the FCC's CI II decision.[8]

Staff auditors determined that, of the $25 million, $6,738,000 had "not been specifically disallowed from intrastate rates." PacBell has been carrying the $6,738,000 as a deferred credit in its accounting records. An additional $191,000 was expected to be reimbursed in September 1983, and PacBell has incurred another $777,000 that has not been reimbursed. These three items amount to $7,706,000 and, with interest at the commercial paper rate, would come to approximately $8 million.

The staff recommends that these CPE preoperational expenses be returned to the ratepayers, by increasing miscellaneous operating revenue by $8 million, to compensate them for subsidizing AT&T's preoperational expenses.

In response to the staff's recommendation, PacBell asserts that at no time did the Commission ever adopt expense levels in any

[8] The history of CI II and of CPE sales arrangements are described in detail in D.83-12-025.

of PacBell's recent rate cases that included CPE preoperational expenses. In fact, PacBell does not disagree with the staff's objective that California ratepayers not pay any of AT&T's CPE subsidiary's expenses and took great pains to see that they did not do so.

On cross-examination PacBell asked the staff accountant to identify where in either PacBell or staff showings in prior cases the CPE expenses had been allowed. The witness could not identify specific instances but observed that there would always be new activities to be conducted and old ones to be dropped off. He conceded that he had no information that would lead him to conclude that any of the CPE subsidiary formation costs were included in PacBell's showing in this case but based his recommendation on the fact that they had never been specifically "disallowed" in past cases.

PacBell further objects that the imputation of revenues would cause an ongoing reduction in its revenue requirement, and refund more than the staff witness claimed is due. The staff counters this argument by pointing out that the frequent rate adjustments requested by PacBell would preclude that possibility.

Discussion of CPE Start-up

Revenue Imputation

The past recorded and adjusted test year was the basis of rates to be established for the future, but it did not give recognition to established trends and the adjustments for "known changes" tended to be selective. Beginning in 1967, with acceptance of PT&T's A.49142, the California Commission began using estimated future test years. Results of operations that reasonably were expected to prevail in the future test year, usually the upcoming calendar year, were predicted. Both utility and the staff presented their estimates of reasonable operations for the future years. Although, in rate increase proceedings, the utility made its estimates first, and the staff showing was usually built upon the utility estimate both the utility and staff showings were estimates, and there were no recorded items to "disallow." If the staff felt a

utility-claimed expense was unreasonable, the staff would not include it in its estimate. Thus future estimates were built up by combining reasonable estimates of the individual components of the results of operations, as compared to the older method of dismantling the utility's recorded operations.

Despite this drastic change in method, which occurred 17 years ago, and which has been copied by many other regulatory jurisdictions, the notion that the staff showing's omission of some item claimed by the utility constitutes a "disallowance" persists.

Since the Commission's last adopted cost of service did not include an allowance for CPE preoperational expense, they were not included in past rates. Since the CPE expenses were not included, there was nothing to specifically "disallow."

The Commission finds that no allowance for CPE preoperational costs was ever included in PT&T's or PacBell's rates, and concludes that there should be no imputation of revenues for reimbursed CPE preoperational expenses.

Commercial Expense - Summary of Issues

The PacBell and staff recommended 1983 Commercial Expenses adjusted for divestiture, as shown in Table 3, are reproduced below as Table 7:

Table 7
PACIFIC BELL
Adopted 1983 Total California Commercial Expenses Adjusted for Divestiture

	PacBell	Staff ($000)	PacBell Exceeds Staff
Commercial Expenses	630,091	664,686	(34,595)

Reasons for Differences

1. Staff estimated a smaller marketing and sales force divested to AT&T Information Systems and AT&T-C.
2. Staff estimate reflects costs associated with leasing of shared multifunctional facility charges as being "above the line."

3. Staff estimated lower costs for some of PacBell's sales and marketing activities, in an amount of $12,300,000, concentrated in two accounts:

Ac. 640 General Commercial Administration: $6.7 millllion.
Ac. 642 Advertising: $5.6 million.

PacBell is contesting the two items which make up the $12.3 million difference in sales and marketing costs. This difference is comprised of two items, a $6.7 million difference in Ac. 640, General Commercial Administration and $5.6 million in Ac. 642, Advertising.

The $6.7 million was for marketing staff expenses to perform functions that AT&T had undertaken for the BOCs before divestiture. The staff believed that the CSO would provide these services for PacBell and allowing them as a PacBell cost would be a duplication.

The Ac. 642, Advertising, difference of $5.6 million was caused by the staff's declining to include the costs of business usage advertising that the staff considered to be of an institutional nature.

Ac. 640, General Commercial Administration-Difference

Seven Ac. 640 functions, estimated to cost $6.7 million, were challenged by the staff, namely:

1. Market management.
2. Information system planning.
3. Product service and delivery.
4. Practice writing.
5. Registration and interconnection.
6. Methods and practices.
7. Supervision of all of these activities.

It appeared to the staff engineer investigating this category that these functions, previously performed by AT&T for the

BOCs, would continue to be provided for PacBell by the CSO. The staff engineer therefore submitted a data request to PacBell on August 10, 1983, asking the utility to justify the CSO and Ac. 640 marketing charges. PacBell was unable to reply until September 2, 1983. In its reply, the utility maintained that at least four of the six basic functions would not be performed for PacBell by the CSO staff.

The September 2 reply was too late for the staff to evaluate and include in its Post-Divestiture Results of Operations Report, and the staff engineer was concerned that it could open up additional areas that would have had to be resolved. The staff therefore did not revise its showing to include the four functions that PacBell states it intends to assume.

The four of the basic functions that the PacBell September 2 response stated would not be performed by the CSO for PacBell are: (1) product service and delivery, (2) practice writing, (3) registration and interconnection, and (4) methods and practices. Also, supervision, the 7th function, must be prorated between PacBell and the CSO. Although the two remaining functions, market management and information systems planning, will continue to be performed by the CSO, PacBell is claiming the entire $6.7 million as being its estimated cost of the four functions that are being assumed by the utility. PacBell contends that the four functions were never included in the original CSO budget, and, to be consistent, the staff should increase the CSO allowance by any amount not allowed to PacBell in Ac. 640.

PacBell was under an obligation to prove the reasonableness of the $6.7 million it is requesting for the test period. However, it was demonstrated that, of the seven functions to which these funds were to be committed, at least two and part of a third were to be provided through the CSO. We are not convinced that PacBell requires the monies here requested, however, staff's exclusion of the entire amount from Ac. 640 appears to be too drastic a solution. We will therefore allow amounts to fund the four functions which the CSO will not provide to PacBell. PacBell is therefore authorized $3.8 million for this account.

Ac. 642, Advertising - Difference

The staff's showing excluded $5.6 million in "business usage advertising" from the 1983 adopted results as adjusted for divestiture on the grounds that it is institutional advertising in nature and contrary to the policy of the Commission as expressed in D.83162 (1974) (77 CPUC 117, 150-157) and D.88232 (1977) (83 CPUC 149, 190-196).

In response to a staff data request, PacBell supplied the staff with three separate budget estimate sheets justifying three different business usage campaigns. Expenditures proposed for the three campaigns amounted to a total of $6,107,000.

The elements of these campaigns are summarized in Table 8:

Table 8

PACIFIC BELL

Elements of Business Usage Advertising,
Budget Estimates

Purpose	Audience	Media	Cost
Enhance image of PacBell as a financially sound aggressive and forward-looking company able to provide customers with state-of-the-art communications.	Primary-general business (1-40 lines).	Direct mail-letters, brochures, reply cards. Newspaper 1200 line black and white display ads plus regional magazines.	$1,070,000
	Secondary-industrial and major accounts.		
Stress universal service, new restructural/ competitive rates, quality, reliability, and ready access provided by PacBell as a stand-alone financially sound, aggressive, and forward-looking communications company.	All industry segments statewide - 1,500,000 business customers.	TV, radio, print	$4,600,000
Enhance image of PacBell as a stand-alone company, financially sound, aggressive, forward-looking, and well-equipped to provide services enabling business customers to take advantage of new business opportunities.	Small and medium-sized businesses (750,000 to 800,000).	Letters, brochures, reply cards, black and white print 1200 line newspaper display ads in four markets - LA, SF, SD, and Sacramento plus regional magazines throughout state.	$500,000

The record is not clear why the staff was disposed to allow $500,000, presumably the third campaign, while excluding $5.6 million.

The Commission's discussions in D.83162 and D.88232 made it perfectly clear that institutional advertising tending primarily to build the image of the company will not be charged to the ratepayer.

PacBell's contention that the business usage campaigns were not intended to be institutional in nature is weakened by the declared purpose stated on two of the three sheets as being to "enhance the image" of the divested telephone utility. It was this declared purpose that caused the staff witness to classify the proposed ads as institutional.

A closer analysis of the three budget estimate sheets shows that all are intended to produce sales leads for followup by salespeople. The estimates all include targets, such as 800, WATS, teleconferencing, Centrex, etc. (It is hardly likely that an institutional advertisement would be sent by letter and include a reply card.)

In considering the campaigns as a whole, it should be noted that the $4,600,000 program does not contain the phrase "enhance image." The ad campaigns are clearly intended to attract new business, and customers for services require confidence in the organization from which they purchase service. At the time of the staff investigation the final ads had not been designed and the staff witness was not able to evaluate the ads themselves. PacBell management may feel that prospective customers need reassurance as to the utility's ability to "stand alone" when subscribing for new or additional telephone service, but this image enhancement is obviously merely a part of a larger intention to promote service. With the large amount of PacBell's plant investment now underutilized, some sales promotion is beneficial to both PacBell and the ratepayers.

The Commission will include the $5.6 million business usage advertising expense in its adopted divestiture results and finds such business usage advertising expense to be reasonable.

While we disagree with the Staff's position here, we will look to the next rate case for evidence that the advertising campaign was in fact successful. There is little reason for current customers to subsidize a promotional campaign whose expenses are greater than the revenues it produces. We therefore expect PacBell to prove that campaign-generated revenue, i.e., those beyond growth-related business, exceed the costs we authorize in this case. Without such proof, we would be extremely reluctant to include similar expenses in future cases.

General Office Salaries and Expenses - Summary of Issues

Table 9 below sets out the PacBell and staff adopted 1983 General Office Salaries and Expenses, adjusted for divestiture:

Table 9

PACIFIC BELL

Adopted 1983 Total California General Office Salaries and Expenses Adjusted For Divestiture

	PacBell	Staff ($000)	PacBell Exceeds Staff
General Office Salaries and Expenses	$484,520	$495,204	$(10,684)

Reasons for Differences

1. Staff estimate reflects costs associated with leasing of shared multifunctional facility charges as being "above the line."

2. The staff estimate excludes $4.0 million of expense that PacBell includes in Ac. 663, Treasury Department, for PacBell's share of "clearinghouse" for divested stock of BOCs.

Ac. 663, Treasury Department - Difference

The staff proposes exclusion, for ratemaking purposes, of $4.0 million of Treasury Department expense claimed by PacBell. During the course of the divestiture, AT&T stockholders were entitled to receive a prorata share of each of the seven regional holding companies being divested. Since AT&T is the quintessential "widows' and orphans'" stock, it was inevitable that most of the stockholders would receive relatively insignificant amounts of stock. This situation would be inconvenient and costly for both the companies and stockholders so the POR provided that:

> "To ease these burdens on the owners of the regional companies' smaller accounts on the regional companies themselves, arrangements will be made for reducing the costs associated with distribution and consolidation of these accounts."

To accommodate this requirement, the new AT&T subsidiary organized to handle AT&T shareholder services, American Transtech, established a "clearinghouse" so that holders of between 10 and 500 shares of AT&T could exchange the stock they would receive so as to receive more significant amounts in one or a limited number of the divested companies.

The staff concluded that the cost of this clearinghouse to PacBell was not of benefit to the California ratepayer. Rather, the staff opined that it represented "a subsidy to certain specific stockholder groups allowing them to trade stock at reduced commissions."

That staff opinion is obviously correct. Minimum commissions on any sales of the very small blocks of stock that would have been received by the majority of AT&T's stockholders would have been a significant portion of their value. To the extent that AT&T and the divested regional holding companies provided a low-cost market for these small blocks of stock, the stockholders have received a subsidy. The subsidy enabled them to trade their shares. No benefit accrues to ratepayers from the subsidy and we will exclude the $4.0 million requested.

Phase II Adopted 1983 PacBell Results

In addition to the significant contested issues defined and discussed earlier in this opinion, there were numerous small differences in estimating that PacBell did not contest. Since the staff's estimates were the more recent the Commission will adopt the staff's results on those instances.

The Commission's adopted 1983 divested total California and intrastate results are shown in Table 10.

Table 10

PACIFIC BELL

Phase II Adopted 1983 Results of Operations
Adjusted for Divestiture
Recast 3

	Total California	California Intrastate
	($000)	
Revenues		
Local Service Revenues	$2,071,193	$2,071,193
Toll Service Revenues	1,401,511	1,401,511
Miscellaneous Revenues	3,706,332	1,677,334
Uncollectibles	(59,624)	(51,943)
Total Revenues	$7,119,412	$5,098,095
Expenses and Taxes		
Current Maintenance	$1,609,048	$1,152,078
Depreciation & Amortization	948,558	671,484
Traffic Expenses	238,493	212,593
Commercial Expenses	674,088	582,614
Gen. Office Salaries & Expenses	495,204	368,182
Operating Rents	222,273	208,403
Balance Other Operating Expenses	831,306	629,096
Total Expenses	$5,018,970	$3,824,450
Taxes - Federal Income	484,562	239,184
Cal. Corp. Franch.	100,234	47,567
Social Security	155,909	118,304
Other	141,048	103,910
Total Expenses & Taxes	$5,900,723	$4,333,415
Balance Net Revenues	$1,218,689	$ 764,680
Rate Base		
Telephone Plant In Service	$16,005,900	$11,956,407
Property Held For Future Tel. Use	55,100	40,967
Working Cash	260,320	201,592
Materials & Supplies	77,948	59,911
Less: Depreciation Reserve	2,902,244	2,201,642
Less: Deferred Tax Reserve	1,782,742	1,382,873
Total Rate Base	$11,714,282	$ 8,674,362
Rate of Return	10.40%	8.82%

( ) Denotes negative amount.

The Commission finds this determination to be reasonable. The calculation of a revenue increase requirement for adopted Phase II 1983 intrastate operations is shown in Table 11.

Table II

PACIFIC BELL

Phase II Adopted Impact of Divestiture On
1983 Results of California Intrastate Operations

Recast 3

	($000)
Results of Operations	
Revenues	$5,098,095
Expenses and Taxes	4,333,415
Balance Net Revenues	764,680
Rate Base	8,674,362
Rate of Return	8.82%
Revenue Requirement Calculation	
1983 Intrastate Rate Base	8,673,362
Times Requested Rate of Return	.1270
Equals Net Revenues Required	1,101,644
Minus 1983 Net Revenues	764,680
Equals Increase in Net Revenues Required	336,964
Times Net-to-Gross Multiplier	2.0734
Equals Increase in Gross Rev. Required	698,661
Impact of Divestiture Calculation	
Underutilized Plant Effect	(45,439)
Gross Revenue Inc.	653,222
Minus Current D.83-12-025 Rev. Increase	445,450
Impact of Divestiture Rev. Increase	207,772

(*) Denotes negative amount.

Subtracting the D.83-12-025 revenue increase gives the impact of divestiture. The Commission finds the revenue requirement thus determined to be reasonable.

The underutilized plant effect in Table 11 of S(45,439,000) is higher than the agreed upon amount of S(41,737,000) used by PacBell and the staff in their Phase II showings as summarized in Table 2. The reasons for this increase will be explained later in this decision when the effects of the acquisition of underutilized plant by AT&T are considered.

Attrition Mechanisms - History

In the years following the adoption of our Regulatory Lag Plan, now the RCP, California utilities have experienced difficulty in earning between rate cases the rates of return authorized by the Commission because of rapidly escalating costs of labor and materials. Accordingly, attrition mechanisms were proposed to provide for revenue adjustments to compensate the utilities between rate cases for cost increases contemplated in the normal ratemaking process.

The first attrition mechanisms were instituted for water utilities and energy utilities followed soon thereafter. In D.82-04-028, issued April 6, 1982, General Telephone Company of California (GTC) was awarded the first attrition mechanism for a major telephone company. Continental Telephone Company of California and the telephone utility branch of Citizens Utilities Company of California followed soon thereafter.

In Phase I of this case, both PT&T and the Commission staff proposed mechanisms similar to that established for GTC, and it was after consideration of the attrition question as illustrated by these showings the Commission made its finding that the establishment of an

attrition allowance for PT&T was reasonable and that the method of determining such an allowance is appropriately the subject of Phase II of this proceeding.

Effects of Proposed Attrition and Technical Depreciation Update Allowances on Revenue Requirements

Derivations of the cumulative effects of the PacBell and staff recommendations for divestiture, attrition and technical depreciation updates are shown in Table 2 above. The effect on revenue requirement for 1984 is repeated in Table 12 following:

Table 12

PACIFIC BELL

1984 Revenue Requirement Changes Indicated By Divestiture, Attrition Allowances, and Technical Depreciation Updates

	PacBell	Staff ($000)	PacBell Exceeds Staff
Intrastate Rate Base	$9,332,859	$9,498,636	$(165,777)
Times Rate of Return	12.70%	12.70%	-
Equals Net Revenue Requirement	$1,185,273	$1,206,327	$ (21,054)
Minus Balance Net Revenues	970,807	1,093,233	(122,426)
Equals Increase In Net Revenue Req.	$ 214,466	$ 113,094	$ 101,372
Times Divested Net-to-Gross Multiplier	2.0734	2.0734	-
Equals Indicated Increase In Revenue	$ 444,674	$ 234,489	$ 210,185
Indicated Increase Excluding Technical Depreciation Rate Changes	$ 351,672	$ 234,489	$ 117,183
Technical Depreciation Rate Changes	93,002	76,409	16,593
Indicated Increase Including Technical Depreciation Rate Changes	$ 444,674	$ 310,898	$ 133,776
Underutilized Plant Adjustment	(41,737)	(41,737)	-
Proposed Gross Revenue Increase	$ 402,937	$ 269,161	$ 133,776

( ) Denotes negative amount.

Attrition Allowance - Issues

There are five issues before the Commission that must be resolved in determining reasonable attrition allowances for PacBell, as follows:

1. Should the 1984 attrition allowance recognize the following factors:
   a. PacBell's composite wage and salary growth rate or the lower rate recommended by the staff?
   b. Growth in the interest deduction in the income tax determination?
   c. Growth in the Property Held for Future Use (PHFU) and Materials and Supplies (M&S) rate base components?
2. Should the attrition allowance include a "technical update" to the depreciation rates used in D.83-12-025?
3. If there is to be a "technical depreciation update" what items should be considered?
4. Are other components of the 1984 attrition mechanism reasonable?
5. Should an attrition mechanism be used for year 1985?

The last of these issues will be discussed in Section V.

The attrition mechanism as finally proposed by PacBell and the staff consists of 14 formulas that are intended to project the various elements of the D.83-12-025 adopted results of operations for PT&T to a proposed divested PacBell gross revenue change for year 1984.

Although the utility and staff agree on the set of formulas to be used, differences of opinion in their application produce the differences shown in Table 12, an allowance of $402,937,000 as proposed by PacBell and $269,161,000 as recommended by the staff.

Since the attrition is used to project divested results, $10 million of the difference arises from the difference in the impact of divestiture on 1983 revenue requirement as shown in Table 1.

Attrition Mechanism - Discussion of Differences in 1984 Allowance

The differences in the 1984 attrition allowance depending on the base divested 1983 results were resolved with the Commission's adoption of a figure for those results and, while necessary to the derivation of the parties' showings, need no further discussion at this point.

The staff used a lower growth rate than PacBell's for wages and salaries, resulting in a $42 million difference in this category. For its controverted growth rate in wages and salaries, PacBell took into account its labor contracts, "management structure adjustments," and projected force growth, productivity improvements, access line growth, and overhead increases. The staff's growth rate in wages and salaries also recognized projected access line growth and productivity improvements, but, instead of using PacBell's home-grown data, used a labor escalation factor developed by the Economics Unit of the Revenue Requirements Division. This factor is, in turn, based on data obtained from DRI.

PacBell objects that the staff wage and salary growth rate, while propounded later than that of the utility, makes no attempt to reflect projections specific to PacBell's operations. The Commission recognizes this lack of specificity as a major strength in favor of the staff proposal, rather than a weakness. By using impartial composite compensation data obtained from one of the nation's preeminent economic consulting firms, the staff method eliminates an element of self-fulfilling prophecy inherent on PacBell's method. Without this independent restraint, contracts more generous than the

national trend would automatically be ratified into rates. Automatic recognition of "management structure adjustments" could lead to a proliferation of management, a condition that the MIPP discussed in D.83-12-025 was designed to reduce. Likewise, it would provide no check to the already generous managerial compensation levels.

The Commission finds the staff method of projecting wage and salary costs to be reasonable.

The imputation of growth in the deduction for interest by the staff is for the purpose of recognizing the tax savings that the staff contends will become available because of anticipated growth in interest deductions associated with financing of growth in rate base.

In its initial testimony in Phase I, the staff proposed formulas for computing prospective attrition that would have accomplished the recognition of the growth in the interest deduction by adjusting the net-to-gross multiplier.[9] In determining its 1984 attrition allowance, the staff made a detailed calculation of income taxes, using a direct estimate of the additional interest deduction available.

PacBell contends that, by imputing growth in the interest deduction, the staff understates 1984 taxes based on income by $22 million and revenue requirements by $44 million.

The imputation of an income tax deduction for interest associated with the financing of growth of rate base presents the Commission with a difficult issue to resolve. In the regulatory process, interest is not considered to be an operating expense, but a part of the return on invested capital. Thus, authorized rates of return include weighted components for return on equity and debt costs. For income tax purposes, however, interest is recognized as

[9] The term "net-to-gross multiplier" is defined and explained on page 182 of D.83-12-025.

an expense and taken as a tax deduction. To resolve the question of the reasonableness of the staff's imputing increased interest deductions in determining an allowance for attrition, the Commission must be careful to apply established regulatory principles consistently.

The attrition mechanism in this case should adjust for known changes in the general economy and readily measured growth of the utility (in this case access line growth and growth in usage). By applying the last Commission-established reasonable rate of return to the increased rate base the attrition method tacitly assumes that a portion of the growth of rate base will be financed, and financed at the same relative cost of capital as was found reasonable in the last rate case. Since a portion of the financing will be by debt, the interest component will grow in direct proportion to the growth in rate base, and so will the income tax deduction.

The Commission finds that the staff method of recognizing interest growth is correct and it is adopted.

Staff asserted that no attrition year growth should be assumed in the Plant Held for Future Use (PHFU) component of rate base because of its volatile nature. PacBell, while agreeing that, for PHFU, "the data did not fit any least squares trend model tried," selected a 2.5% growth rate based on a linear model. Upon review of the historical data, we agree with staff that the PHFU balance is too unpredictable to support an attrition year adjustment.

For the Materials and Supplies (M&S) rate base component, staff also recommended no attrition adjustment, because the staff witness disagreed with PacBell's method of calculating its M&S attrition request. PacBell calculated a five-year average of the ratio between its M&S account and average Plant in Service, and then applied that average to its 1984 request for Plant in Service. We agree with staff that PacBell's method may not be appropriate.

However, the M&S account has exhibited steady growth, roughly in proportion to the growth in plant in service. We find that an attrition growth rate for M&S equal to that approved for the Plant in Service account is more logical than PacBell's approach, and is reasonable and will be adopted.

Technical Depreciation Update - Concept

A precise definition of the depreciation term "technical update" would require a resolution of the issue as to the proper composition of the technical update, so, for the purpose of discussion, the staff's concept will be used as a starting point.

To appreciate the operation of the straight-line remaining life depreciation process, it is necessary to have an understanding of the formula for the procedure, as prescribed in this Commission's "Standard Practice U-4, Determination of SLRL Depreciation Accruals." The basic remaining life formula for determination of depreciation rates is:

$$d' = \frac{(1 - c')u'}{E}$$

where

d' = straight-line remaining depreciation rate

c' = average net salvage ratio for remaining plant units

u' = ratio of depreciation reserve to original cost

E = future life expectancy of unit or average expectancy of group of units

(The apostrophes are used to distinguish from similar factors in the related straight-line total life formula.)

One of the terms of this equation, "u'" (the reserve ratio) can be derived by dividing the depreciation reserve as accumulated on the utility's books, by the recorded depreciable plant. The other two terms, "c'" (the future net salvage ratio) and "E", (the composite future life expectancy or remaining life of the surviving plant) require estimates of future conditions.

The detailed techniques for estimating "c'" and "E" and the operation of the FCC's three-year depreciation represcription cycle were explained in detail in D.83-08-031 and D.83-12-025 and will not be repeated here, as an understanding of their derivation is not necessary for an appreciation of the objections to the technical update.

The technical update, as conceived by the staff, consists of finding new values for "u'" and "E" to reflect changes occasioned by the passage of time, and the passage of time only. As new plant is added, older plant retired, and depreciation accruals are added to the depreciation reserve, the "u'" ratio will change. Similarly, "E", the remaining life, will change as the average age changes, although the overall determinations of average service life remain the same until a new depreciation study is made. Likewise, "c'", the future net salvage ratio, will not change until a new value is established in the course of a depreciation study.

The basic objective of depreciation is the recovery of the cost of plant, less salvage, over the useful life of the property. The remaining life method of depreciation meets this objective, since it provides a rational basis for adjusting depreciation rates so that the cost of the depreciable plant, no more and no less, can be recovered over its useful life. The technical update is an essential part of the remaining life process in that it provides for automatic adjustment of depreciation rates to account for changes in the composition of utility plant and relative growth or decline in depreciation reserve. Without the technical updates, changes to rates resulting from the three-year represcription of service lives and salvage would also need to include adjustments for three years of changes in depreciation reserve and age distribution of plant. The transitions to new levels of depreciation expense would thus be much

more abrupt. Also the deferral of the charging of depreciation expense to a later period, even though the plant has been consumed by current ratepayers, would be unreasonably burdensome and inequitable to later ratepayers.

Nature of PacBell and Staff's Technical Depreciation Update Proposals

PacBell's technical depreciation update proposal differed from that of the staff in three ways:

1. The staff determination of the technical update per se is based on "above the line" treatment of shared multifunctional facilities and therefore includes depreciation on these items.
2. PacBell is proposing use of prospective rates obtained by determining "u", the reserve ratio, by using 1984 average plant and depreciation reserve rather than beginning of year values.
3. PacBell is using equal life group (ELG) depreciation methodology for selected central office equipment and outside plant accounts.

The quantitative differences between the two depreciation proposals are shown in Table 13 below:

Table 13

PACIFIC BELL

1984 Total California Effect of Depreciation Technical Update of Depreciation Expense

	PacBell	Staff	PacBell Exceeds Staff
	($000)		
Technical Update Per Se	$105,863	$105,921	$ (58)
Prospective Rates	(699)	-	(699)
Equal Life Group	33,336	-	33,336
Total	$138,500	$105,921	$32,579

Any change in depreciation expense would affect other elements of the results of operations. The effects are contra to the change in expense. An increase in depreciation expense would increase the weighted average depreciation reserve, thus reducing rate base, and would increase the depreciation deduction for income taxes, thus reducing income tax expense. Thus the net effect of the staff's technical update is to increase its 1984 revenue requirement by $76.4 million.

The staff technical update witness explained that over 90% of the $106 million increase in 1984 depreciation expense caused by the technical update per se was concentrated in Central Office Equipment (COE), in the Step-by-Step (SXS), and Cross Bar (X Bar) subaccounts. Shortened average service lives for the equipment represented by these accounts and the resulting increased California memorandum record depreciation rates caused by the 1982 represcription did not become effective until the January 1, 1984 date authorized by D.83-12-025. The depreciation reserve was thus underaccrued for a two-year period. This shortfall must, by the operation of the remaining life formula, be made up over the remaining lives of these COE subaccounts, and the shortening of the lives themselves further compounds the effect of the two-year delay in recognizing the shortened lives. A second and less important reason for the increase is that, since SXS and X Bar COE is not being replaced in kind but by modern electronic switching equipment, these dying accounts have ever-shortening remaining lives as the ultimate retirement of the final units approaches.

Propriety of Technical Update of Depreciation

Before proceeding to a resolution of the disputed differences in the PacBell and staff updates the Commission must first decide whether the issue is properly before it.

The propriety of the Commission's considering a technical update in this proceeding was challenged vigorously by a counsel representing certain cities. Counsel contended that the limited issues which were specified in the decision scheduling these proceedings, D.83-04-21, contained no inference that the issue of technical updating would be permitted. According to the cities' counsel depreciation rates have normally been taken into account in context of rate cases, and only in the context of rate cases.

The concept of a technical update is as old as the remaining life procedure itself. The Commission's standing procedure for depreciation, "Determination of Straight-Line Remaining Life Depreciation Accruals, Standard Practice U-4, Revised January 3, 1961," devotes an entire chapter, Chapter 8, to the process of carrying forward depreciation accrual determinations. The introductory paragraph of Chapter 8 describes the continuing and on-going remaining life process. Paragraph 1. of Chapter 8 describes three problems that arise in applying a depreciation determination to a utility's books:

> "First, the accrual to record for the study years is needed. Next, it is necessary to consider the means of determining accruals in the intervening years before another complete study of the account is made. Finally, the length of period between complete studies should be considered, it being inherent in the remaining life method that periodic reviews of estimates and reappraisals to correct for changing conditions will be made."

It is the second of these problems that involves the technical update, and Paragraph 3.f. of Chapter 8 specifies one of the acceptable methods for determining accruals during intervals between depreciation studies:

> "f. Using the service life estimates developed in the study, derive a new remaining life estimate by judgment method from new average ages of plant and recompute the accrual using standard forms D-1 or D-2 for new beginning-of-the-year plant and reserves."

Standard Practice U-4, and its predecessor documents dating back to 1952, have specifically recognized the necessity of updating of remaining lives during the intervening years between complete studies.

A further compelling reason for employing the technical update to allow for the effects of known established changes to depreciation factors on depreciation rates is illustrated by the effect of not implementing the 1982 represcription rates until 1984. It must be remembered that remaining life depreciation is a balancing account process. Under balancing accounts procedures, reserve deficiencies must be made up, and if delayed, made up over shorter remaining lives.

The Commission finds that the technical update of depreciation reserve and remaining life in the context of establishment of an attrition allowance is reasonable.

Discussion of PacBell and Staff Technical Update Differences

The issue of the effect of "above the line" treatment of shared multifunctional facilities on the technical update is dependent on the Commission's resolution of the overall issue. The Commission having decided on "above the line" treatment, the technical update must follow that determination. The staff figure of $105,921,000 will be accepted.

As for the "prospective rate" issue, or the use of average plant and reserve balances, the adoption by the Commission of such practice would require revision of Standard Practice U-4 - Chapter 4, Paragraph 2 of that text declares that beginning of year values for plant and reserve are the accepted method, and the use of beginning of year values are presented on the Form D-2s[10] included in Chapter 4.

[10] Form D-1 mentioned in the quote in the propriety discussion above is identical to D-2 except that D-1 has lines for pencil work and D-2 has no lines so as to permit typing.

The memorandum records that PacBell and its predecessor PT&T have maintained since so ordered in 1954 in D.50258 are predicated on the Standard Practice U-4 procedures. Time has proven that consistent use of these procedures will meet the primary objective of depreciation which is, in the Commission's opinion, to recover, during its useful service life, the original cost of plant, not more, not less. The Commission sees no reason to depart from such practices and reaffirms its dedication to the classical features of remaining life depreciation as set out in Standard Practice U-4. "Prospective rates" will not be adopted.

The proposal by PacBell to implement the ELG methodology for selected central office and outside plant accounts received only casual and perfunctory support by the utility. After noting that it had been an issue in A.59849 PacBell's divestiture witness devoted exactly three lines of his prepared testimony to justification of ELG.

The staff depreciation witness, in his prepared testimony, declared that, because the Commission had rejected ELG in two previous decisions, D.82-04-028 and in D.83-08-031, he had not used that method in this decision.

The Commission concurs with the course taken by the staff witness. D.83-08-031, in A.59849, considered and discussed the ELG issue at some length and made a specific finding (Finding 17) that, when the time value of money is taken into account, the vintage group method of depreciation is less costly for ratepayers in the long run than the ELG method. For the Commission to adopt the ELG method, it must overturn its previous finding in D.83-08-031. PacBell's passing reference to ELG is hardly a sufficient showing upon which to overturn the Commission's judgments concerning ELG as set forth in D.83-08-031.

The Commission will reaffirm its previous finding not to use ELG as a basis for setting rates.

Having accepted the staff's technical update recommendation the Commission finds that a reasonable effect of the technical update on 1984 depreciation expense is $105,921,000 and, on 1984 revenue requirement, is $76,500,000.

Attrition Mechanism - Other Components

Except for the differences discussed above, staff and PacBell agreed by the end of hearings on the attrition mechanism and formulas to be used. In our review of the record in this matter, we are disturbed by the relatively high escalation factors used by both PacBell and staff in escalating 1983 approved budgets to 1984 amounts. Factors used in the following categories in particular are far higher than any inflation rates currently projected for 1984:

Materials, Rents and Services	
Growth per access line	15.26%
Access line growth	3.59%
Compounded growth rate	19.40%
Other taxes	12.20%
Plant in Service associated with access lines:	
Growth per access line	9.54%
Access line growth	3.59%
Compounded growth rate	13.47%
Plant in Service associated with messages:	
Growth per message	0.68%
Message growth	10.35%
Compounded growth rate	11.11%
Total Plant in Service (weighted)	12.55%

Further checking led us to the underlying methodology which produces these anomolous results. PacBell derived all these factors, except the growth in plant in service per message, from least squares trends of expenditures during the years 1975 to 1983. The growth in plant in service per message was calculated as the simple average of plant growth rates between 1976 and 1983.

We see several problems with this methodology. First, by including 1983 expenditures in the data base at levels requested in the rate case, which are much higher in some accounts than the amounts eventually authorized in D.83-12-025, the trend results are biased higher than they would be were the authorized 1983 expenditures used. This fault could be corrected. However other shortcomings are more serious.

PacBell's methodology uses historical expenditure growth rates during periods of high inflation to predict growth rates during 1984, which will see relatively low inflation. This greatly overestimates attrition increases needed to offset the effects of inflation. Adjustments to the trended data could also be made to correct for inflationary effects. This would have a dramatic effect on the escalation factors, but still probably would not reduce them to levels comparable to current projections for 1984 inflation. Based on the trend of 19.4% annual growth in materials, rents, and services it appears that expenditures in this category in particular have been increasing more rapidly than can be explained by either inflationary pressures or system growth requirements.

PacBell's request that the attrition adjustment reflect such high escalation rates brings us to the fundamental question of the purpose of the attrition mechanism. During recent years, the driving forces which led us to adopt attrition increases for various utilities have been unknown but increasing inflation and volatile interest rates. We have reached the point where energy utilities especially view attrition mechanisms as a right, and telephone utilities are clamoring to not be left behind. We are told the financial community expects nothing less than a dollar-for-dollar pass-through of any and all additional costs through rates.

We see a clear danger that overly generous attrition mechanisms such as that proposed by PacBell would remove all incentives for utilities to vigorously apply management acumen to hold down operating costs. The attrition mechanisms we have adopted for energy utilities are much more narrow, recognizing the most recent projections of attrition year inflation, but generally not authorizing expense increases resulting from anticipated system growth and certainly not allowing general increases beyond those that can be attributed to either inflation or system growth.

The energy utilities are protected against fluctuations in their fuel costs, which comprise their largest variable expense if system demands grow. Since PacBell has no comparable balancing account protection, we find it reasonable to provide for increased costs due to anticipated system growth.

We will not, however, provide for increases beyond inflation and system growth in today's decision. This is consistent with our discussion in D.83-12-068 regarding Pacific Gas and Electric Company's 1985 attrition request:

> "Finally, we should point out that the attrition allowance is not intended to cover every conceivable area where the utility can foresee possibility of an increase from the test year. It is only intended as a reasonable allowance to get by in the second year of rate life. If productivity increases do not offset increases in expenditures, we suggest that the utility pull-in its corporate belt a notch tighter." (D.83-12-068, p.85).

As a measure of inflation, we will use a composite of DRI's April 1984 published wholesale and consumer price indexes, consistent with staff's use of these indexes in this proceeding. We will, however, include a one-third weighting of DRI's labor escalation forecast to make the escalation factor more applicable to PacBell's Materials, Rents, and Services expenses. This results in a 4.5% inflation prediction for 1984. Compounding this inflation estimate

with the projected access line growth, we will authorize an 8.25% attrition adjustment in Materials, Rents, and Services. Only the 4.5% inflation rate will be applied to the "Other Taxes" category.

Growth in the Plant in Service component of rate base is more problematic. Because Plant in Service is largely embedded investment and the year-to-year change is the net effect of new plant investment less retirements, basing its percentage growth directly on inflation and the anticipated system growth rates is not logical. Upon review of the 1983 authorized increases in the Plant in Service category, we conclude that a 10% increase in Plant in Service during 1984 is reasonable.

The record before us does not present an attrition mechanism which is acceptable to us. We adopt the above attrition adjustments on an interim basis because of this deficiency in the record and because these adjustments more closely comport with the attrition mechanisms which we have adopted in our prior decisions for major utilities. We will hold further hearings within 60 days to reexamine the proper level of revenue requirements associated with 1984 attrition. At these hearings, the parties may present evidence on the appropriate measures of inflation, system growth, and labor productivity which should be reflected in an attrition allowance. We are disappointed with the methodologies which were presented in this proceeding and will reject summer reruns of these methodologies if presented in our upcoming hearings. At a minimum, parties should address the following issues:

1. What inflation index is best suited for use in escalating nonlabor expense categories?
2. How should growth in plant in service and other rate base items be projected for attrition purposes?
3. How should system growth and labor productivity be projected?
4. Should 1984 revenues, expenses, and rate base be adjusted to provide a modified base for 1985 attrition calculations and, if so, how?

Phase II Adopted 1984 PacBell Results and Incremental Revenue Increase Requirement

The Commission adopted 1984 PacBell Recast 3 results of operations are summarized on Table 14 following.

Table 14

PACIFIC BELL

Phase II Adopted 1984 Results of Operations
And Incremental Revenue Increase
California Intrastate Operations

Recast 3

	($000)
RESULTS OF OPERATIONS	
Revenues	$6,076,494
Expenses and Taxes	
Depreciation	734,756
Relief and Pensions	523,072
All Other Expenses	2,827,420
Taxes - FIT	517,070
CCFT	(104,955)
Soc. Sec.	122,614
Other	111,684
Total	$4,941,571
Balance Net Revenues	1,134,923
RATE BASE	
Plant In Service	$13,148,735
Plant Held For Future Use	40,967
Working Cash	209,601
Materials & Supplies	65,884
Less: Depreciation Reserve	2,419,895
Less: Deferred Tax Reserve	1,713,149
Total Intrastate Rate Base	$ 9,332,143
REVENUE REQUIREMENT CALCULATION	
Intrastate Rate Base	$ 9,332,143
Times: Adopted Rate of Return	.1270
Equals: Net Revenue Reqt.	1,185,182
Minus: Balance Net Revenues	1,134,923
Equals: Increase in Net Rev. Reqt.	50,259
Times: Div. Net-to-Gross Multiplier	2.0734
Equals: Increase in Gross Rev. Reqt.	104,227
Underutilized Plant Adjustment	(45,439)
Technical Update of Depr. Rates	76,409
Required Incremental Gross Revenue Increase	$ 135,177

( ) Denotes negative amount.

Also shown in Table 14 is the derivation of the required incremental Phase II Recast 3 revenue increase of $135,177,000. The Commission finds this increase, when modified to accommodate D.84-04-104, to be reasonable.

The derivation of the combined Phase I and Phase II increases of $580 million is shown in Table 15.

Table 15

PACIFIC BELL

Phase II Adopted 1984 Combined Revenue Increase Requirement for California Intrastate Operations

Recast 3

(Dollars in Millions)

Phase I 1983 Adopted Results	
Adopted Revenue Increase Amount - Phase I	$445
Phase II Divestiture Overlay	
Impact of Divestiture on 1983 Adopted Results	208
Impact of 1984 Attrition	(149)
Depreciation Rate Technical Update	76
Amount Adopted in Phase II	135
Combined Phase I and Phase II Revenue Increase Requirements	
Phase I Adopted	445
Phase II Adopted	135
Total	$580

We note that the attrition adjustment, including the approved technical update, is a $73 million reduction. This is largely because revenues are projected to grow due to increased system usage more than enough to offset authorized expense growth.

Table 16 shows the reduction in ongoing revenue requirement caused by D.84-04-104. Adjustments to rates required by D.84-04-012 will be considered in the rate design portion of this decision.

Table 16

PACIFIC BELL

Phase II Adopted Revenue Increase
Reduced for D.84-04-104 Effects

	Phase I	Phase II ($000)	Combined
Recast 3 Revenue Incr.	$445,450	$135,178	$580,628
D.84-04-104 Rev. Effect	(11,110)	1,404	(9,706)
Final Revenue Incr.	$434,340	$136,582	$570,922

IV. AT&T-C 1984 REVENUE REQUIREMENT

Format of Estimates and Tables - AT&T-C

Although AT&T-C participated in these consolidated proceedings as a respondent to OII 83-04-02, the practical effects of the divestiture process were such that AT&T-C, by succeeding to PT&T's interLATA service, inherited a portion of PT&T's status as an applicant.

Because AT&T-C came into what started out as a PT&T rate case, consistency necessitated that the methodology established to determine PT&T's California intrastate revenue requirement be used to determine that of AT&T-C.

Divestiture procedures required PT&T to transfer those of its operations which became interLATA to AT&T-C and its "embedded terminal equipment" or CPE activities to an AT&T entity tentatively designated the "Embedded Base Organization" (EBO), now called AT&T Information Systems. Accordingly, PT&T separated its results into three major showings: the portion representing residual PT&T; the portion representing PT&T predivestiture interLATA activities which would be transferred to AT&T-C on 1/1/84; and the portion representing PT&T predivestiture terminal equipment activities which would be transferred to AT&T EBO.

In June 1983, the staff met with representatives of the organization that would become AT&T-C upon divestiture and the two parties reached a procedural agreement that, to determine consistent results of operations showings, AT&T-C and the staff would start with PT&T's (now PacBell's) predivestiture 1984 attrition year results of operation line items, multiply them by a divestiture factor, adjust for contract and access charge impacts, and then separate the results to get AT&T-C line items.

The process can more clearly be understood from the following illustration from the staff AT&T-C revenue requirement report.

DIVESTITURE OVERLAY FORMULA

(1)	(2)		(3)		(4)		(5)		(6)
LINE ITEM	PRE-DIVESTITURE ATTRITION YEAR 1984 RESULTS OF OPERATIONS LINE ITEM	X	DIVESTITURE FACTORS	+/-	CONTRACT AND ACCESS CHARGE IMPACTS	X	SEPARATION FACTORS	=	AT&T-C 1984 INTRA-STATE R/O LINE ITEM

Example:

AT&T-C All Other Expense Component = [[[1983 base (total ops) + 1984 attrition change (total ops)] X % AT&T-C] + Payments to BOC for plant & services - leased/ contracted from PacBell.] - [All other expense assoc. w/plant & services leased/ contracted to PacBell] X % Intra-State] + Intra-State Access Charges.

= AT&T-C 1984 Intra-State All Other Expense

After the staff and AT&T-C had obtained the AT&T-C 1984 intrastate results of operations line items, they would add their 1984 estimates of appropriate allocations to California intrastate operations of AT&T's "Central Management Organization" (CMO) to complete their respective estimates of AT&T-C's 1984 California intastate operations.

Since the original schedule for these combined proceedings set by D.83-04-021 did not provide for AT&T-C's participation as a California regulated utility, the Commissioner then assigned to this case, acting according to authority granted to her by D.83-04-021, modified the RCP schedule to accommodate AT&T-C's participation.

Pursuant to the assigned Commissioner's ruling, AT&T-C filed, on August 15, 1983, testimony and exhibits showing its estimate of intrastate interLATA results of operations in California.

AT&T-C apparently did not understand that the purpose of the Commission's standing RCP, as established by Resolution ALJ-149, as amended by D.82-12-072, and as modified for these proceedings by D.83-04-021, is specifically intended to eliminate the necessity of aiming at a moving target, and accomplishes this by allowing one update of material filed with a rate application, and the categories for which updating is permitted are strictly limited.

AT&T-C's August 15 testimony and exhibits were based on PT&T's "Recast 3," the basis upon which Phase I of these consolidated proceedings was conducted. Apparently unaware of this Commission's expressed aversion to continuous revisions to duly filed results of operations material, AT&T-C proceeded to file its own series of "recasts," designated as Recasts 4, 4A, 5, and 5A. The definitions of the recasts changed from time to time and from filing to filing.

Fortunately, for the understanding of the record, the establishment of adopted results of operations by D.83-12-024 and D.83-12-025 on December 7, 1983, provided a definitive base for projecting the 1984 estimated results of AT&T-C and the nuances of the recasts made prior to that time are now moot and may be disregarded.

For the purpose of this decision, the Commission will use the recast definitions contained in AT&T-C's brief as filed February 24, 1984:

Recast 3	Revenue requirement data reflecting impact of D.83-12-024 and D.83-12-025.
Recast 4	Recast 3 plus the impact of an AT&T-C depreciation proposal to the FCC and for additional "Independent Company" (ICO) contract expense identified by "General Telephone" an unspecified access charge application.
Recast 5	Recast 4 plus the effect that the Moore Act is expected by AT&T-C to have on AT&T-C.

Compatibility of AT&T Recasts 4 and 5 with Commission's Rate Case Plan and the Scheduling Established by D.83-04-021

Without the restraints to continuing revision of the data before the Commission, the record that the Commission must process would be in constant turmoil and the tight schedules required by the RCP would be impossible to achieve. It is for this reason that the RCP provides for only very limited revisions to the applicants' showings and those revisions are confined to Day 0 and Day 265 of the proceeding (D.82-12-072, pp. 3, 6, and Appendix D).

These consolidated proceedings are being conducted under the RCP, as modified by D.83-04-021, and it is therefore incumbent upon the Commission, sua sponte, in the absence of objection to the

concept of AT&T-C's "recasts," to examine the series of recasts and to determine whether the data provided by Recasts 4 and 5 are properly before the Commission for its consideration.

The Commission does not need to concern itself with Recast 5 in this proceeding. The administration of the Moore Universal Telephone Service Act (PU Code § 739.2 and Revenue and Taxation Code §§ 44000-44190) is the subject of this Commission's OII 83-11-05, and a decision has issued that provides a consistent basis for administration of the act. AT&T-C may file an advice letter requesting recovery, through revenues, of the taxes imposed by the act.

As explained under the previous heading, AT&T-C is requesting, through the final version of its Recast 4, that it recover, through revenues, the cost of increased depreciation expense that would result from an AT&T-C depreciation proposal that was pending before the FCC at the time of submission of these proceedings, and also additional ICO contract expense.

In evaluating the propriety of these two items, the Commission must either apply its established update policy as set forth in Appendix D of D.82-12-072, or else make a specific finding, based upon a showing in this record, that a deviation from the policy is warranted.

The D.82-12-072 established policy is, as set forth in Appendix D:

APPENDIX D

STANDARD UPDATE EXHIBIT
FILING REQUIREMENTS LIST

Any update testimony or exhibits filed by applicant, staff, or interested party shall be limited to:

a. Changes in cost of capital reflecting issuance of new debt or equity since the NOI was accepted.

b. Known changes in cost of labor based on contract negotiations completed since the tender of the NOI.

c. Changes in nonlabor escalation factors based on the same indexes the party used in its original presentation during hearing.

d. Known changes due to governmental action such as changes in tax rates, postage rates, or assessed valuation.

The update exhibit may include decreases as well as increases in the above categories. All testimony and exhibits for updating shall be in fully prepared form and served on all appearances 10 days before hearing.

The PT&T recasts of Phase I of these proceedings met these criteria as does AT&T-C's Recast 5. Recast 4, however, clearly does not. The depreciation portion of Recast 4 reflects a proposal to the FCC for shorter lives and higher depreciation rates for X-Bar COE transferred by PT&T to AT&T-C as part of the divestiture process. AT&T-C claims that "the account life characteristic" of the transferred plant is shorter than "the composite account life characteristic of [PT&T's] total crossbar investment." According to AT&T-C, "the effect of its Recast 4 depreciation proposal would be to increase expense by $4,003,000 and to reduce rate base by $2,451,000."

The ICO contract expense change, as finally proposed to the Commission by AT&T-C at the March 2, 1984 oral replies, reflects a document entitled "Transition Lease Agreement AT&T Communications of California and General Telephone Company of California." AT&T-C maintains that this document, as finally signed by AT&T-C on February 10, 1984 and by General Telephone Company of California on February 15, 1984, would cause its California intrastate expenses to increase by $19,086,000 and its intrastate rate base to increase by $1,139,000 over the corresponding Recast 3 amounts.

The Commission staff did not object to the Recast 4 depreciation proposal, and in fact, supported the concept by presenting an alternate proposal. The staff did, however, object strenously to the ICO portion of Recast 4 being a moving target.

The Commission recognizes that AT&T-C is before it as a respondent to a Commission order instituting investigation, and not as an applicant in the sense contemplated by the RCP. The Commission also recognizes that this unique rate case is but a part of the much larger happening of the breakup of the old Bell System to the new AT&T and BOCs, and inevitably must recognize that events transpiring in the course of the breakup will have an impact on the record in the case.

AT&T-C is, however, seeking a rate increase in this investigation and, as explained earlier, orderly processing of that request requires a stable record. The consolidated PT&T-PacBell proceeding is definitely before the Commission under the RCP, and fairness and consistency dictate that the technical procedural distinction between applicant and respondent cannot excuse one of the participants in a consolidated rate case from the rules governing the other. This is particularly true when it is realized that the divestiture events affecting AT&T-C also affected PacBell, yet PacBell managed to conduct its case according to the RCP.

The Commission will therefore apply the general spirit of the RCP to AT&T-C and finds that continuing revisions to the record by AT&T-C, outside of the criteria established by Appendix D of D.82-12-072, should not be considered. For the purpose of applying the RCP to the record, AT&T-C Recast 3, the D.83-12-024 and D.83-12-025 basis will be considered as application data and will be evaluated as such.

The Commission will, therefore, without further consideration of "recasts" by AT&T-C, proceed to examine the showing designated as "Recast 3." The other material can be considered in

proceedings subsequent to these, as is done with significant issues affecting other utilities coming under the Commission's RCP.

AT&T-C Estimated 1984 California Intrastate Results of Operations and Revenue Requirements

The AT&T-C and staff's proposals for 1984 intrastate results of operations and revenue requirement, on a Recast 3 basis, are shown in Table 17.

Table 17

AT&T COMMUNICATIONS

Results of California Intrastate Operations

Year 1984 Estimated Based On D.83-12-024 And D.83-12-025 Adopted Results (Recast 3)

	AT&T-C	Staff	AT&T-C Exceeds Staff
		($000)	
RESULTS OF OPERATIONS			
Total Revenues	$1,764,701	$1,819,385	$(54,684)
Expenses and Taxes			
Depreciation	16,023	17,974	(1,951)
Relief and Pensions	24,993	25,897	(904)
All Other Expenses	1,670,049	1,631,025	39,024
Operating Taxes - CCFT	2,129	10,613	(8,484)
FIT	13,746	49,628	(35,882)
Social Security	5,392	6,302	(910)
Other	1,608	2,477	(869)
Total Operating Expenses & Taxes	$1,733,940	$1,743,916	$ (9,976)
Balance Net Revenues	30,761	75,469	(44,708)
RATE BASE			
Average Plant In Service	298,621	360,211	(61,590)
Average Plant Held for Future Use	0	0	0
Working Cash	49,376	48,460	916
Material and Supplies	1,495	1,328	167
Less: Depreciation Reserve	59,722	64,511	(4,789)
Less: Deferred Tax Reserve	34,364	35,508	(1,144)
Total Intrastate Rate Base	$ 255,406	$ 309,980	$(54,574)
Realized Rate of Return	12.04%	24.35%	(12.31)%
REVENUE REQUIREMENT CALCULATION			
Intrastate Rate Base	255,406	309,980	(54,574)
Times: Proposed Rate of Return	0.1349	0.1270	-
Equals: Net Revenue Requirement	$ 34,454	$ 39,367	$(4,913)
Minus: Balance of Net Revenues	30,761	75,469	(44,708)
Equals: Increase in Net Rev. Reqt.	$ 3,693	(36,102)	39,795
Times: Div. Net-to-Gross Multiplier	2.0734	2.0734	2.0734
Equals: Increase in Gross Rev. Reqt.	$ 7,657	$ (74,854)	$82,511
Underutilized Plant Effect	-	(3,750)	3,750
Proposed Gross Revenue Increase	$ 7,657	$ (78,604)	$ 86,261

( ) Denotes negative amount.

The $7,657,000 revenue deficiency shown by AT&T-C would increase its intrastate revenues by approximately 0.4% while the $78,604,000 reduction indicated by the staff results would amount to approximately a 4.3% decrease.

Reasons for Differences in AT&T-C's 1984 Results of Operations and Revenue Requirement

The $86,261,000 difference in the California intrastate revenue requirement comes from four contested differences.

1. The staff, consistent with its PacBell showings, placed "above the line" the revenue, expense, and plant effects of "Shared Multifunctional Facilities," for an effect on intrastate revenue requirement of $(56,000).
2. The staff allowed only $96,830,000 of the $267,060,000 of CMO expense allocated by AT&T-C to total California operations. The effect on intrastate revenue requirement is $(80,025,000).
3. The staff used the 12.70% rate of return found reasonable in D.83-12-025. AT&T-C used the 13.49% requested by PT&T in Phase I of these proceedings for an effect on intrastate revenue requirement of $(2,430,000). (In its brief, AT&T-C requested the 14.70% used by the Commission for separating access services revenue.)
4. The staff carried forward from D.83-12-025 the underutilized plant adjustment associated with PT&T plant transferred to AT&T-C, for a California intrastate revenue effect of $(3,750,000).

AT&T-C Shared Multifunctional Facilities

Earlier in this opinion the Commission examined PacBell's proposal to treat shared multifunctional facilities, found them to be an integral part of PacBell's operations, and concluded that the proper regulatory treatment was to include the results of these operations "above the line."

AT&T-C argues, in its brief, that the shared multifunctional facilities are not an integral part of AT&T-C's operations. According to AT&T-C they are not used at all by the company in its utility business over which this Commission has jurisdiction but instead the contracts and leases in question essentially constitute a private business, not a dedicated public utility service. It is AT&T-C's position that these contracts and leases were made concomitant with the start-up of AT&T-C, which has never used the leased facilities to provide direct public service. There is no demonstration on the record to support AT&T's contention beyond these mere asertions.

The Commission is unable to accept that the facilities, because of the lease treatment necessitated by the mechanics of divestiture, have somehow lost their character of being affected with a public interest (Munn v People of Illinois (1877) 94 U.S. 113, 126). Should the facilities in question be removed, a portion of the public would lose its ability to communicate, over public utility telephone lines, with another portion of the public. What more could be "property clothed with a public interest when used in a manner to make it of public consequence, and affect the community at large" (Munn v Illinois, supra), and thus public utility property?

Upon reviewing the issue a second time, the Commission is reinforced in its conviction that the facilities in question are an integral part of AT&T-C's public utility operations unequivocally dedicated to public use. They are subject to the concurrent jurisdiction of the FCC and this Commission, and through the operation of the separations process, are facilities that should be considered "above the line" for determining a California intrastate revenue requirement for AT&T-C. The Commission so finds.

AT&T-C CMO Expense -
Summary of Differences

Since AT&T-C was unable to provide its budgeted data for its CMO expense estimate in accordance with the Uniform System of Accounts (USA), it is necessary to use the AT&T-C format for the purposes of this decision. This acceptance of non-uniform data in this instance is not intended as a precedent; however, and, in the future, the Commission will expect the data furnished by that utility to conform to the USA. Nonstandard data will not be accepted without a showing of a most compelling reason for not complying with the reporting requirements routinely expected of all American telephone companies.

The differences between AT&T-C and the staff concerning CMO expenses are summarized, by AT&T-C's unofficial expense categories, in the following table:

Table 18

AT&T COMMUNICATIONS

Central Maintenance Organization Expenses
Summary of Utility-Staff Differences
1984 Estimated Total California Allocation

	AT&T-C Nationwide Forecast	AT&T-C California Allocation	Staff California Allocation	AT&T Exceeds Staff
		($000)		
Marketing	$1,190,940	$135,460	$38,000	$ 97,460
Advertising	409,050	46,590	15,000	31,590
Finance	324,010	28,570	19,280	9,290
AT&T Corp. Head.	268,400	23,370	9,390	13,980
BTL (Fund. Res.)	139,500	10,420	4,910	5,510
Public Relations	20,000	1,740	0	1,740
Systems Engineering	280,000	20,910	10,250	10,660
Total	$2,631,900	$267,060	$96,830	$170,230

CMO Expense - Background

In the course of divestiture, AT&T formed the CMO to manage its interLATA business as a nationwide network. The CMO was organized into six operating departments, each with a distinct mission to perform. These departments are Marketing, Network, External Affairs, Finance, Personnel, and Legal.

Since the CMO operates on a national level, its expenses are incurred on a national basis. Those expenses are then allocated to the 22 local interexchange corporations, including AT&T-CC. Expenses for the most part are either directly assigned or are allocated to the local interexchange corporations and to AT&T-C's Interstate Division by use of four allocation factors based on revenues, assets, capital, and employees. A fifth composite allocation factor is used for those that are not directly related to one of the other four factors. The expenses thus allocated are then separated into interstate and intrastate operations.

Some difficulty was experienced by both AT&T-C and the staff in preparing their showings. The preparation of AT&T-C's estimates was, as might be expected, handicapped by the necessity of preparing a rate case during the course of AT&T-C's formation and transition from a regulated to a partly deregulated and competitive business. AT&T's showing was bifurcated between a superficial direct showing and a more intensive rebuttal directed at the "disallowances" proposed by the staff.

The staff presentation was hampered by AT&T-C's making only a cursory direct showing, by the access to only vague and frequently changing base data, by accounting records not maintained in accordance with the FCC's (and this Commission's) US/A for Class A and Class B Telephone Companies, and some stonewalling by security

conscious AT&T-C employees who apparently were unfamiliar with the disclosure requirements of PU Code §§ 581 and 584, the confidentiality provisions of PU Code § 583, and the potential adverse consequences that withholding information can have on the outcome of a rate case being conducted according to the strict schedule of the Commission's RCP.

The difficulties experienced by the staff in its investigation lead the Commission to caution AT&T-C that future resistance to furnishing data or submission of data not compiled in accordance with the US/A could result in a rate application's processing being rejected or, at the very least, suspended. AT&T-C, not staff, bears the burden of justifying its data and revenue requests.

CMO Marketing and Advertising Expense -- Overview

The unofficial expense categories characterized as "Marketing" and "Advertising" correspond in general to the official

FCC category "Commercial Expenses," and were they to be reported according to the US/A, the expenses would be carried on the following accounts:

Ac. 640 - General Commercial Administration
Ac. 642 - Advertising
Ac. 643 - Sales Expense
Ac. 644 - Connecting Company Relations
Ac. 645 - Local Commercial Operations
Ac. 649 - Directory Expenses
Ac. 650 - Other Commercial Expenses

Because of AT&T-C's nonconformance, elements of AT&T's marketing and advertising expense cannot be matched against the corresponding operations of either PT&T or PacBell.

As can be seen in Table 18, the staff's recommended California allocation for Marketing is $97,460,000 lower than AT&T-C's, and its Advertising allocation is lower than AT&T-C's by $31,590,000, for a total of $129,050,000. These related categories thus comprise over three-quarters of the $170,230,000 staff-utility differences in CMO expenses.

On a per capita basis, the AT&T-C budgeted figure of $182,050,000 for marketing and advertising is enormous. Each of the 13.5 million access lines in California would, in 1984, be the target of $13.50 of AT&T advertising and promotion. Another measure of the huge sum budgeted for advertising and promotion is to multiply the $182,050,000 AT&T-C total California allocation for these two items by the intrastate separation factor of 0.3446 used by AT&T-C and the staff to separate "All Other Operating Expenses" and to then divide the product of $62,734,000 by the AT&T-C's claimed intrastate net revenue requirement of $34,454,000, as developed in Table 17. AT&T-C's budgeted intrastate marketing and advertising expenses are thus found to be 1.82 times, almost twice, its claimed net revenue

requirement. AT&T-C is budgeting $1.82 in promotion for each dollar of net revenue it hopes to receive in 1984.

Compared to the total of the contested CMO expenses as shown in Table 18, marketing and advertising expenditures are directed heavily toward California, 11.38% of advertising compared to a total of 10.14%.

CMO Marketing and Advertising - AT&T-C Showing

AT&T-C did not provide a justification for its claimed marketing and advertising expenses until after it completed its cross-examination of the staff witness responsible for these categories on December 8, 1983. The company then, on December 20, 1983, distributed two rebuttal exhibits and a Director of Marketing of AT&T supported them with rebuttal testimony on January 10, 1984. According to the testimony of the AT&T-C Director of Marketing, the marketing organization's purpose is to protect AT&T-C's $35 billion in existing revenue and to stimulate new revenue.

AT&T-C sees itself as operating in a market where it is competing with other common carriers, "value-added networks," domestic satellite carriers, private microwave suppliers, and service resellers. As more alternative suppliers of communication service enter the marketplace, the competitive nature of the market increases. Two-thirds of the population of the United States is located in areas served by one or more of AT&T-C's specialized common carrier competitors.

Where the specialized common carriers have target markets, they have signed up approximately 30% of the residence subscribers. MCI, alone, served about 1,180,000 customers as of March 31, 1983. MCI currently serves more than 270 metropolitan areas and 7,000 communities in more than 80% of the nation's calling areas, a gain of 50 metropolitan areas in its 1983 fiscal year alone. At least 8 value-added network carriers and 6 domestic satellite carriers are competing for interexchange business. In June 1982, when the FCC terminated its requirement for interstate resellers to apply for

permission to provide service, over 3,000 applications had already been filed. Over 1,500 organizations own private microwave facilities in the United States, extending over 300,000 route miles. Sixteen teleport, or common user facilities projects are currently in progress. In some respects these are equivalent to a central office that allows the tranmission of information from one area to another via satellite.

The data on the growth of competition in California are comparable. Four specialized common carriers serve 63 cities in the state. As of May 1983, MCI served 44 cities, up from 23 a year earlier. At least 26 interstate resellers are headquartered in the state and over 200 organizations have been authorized to construct private microwave systems in California.

The Director of Marketing explained how AT&T-C had evaluated the marketing functions and developed the advertising programs that the company believed to be necessary to conduct AT&T-C's business, and how it then estimated the associated expenses. She described the marketing organization as employing more than 15,000 people, of whom over 13,200 are in field sales and service organizations and over 2,000 provide sales support.

Marketing is organized into five regions, each region being headed by a Regional Vice President. In addition, four other vice presidents are responsible for tariff implementation, market management, marketing planning, and for centralized support of the sales force. Each Regional Marketing Organization is structured into two segments, Residence and Business. The Business segment is further divided into Major Markets and General Business Marketing Groups.

The Director of Marketing explained in detail how the force levels and salary requirements were determined. For a large part, staffing and salary requirements were based on historical experience of AT&T Long Lines and the operating companies of the Bell System.

In addition AT&T-C identified marketing functions that would be required by AT&T-C's status as an operator in a competitive environment. In one instance, the General Business Marketing Group, the force allocation was based on time and motion studies conducted for AT&T by the BOCs prior to divestiture.

As for AT&T-C's advertising and promotions program, the Director of Marketing testified that its basic objective is to provide potential customers with information on the quality, attributes, value, and availability of the company's services so that it will be influenced to select AT&T-C from among the various vendors available and thus maintain AT&T-C's existing revenues and generate new revenues. The Director of Marketing said that AT&T has seven categories of Advertising: Business, Residence, Public, International, Federal, Intermediaries, and a general category designated as Other.

To determine its total advertising expenses, each marketing segment develops a segment plan which includes specific goals for such objectives as services to be sold, revenue growth, target audience, and competitive activity. One of the means by which these objectives are achieved is advertising, which AT&T believes is a cost-effective way to reach a large audience. Based on the objectives in the plan and an evaluation of the needs of each segment, the advertising group investigates mass media programs that it thinks will accomplish the objectives. Various media are researched and priced to determine cost-effectiveness. Using research, historical advertising expenses of both AT&T Long Lines and the BOCs, and media price comparisons, a total advertising budget is developed which has expenses allocated to each of the seven categories. This budget is reviewed in the context of the segment plans and total AT&T Communications marketing budget. The vice president responsible for both the segment plans and advertising program is responsible for

working within the budget and resolving any discrepancies in the allocation of dollars among the various categories.

The management applied reasonableness tests to the advertising budget which were based on expense levels and accomplishment of objectives, making comparisons with competitive vendors and comparable corporations. AT&T-C's media decisions are made to reflect the life-cycle stage of the service being promoted, its brand share, brand loyalty, the target audience, competitive activity, seasonal considerations, and geographic shows. The development of the creative advertising material involves considering the complexity of the service, the level of audience sophistication, competitive activity, the theme, the identity of the presenter, the content of visuals, the format, and whether the campaign is new or existing.

AT&T-C compared this budget level to the ongoing sales advertising program in place in 1983, the BOC long distance campaigns that complemented the national ad program in the past, the need to establish customers' brand preference for AT&T-C services, and the need to introduce new services to the consumer.

The company based its expense estimates on historical trends, the ratio of advertising expenses to sales dollars for each program, and media inflation levels. The expense level was judged for reasonableness and effectiveness by comparison to other carriers in terms of impressions per household, by the trend in competitive levels of advertising expense, by typical advertising to sales ratios for selected campaigns in other industries, and by reach and frequency comparisons for each program in each segment to determine the effectiveness and impact of the media delivery.

As a check, one generally used in marketing organizations to ascertain the reasonableness of advertising expense levels, AT&T-C used as a basic measurement the total revenue generated compared to

the advertising expense, the advertising expense/revenue ratio (E/R ratio). AT&T-C's E/R ratio, under its proposed budget, is 0.01. That is, the company plans to spend 1¢ of advertising expense to generate $1.00 of revenue. Comparable ratios for MCI are 0.046 and for Sprint 0.062.

Although AT&T-C did not provide cost details of its advertising categories on the record, it did, after some resistance, provide them off the record to the ALJ by a confidential letter dated December 16, 1983. Because of possible competitive disadvantage to AT&T-C, and because the staff had no opportunity to evaluate the contents,[11] the ALJ did not require that the budget details be disclosed openly on the record of these proceedings and they are not being used in formulating this decision.

The purposes of the business, residence, and international categories of advertising are generally indicated by their names. They are designed to advise customers of the services available and of the most advantageous rates and thus stimulate usage.

Public advertising, aimed at people in transit and agents of airports, hotels, and restaurants consists of posters in airports, magazine ads, and some limited TV advertising. Its intent is to inform end users and the agents who make these services available to users about AT&T-C's public service offerings including use of the new AT&T Calling Card, optional calling plans, and new services such as calling stations. The focus is on increasing customer awareness of current station and operator-handled services and to inform users of their location in order to stimulate sales.

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[11] The December 16 letter was not forthcoming until eight days after the staff advertising witness was cross-examined by AT&T-C and formally excused on December 8, 1983.

Intermediaries advertising uses print and television ads to explain to customers how they can use AT&T-C's facilities and services in conjunction with another vendor's equipment. Some of this advertising will be done jointly with the other suppliers.

The purpose of the Federal advertising campaign is to inform Federal agencies of the many ways AT&T-C can help to improve their agency operations and better serve their constituents. The means of accomplishing this objective was not specified.

The Other category includes Cross Segment advertising, Legal Ads, Yellow Pages advertising, and advertising production costs. Cross Segment advertising describes those ads that are targeted at more than one of the seven categories and are designed to promote all services provided by AT&T-C rather than a particular business or residence service. Legal advertising provides for AT&T-C's legal obligation to inform customers of proposed changes in rates for the services provided by AT&T-C. The advertising appears concurrently with tariff filings. Yellow Pages advertising will be placed in BOC and other directories and will provide a list of services that AT&T-C offers and telephone numbers for customers to call to obtain service and to resolve billing and service problems. After divestiture customers can no longer contact their local telephone company about interLATA services.

The Director of Marketing presented an exhibit with copies of AT&T-C's current media ads and scripts of its radio and television ads. AT&T-C provided a video-cassette recorder and television set and the radio and TV ads were screened for the participants.

The TV ads, featuring groups of cute moppets, good ol' boys, and loving, well adjusted, tension-free family groups, as well as plugs for AT&T by nationally-known Hollywood personalities, with appropriate singing-and-musical interludes of repetitious choruses of

"Reach out and Touch Someone", included exhortations to call Japan, the United Kingdom and Ireland, Italy, and Europe in general. Other ads stressed that only AT&T was able to supply complete nationwide long distance service to all communities, regardless of size.

In addition to media advertising AT&T-C conducts a promotion program that is divided into three segments: business, residence, and public.

The business promotion segment consists of direct mail, trade show exhibits, sales brochures for use by the sales force in the field, audio-visual presentations, an Olympic Games program in areas where the Olympic Torch Run is to be held, and seminars on communications for business executives.

The expenses associated with these programs are:

Direct Mail	$19.2 million
Trade Shows	$ 1.9 million
Audio-Visual	$ 5.9 million
Olympic	$ 1.9 million
Seminars	$ 5.0 million
Total	$33.9 million

There are five categories of residence promotion programs:

Gift Certificates	$14.7 million
AT&T Calling Card	$37.8 million
Optional Calling Plans	$ 5.3 million
Lifestyle	$ 6.4 million
Usage	$ 6.4 million
Total	$70.6 million

The purpose of the gift certificate program is obvious from its name.

The Calling Card program is divided into two areas: issuance of the card, at a cost of $28.5 million, and promotion of the use of the card, at $9.3 million.

Optional Calling Plan consists of providing potential customers for alternative pricing arrangements with, in some unspecified way, "information concerning these plans."

Lifestyle is targeted at customers who share a common lifestyle, such as military, college students, or working women. Also in some unspecified way the persons comprising these groups are informed of the various applications of AT&T-C's long distance operations that relate to their individual situations.

Usage is intended to provide customers with information of general interest regarding AT&T-C's services. In some unspecified way the general customer is to be supplied with "information" to allow her/him to make an informed decision regarding her/his use of AT&T-C's services.

The public promotion budget is divided as follows:

Direct Mail	$5.3 million
Sales Aids	$0.7 million
Exhibits	$0.1 million
	$6.1 million

Public segment promotions are directed at the end user when he/she is in transit and agents of public places like airports, hotels, and restaurants. They primarily involve direct marketing and direct response promotional pieces sent to business travelers, drivers, parents of college students, and military personnel. Some expenses are allocated to making sales support material available to the public sales force and to exhibits at tradeshows that agents of these public places would attend. In addition, there are points of purchase promotions to customers, in-flight magazines, brochures, and sales aids that explain AT&T-C's public telephone services to public telephone users and the business establishments that serve them. The

"information" concerns calling card usage, restricted personal identification numbers, optional calling plans, and new service trials such as credit card readers.

Some of the promotional programs, such as gift certificates and calling card, are contracted to vendors. The costs of the others were, in general, estimated by multiplying the number of customers to be targeted by the costs of the individual pieces of promotional material supplied.

AT&T-C's national marketing expense/revenue ratio (M/R ratio) for 1984 is expected to be 0.05, and its California intrastate ratio to be 0.04. The Director of Marketing stated that one of AT&T-C's major competitors was spending 10¢ per dollar of revenue, an M/R ratio of 0.10.

CMO Marketing and Advertising Expense - Staff Showing

In preparing its marketing and advertising recommendations for submission the staff experienced the data collection difficulties outlined earlier and had the advantage of access to only selected parts of the AT&T-C descriptive material summarized under the last heading. The complete material, absolutely essential for an effective appraisal of the marketing and advertising programs, is contained in AT&T-C exhibits distributed in rebuttal to the staff report on December 20, 1983. The staff report itself was issued November 9, 1983.

The first question to occur to the staff in investigating AT&T-C's advertising was why AT&T-C's estimated $46,591,000 advertising expense for its 1984 California operations is over four times the $11,010,000 associated with PT&T's divested operations. The staff concluded that some of AT&T's advertising is institutional in nature, a PT&T issue long settled, (D.88232 (1977) 83 CPUC 149, 189-193) and should not be recognized at all for rates. Stimulation of interstate calls should be recognized to the extent of 50%, as specified in D.85287 ((1975) 79 CPUC 240, 247). The staff would not

include any of the international calling advertising in California intrastate operating expense.

At the time of preparation of the staff report, AT&T-C was withholding its specific advertising cost estimates as being proprietary so the staff formulated its allowance by adding a judgment increment to the PT&T divested advertising programs of $11,010,000.

Counsel for AT&T-C cross-examined the staff witness as to his basis of characterizing some of AT&T-C's advertising as institutional. The staff witness indicated that in identifying the advertiser as AT&T rather than AT&T-C, AT&T built up the image of the parent company rather than directly promoting increased usage. To this line of questioning, and to questions about other of AT&T-C's advertising, the staff witness stressed that he did not examine each of AT&T-C's ads and "disallow" those not meeting the Commission's established criteria for the reason that he had no quantitative data to "disallow." His total California allowance, in the absence of AT&T-C's furnishing quantitative details of its advertising program, was independently determined at $15,000,000.

The staff estimate of total California marketing expense is $38,000,000 or $97,460,000 lower than AT&T-C's claimed $135,460,000. After meeting with AT&T-C the staff was not satisfied with AT&T-C's claimed amounts. The staff was concerned about the following points:

1. AT&T-C offered no documentary justification of its claimed amounts.
2. There were no profitability studies or other substantiation to show that the additional expenses for protecting AT&T-C's marketing position would be cost-effective.
3. AT&T-C's revenue estimates did not indicate additional sales revenue resulting from the marketing efforts, thus indicating a lack of confidence by AT&T-C in their effectiveness.

4. The claimed expenses included costs of a large scale training program to train the marketing sales force of AT&T Long Lines to sell interLATA services for the first time, and to train personnel from PT&T to sell interstate services. These are one-time startup costs not proper for ratemaking purposes.

5. Some of the marketing efforts were directed toward AT&T brand recognition and system selling that may benefit other AT&T subsidiaries or enhance AT&T's corporate image.

The staff's showing was based on its Phase II showing for PacBell and assigned the staff version of PT&T expenses associated with PT&T's divested activities to AT&T-C, but with one exception, Ac. 643, Sales Expense. Since the staff did not apportion any divested PT&T sales expense to AT&T-C, and since AT&T-C will have to replicate PT&T's sales force in 1984, the staff recommends that the amounts for this divested activity allocated by PacBell, $19,402,000, be used.

The staff derivation is shown in Table 19.

Table 19

AT&T COMMUNICATIONS

Development of Staff Allowance
For Marketing Expenses
1984 Estimated Total California Allocation

Account		Staff California Allocation ($000)
640	General Comm Admin	$ 9,530
643	Sales Expense	19,402
644	Connect. Company Relations	410
645	Local Commer. Oper.	8,408
	Subtotal	$37,750
	Multistate Marketing Adjustment	(3,693)
	Total 1983 Level	$34,057
	Attrition Factor	1.10
	1984 Recommended Level (L7 x L8)	37,463
	Use	$38,000

CMO Marketing and Advertising
Expense - Commission Discussion

In its brief AT&T-C argues that all of its advertising and promotions are sales-oriented, and none of them is designed for the purpose of enhancing the company's image. It also argues that no part of the interstate or international advertising costs should be "disallowed" pursuant to D.85287 and D.88232 since AT&T-C allocates advertising and promotions program costs to each state based on direct revenues generated within each state and then separates them, thus satisfying the Commission's concerns as expressed in the aforementioned decisions. Finally it declares that E/R ratios should be used as a test of reasonableness, comparing AT&T-C's ratio with

one computed for PT&T's accounts carried in the FCC USOA "Commercial Expenses."

In the absence of definitive evidence on the record, and of the benefit of a staff report based on a meaningful review of AT&T-C's marketing and advertising program under the confidentiality provisions of PU Code § 583, the Commission finds itself in much the same position as did the staff upon its return from New Jersey. The Commission wants to make a fair appraisal of AT&T-C's promotional costs but has no basis for so doing. In making this statement the Commission categorically rejects E/R ratios as giving any valid measure of reasonableness. Unreasonable expenditures are unreasonable, regardless of their size compared to revenues.

The Commission notes that the staff's proposed allowance of $53,000,000 for advertising and marketing, while only 29% of AT&T-C's $182,050,000, would still provide for expenditure in 1984 the not inconsiderable sum of $3.93 for each of the state's 13.5 million access lines. Recognizing the unusual circumstances faced by AT&T-C in establishing itself in the newly competitive field of interLATA communications the Commission finds, by exercising its expertise and judgment, that $5 per access line, or $67,500,000, for total California AT&T-C marketing and advertising, is a reasonable allowance for advertising and marketing expense combined.

In establishing this allowance the Commission has in mind AT&T-C's objections to the staff proposal. As explained earlier in this opinion, however, the Commission must have quantitative data in each category of advertising expenditure before it can decide which portion of each is institutional, international, or interstate. It also must study the operations of AT&T-C as an integral operating entity and cannot, until the separations process is applied, confine its examination to intrastate allocations only. Finally, the Commission does not consider ratios based on revenues appropriate for the purpose of establishing revenues, because, among other considerations, of the introduction of the circular reasoning aspect. Moreover, comparing ratios to other ratios is meaningless,

for regulatory purposes, unless the reasonableness of the ratios used for comparison is also established. Findings of the rigorous type required from this Commission by the laws of this state cannot be predicated on meaningless statistics.

CMO Finance Department -
Results of Staff Investigation

AT&T-C's Finance Department (Finance) is one of the utility's six departments and employs about 4,000 of AT&T-C's 118,000 employees. Finance is divided into six groups: Comptroller Operations, Information Systems Organization, Financial Systems and Methods, Treasury, Financial Planning, and Strategic Plannning. AT&T-C's 1984 nationwide forecast includes $324,010,000 for Finance, of which it allocates $28,570,000, or 8.82% to California.

In evaluating Finance, the staff experienced the twin difficulties of lack of comparability of data and severe time constraints. The staff engineer conducting the Finance investigation noted that Finance management and nonmanagement salary rates were comparable to PT&T and then limited his attention to the two largest groups which together comprise over 70% of the Finance expenses, Treasury and Comptroller operations.

Treasury is responsible for the management of AT&T-C's financial resources, including financing, accounts payable, accounts receivable, and payroll. Treasury is also responsible for developing banking relations and financial testimony in rate case proceedings. This group is sufficient to perform all the treasury functions for AT&T-C without outside help, except for some expert testimony in rate cases.

The staff engineer found the utility had adequately justified the expenses for this area. A staff comparison of Treasury expenses per dollar of assets between PT&T and AT&T-C further confirmed the estimate as reasonable. The staff accepted AT&T-C's 1984 Treasury estimate.

The second group that the staff engineer examined was Comptroller Operations, the largest of the six Finance groups.

Comptroller Operations consists of nine subgroups. Accounting Operations is the largest of the nine, representing 65% of this group's employees. The staff engineer's analysis concentrated on this subgroup.

Responding to a staff data request, AT&T-C indicated that out of a 1984 average of 1,772 Accounting Operations employees, 1,227 perform intrastate work which they classify under Bell System JFC 12XX.[12] Included in JFC 12XX is billing and collection for local calls, toll calls, and CPE as well as service orders for starting, ending, or modifying service. The staff concluded that many of the JFC 12XX functions purported to be performed by AT&T-C personnel will actually either be performed by others for AT&T-C or won't be applicable to AT&T-C and to permit these expenses would allow the company to recover the expenses twice.

JFC 12XX is segregated into 13 functions. The staff determined which of the functions it believed would apply to AT&T-C, would be performed by PacBell for AT&T-C, and would not apply to AT&T-C at all. Having determined how much of each of the 13 functions he believed would actually be performed by AT&T-C, the staff engineer applied a weighting factor to each based on PT&T's 1982 recorded data. As a result of this determination, the staff engineer allowed 46% of the Accounting Operations force and associated support functions, for an $86 million adjustment to the nationwide CMO forecast.

A second staff adjustment was to the Chief Financial Officer (CFO) subgroup of Comptroller Operations. The staff noted that the CFO subgroup consists of two people, the CFO and an assistant, and that these two generate $25 million expenses,

[12] A JFC, known as a job function code, is a work description. JFC 12XX is the 1200 series job function code and corresponds to work associated with US/A Subaccount 662-01, Customer Accounting.

excluding computer operations and support. It was unclear to the staff how two people could generate that level of expense, even when it is recognized that the CFO is paid more than the average employee. The staff used the 1982 compensation of PT&T's CFO as a base, and, after allowing for annual salary increases, arrived at an allowance of $24 million less than claimed by AT&T-C in its nationwide forecast.

Finally, when allocating the Finance expenses to California the staff took exception to the composite allocation factor used by the utility. AT&T-C's composite "Accounting and Finance" factor is comprised of employees, assets, expenses excluding access charges, and revenue excluding access charges. In the staff's view, all the components except the revenue excluding access charges are reasonable. Revenue is more subject to the discretion of the various regulatory bodies and therefore not as meaningful a measure of cost generation as the other three factors. The staff, therefore, used the arithmetic average of the remaining three components as its composite allocator. This results in a $1.8 million reduction to the CMO expense allocated to California, for a staff estimated total California allocation of $19,280,000 for Finance.

CMO Finance Department -
Company's Rebuttal

In rebuttal to the staff Finance estimate, AT&T-C presented the testimony of a Division Manager - Accounting Regulatory Support. The AT&T-C witness testified that the staff had misused the document relating to JFC 12XX furnished in response to the staff data request. She explained that document had been created by AT&T-C for the limited purpose of internally checking responsibility of force levels. It was intended to show that AT&T-C's Accounting Operations subgroup performing seven functions would compare favorably in size with BOC customer accounting group which are just one element of BOC accounting operations.

Accounting Operations of AT&T-C covers far more than just customer accounting, and the Division Manager presented a table of functions which described the seven responsibilities of the subgroup in detail. Fewer than one-third of the employees within Accounting Operations will be performing customer accounting functions. She specifically denied that there would be duplicative work effort.

The AT&T Division Manager also said that AT&T-C will perform all of the JFC 12XX functions except the two associated with local message processing. Moreover, contrary to the staff assumptions, the AT&T-C customer accounting operation will devote its major effort to the service and equipment processing function and relatively few resources to the customer output function, whereas the PT&T customer accounting operation devotes the largest portion of its force to customer output processing.

Concerning the $25 million CFO budget, that amount was for support services for the entire Finance Department. This budget amount was assigned to the CFO himself until a reasonable method of allocating these expenses to the other Finance subgroups could be established. This was done to keep better control over the distribution of these expenses on an interim basis.

As for the allocation factor, AT&T-C did not address this point in its rebuttal, but did in its brief. AT&T-C characterized the staff's rationale for rejecting revenue as an allocation factor as a "curious explanation of utility regulation." The following passage from the utility's brief sets out the argument of AT&T for use of revenues in allocating expenses:

> "AT&T Communications submits that the staff is wrong in rejecting the use of revenue as an element of the composite allocation factor. In the competitive environment which AT&T Communications now faces, revenue is perhaps one of the best measures of revenue-related expense generation.
>
> "The interexchange telecommunications industry is clearly not a cost plus utility operation. To

> survive in that rivalrous marketplace, AT&T Communications must specifically look to the results of a competitive marketplace and efficiently structure its organization to maximize its revenues. It is only proper in the competitive environment to allocate work force and channel efforts in support of the financial objectives of the company. Therefore, revenue should be allowed as one of the components in the composite and given the weight it deserves as one of the four indicators of the accountability, rather than being only a measure of the 'generosity of the regulatory agency.'"

During the cross-examination of the staff Finance witness, AT&T-C introduced an internal memorandum that reported an attempt by the utility to apply the Commission's standard[13] "four-factor" method of allocation. Not having gross plant (why this vital statistic should be unavailable was not explained) nor "direct" employees, AT&T-C substituted "assets" and employees. The resulting factor would have allocated 10.96% to California, rather than 8.74% allocated according to the AT&T-C method, thus indicating to AT&T-C that its method would be reasonable.

AT&T calculated its four-factor result as follows:

Assets	7.87%
Employees	10.34
Customers	16.96
Expenses	8.67
Composite	10.96%

The 16.96% customer factor seems extraordinarily high when compared to the other factors and the record does not explain how AT&T-C could serve 17% of its customers with less than 8% of its assets and only incur less than 9% of its expenses in serving them.

[13] The Commission's standard four factors are gross plant, direct number of employees, number of customers, and direct operating and maintenance expenses. (Direct operating and maintenance expenses exclude depreciation and administrative and general expenses.)

AT&T-C noted in its four-factor study "that the Marketing data provided to the staff identified a national total of 67,822,300 accounts and associated 11,502,583 of those with California (16.96%)."

A staff accountant was made available to answer questions of AT&T-C's counsel regarding use of the four-factor method. The staff accounting witness would not agree that the substitution of assets and employees would necessarily yield the correct application of the four-factor method.

In response to questions by the ALJ, the staff accountant testified that the four-factor method was questioned as to reasonableness in 1956 and that it has withstood Commission decisions since that time. The witness also testified that concern over the use of revenues in an allocation factor used for the purpose of establishing revenues was one of the reasons that the four-factor method was developed.

CMO Finance Department - Commission Discussion

Taking up the last item first, the staff has indeed correctly perceived the Commission's long standing rejection of revenue as an allocation factor. For nearly 30 years the Commission has consistently applied its standard four-factor allocation method to avoid the circular process of using levels of realized revenues to determine what levels of revenue should be realized.

Without some substantiation of the disproportionately high customer factor of 16.96%, however, the Commission cannot attempt to adapt its standard four-factor method to AT&T-C's allocators. It will, for this purpose only, therefore, accept the method used by the staff and make use of the 7.81% composite three factors used by the staff.

Considering next the nationwide forecast of the AT&T-C Finance Department, the Commission, for the purpose of this proceeding only, accepts AT&T-C's estimate. The Commission

recognizes that it is unlikely that AT&T-C would assemble an [illegible] accounting staff and then assign that staff to duplicating work done by the BOCs. Also, the Commission would require some analysis of the intended ultimate disposition of the $24 million that the staff proposes to eliminate from the CFO's budget. [illegible]

The Commission finds that $324,010,000 is, for the limited purpose of this proceeding, a reasonable estimate of the 1984 cost of AT&T-C's Finance Department, and $25,305,000 is a reasonable [illegible] allocation of that cost to total California operations. [illegible] CMO AT&T Corporate [illegible]

Headquarters - Differences

AT&T's Corporate Headquarters (CH) provides advice and assistance to the AT&T entities in legal, personnel, treasury, labor relations, public relations, and public affairs matters. In addition, CH furnishes financial advice and assistance, and pursues continuous fundamental research in the art and science of telephony.

AT&T-C allocated $23,370,000 of the CH costs to its California operations, of which the staff allowed $9,390,000. The staff's allowance was based on a 60% factor that was intended to exclude investor-related expenses, and duplicative and product development activities from the estimate. The staff estimate was developed consistent with the methods established by the Commission in D.90362, dated June 5, 1979, and used in D.93367, dated August 4, 1981.

D.90362 (1 CPUC 2d 488) was the first complete [illegible] investigation of the Bell System's license contract. In the summary

and conclusion of D.90362, on Pages 570 and 571, the Commission expressed its hope that, in future investigations, evidence and argument may be simplified by its determinations in that proceeding.

AT&T-C did not present an affirmative showing as to the reasonableness of its CH estimate, nor did it cross-examine the staff CH witness. Instead the utility presented as a rebuttal witness a member of AT&T-C's CFO organization who testified that the staff report merely used a 60% mathematical relationship between the amount not allowed in D.93367 and the license contract billing associated with that particular case. The Commission's action in D.93367 was based on circumstances unique to that case, he said, and it clearly has no application to the AT&T CH costs in these proceedings.

The organization of AT&T CH and the portion of associated costs funded by AT&T-C are significantly different from the organization and license contract costs that were the basis for the Commission's allowance in D.93367, the witness contended. For example, the adjustment in D.93367 that, he said, the staff used to develop its 60% recommendation contained the staff's General Department realignment adjustment, an adjustment for an organization change in 1980 designed to comply with the FCC's order in CI II. The organization and the situation that created this recommendation are present in AT&T CH 1984 costs, the witness asserted.

According to the AT&T-C witness the D.93367 license contract allowance also excluded product development and Bell Laboratory costs. No such costs are contained in the AT&T-C CH figure except for fundamental research costs.

The AT&T-C rebuttal witness testified that there are two different ways that CH costs differ from the old license contract costs. In performing license contract work, the AT&T General Department had more than 25 major organizations and 11,000 employees. In 1984, AT&T CH will have about 13 major organizations

and 1,700 employees. Moreover, he said, in D.90362, the Commission accepted staff recommendations involving organizations which the staff identified as performing product development or product-related activities, such organizations as Business Marketing, Business Services, Residence Marketing, and Network Planning Design. These organizations represent activities and costs that have no equivalent or counterpart in 1984 at AT&T CH, or in the costs allocated to AT&T-C, he declared.

The witness went on to say that in the past, the General Department of AT&T was funded exclusively by the regulated portion of the business. AT&T CH costs, on the other hand, will be shared by all AT&T entities not just the rate-regulated portion of the business. According to the witness, AT&T-C, the only rate-regulated portion of AT&T's business, is allocated less than half of the CH costs. As a result of these allocations, costs are assigned directly to Western Electric and to other AT&T entities.

As for funding methods, the witness testified, the funding of fundamental research costs differs from the funding for research under the license contract.

Fundamental research was historically funded by the regulated AT&T entities under the license contract. After divestiture fundamental research costs are also shared by the unregulated entities of AT&T. Less than half, 46%, of fundamental research costs are allocated to AT&T-C. The CH costs will be shared by AT&T-C, Western Electric, Bell Telephone Laboratories (BTL), 195 Broadway Corporation, AT&T International, AT&T Information Systems, and American Transtech Inc. Fundamental research costs will be shared by AT&T-C, AT&T International, and AT&T Information Systems.

The AT&T-C witness admitted, under cross-examination, that he had not examined the staff workpapers and was unsure just exactly how the staff witness had arrived at his 60% factor. In rejoinder the staff witness, a Certified Public Accountant, testified he had not simply used a 60% overall composite factor to determine his

allowance, but applied the principles of D.93367 on a departmental basis and broke out the budget that way. He specifically denied that he had made an exclusion for realignment or product development costs and he reproduced his CH workpapers which were received into the record as an exhibit.

CMO AT&T Corporate Headquarters - Discussion

From the above description of the differences between AT&T-C and the staff CH estimates, it is clear that the staff conducted as detailed a study of CH costs as it could and made a sincere effort to apply the license contract principles established in D.90362, and reiterated in D.93367, to AT&T-C's present operations. AT&T did not make a direct showing as to the CH reasonableness, despite the Commission's concern over this subject as evidenced by the two aforementioned decisions. Instead, after the staff presentation, AT&T-C's showing on rebuttal indicated that it had misunderstood the mechanics of the staff study.

The Commission recognizes that divestiture may well require some modification of the principles worked out in D.90362 and D.93367. The formulation of these principles required a considerable expenditure of the Commission's limited resources, however, and these principles are not to be abandoned on the mere assertion that things are changed. The Commission finds the staff total California CH allocation of $9,390,000 is reasonable for the purposes of this decision.

CMO AT&T Bell Telephone Laboratories and System Engineering - Differences

Estimates for Bell Telephone Laboratories (BTL) and system engineering (SE) were made separately but they are so closely related that they will be considered here together.

The BTL category applies to fundamental research funded by BTL. SE concerns itself with more practical applications.

As with the other CMO expense categories, the primary BTL and SE showing was made by the staff and rebutted by AT&T-C.

The staff BTL and SE estimates were taken by increasing 1983 costs by 8% and then, by following the guidelines for BTL that were laid down in D.90362 and D.93367, eliminating 50% of fundamental research and SE costs. The staff witness asserted that fundamental research and SE activities had not changed since the two previous landmark PT&T decisions and therefore the 50% factor is still applicable. AT&T-C estimated these costs by increasing 1983 BTL costs by 14.6% and SE costs by 11%.

A comparison of the two estimates, for total California operations, taken from Table 18, is shown below:

	AT&T	Staff
	($000)	
Bell Labs. (Fund Res.)	$10,420	$4,910
System Engineering	$20,910	$10,250

AT&T-C's BTL and SE witness is a Director - Network Capabilities Planning in the Planning Organization of AT&T-C. His organization develops the methods and procedures used in managing AT&T-C's overall BTL budget and he serves as project manager for the network services part of the Bell Labs program.

According to the AT&T-C witness, BTL's fundamental research has, contrary to the staff assertion, changed since divestiture. He testified that, while work in the fundamental research program is, in general, similar to work previously done as part of the license contract funded research program, the former research program included many areas of work now pertaining to the BOCs' operations that will no longer be included in the research program for 1984 and beyond. In addition, the research work on economic methods has been suspended because most of that work was being done specifically for the operating companies.

Historically, fundamental research was funded completely by AT&T through license contract fees paid by the BOCs and the Long

Lines Department of AT&T. Western Electric and other Bell subsdidiaries made no contribution toward these costs. Fundamental research activities were overseen by the AT&T General Department and BTL. Beginning January 1, 1984, however, funding was allocated among all of the AT&T affiliates, including Western Electric, AT&T Information Services, AT&T International, as well as AT&T-C. Under the new arrangement, AT&T-C funds less than half of the BTL fundamental research costs.

AT&T-C's BTL witness also rebutted the staff's SE showing. He testified that the staff conclusion was incorrect and that there will be substantial changes in SE. AT&T-C itself, and not the parent company, will define and manage BTL's work programs and will be the direct recipient of the work and its benefits. Before, AT&T's general departments proposed work programs. In addition, 1984 will include work that was not done before by BTL.

The AT&T-C's BTL witness was briefly cross-examined by staff counsel. In response to a series of questions concerning selection of areas of investigation which might be most fruitful, the witness responded that BTL alone determines those areas. AT&T-C might participate in the recommendation process; it does not participate in the decision-making process that develops the fundamental research budget.

The AT&T-C witness then went on to describe the SE work, which was classified as follows:

Forward looking work - 11%
Systems analysis - 59%
Proprietary development - 28%
Other - 2%

Forward looking work is the analysis of new ideas to see if they would be applied to the AT&T-C communications network. Systems analysis is engineering staff work to develop plans, procedures, methods, and specifications for AT&T-C. Proprietary development is

design and development of hardware and software to provide switching and transmission capabilities and operating support systems. AT&T-C pays for this work "in order to maximize benefits to its ratepayers rather than to any manufacturer."

The AT&T-C witness concluded his testimony by stating that the funding of fundamental research, and of the related item, system engineering, is reasonable and appropriate since it directly benefits the California ratepayer. He recommended that the Commission should allow, as operating expenses, the cost of these activities as allocated to AT&T-C's California operations and as included in the company's results of operation showing.

CMO AT&T Bell Telephone Laboratories and System Engineering - Discussion

The AT&T-C witness emphasized, and AT&T-C repeated in its brief, how the role of BTL has changed with divestiture and why all fundamental research and systems engineering costs should now be passed through to the ratepayers. The staff was not impressed and neither is the Commission. As the staff argues in its brief, it is evident that the same basic procedures are being utilized to determine ongoing research budgets and the primary benefit test established in D.90362 and followed in D.93367 is still valid.

The primary benefit test requires that "if an expenditure's purpose is not shown to be directly and primarily beneficial to the ratepayers, it should not be charged to them" (D.90362, 1979, 7 CPUC 2d, 488, 499). The Commission's procedures for dealing with the complex organizational structure of the Bell System required an enormous expenditure of time and effort over a period of more than 50 years. The Commission recognizes that divestiture has changed the relationships between BTL and the former BOCs. AT&T still owns BTL, Western Electric, and AT&T-CI (the transformed Long Lines Department), however. The problems caused by subsidiaries of a holding company

dealing with each other at less than arm's length in intercompany transactions remain. Under the circumstances the Commission will retain the D.90362 and D.93367 principles and the 50% factor and finds the staff total California allocation of $4,910,000 for BTL and $10,250,000 for SE to be reasonable.

CMO Public Relations - Differences

In addition to the public relations activities included in the CE estimate, AT&T-C proposes to allocate the cost of another $1,740,000 of public relations (PR) to its total California operations. The staff provided no allowance for this item.

PR consists of media relations, community relations, briefings, tours, corporate contributions, employee communications, executive speeches, and public opinion research.

The staff, as was customary in this proceeding, made the first definitive study of PR and provided no allowance for PR because it considered activities such as community relations, tours, corporate contributions, and public opinion research to be investor-related expenses. Investor-related expenses have been consistently excluded for ratemaking purposes by this Commission.

AT&T-C's public relations estimate was based on AT&T's PR experience, except for approximately $390,000 which was included because of AT&T-C's uncertainty of the 1984 environment. As AT&T-C used a tops down budget approach, individual activity budget levels were not provided to the staff. The staff was merely provided with a list of activities, without explanation or supporting documentation.

While undergoing cross-examination on his PR recommendation, the staff witness was asked to read a list of activities involving the dissemination of factual information to investors and customers. The witness agreed that, had he had the required justification, he would have allowed the costs of these activities.

AT&T-C, again, as was customary, made its first definitive showing on rebuttal by an AT&T-C Director of Public Relations. The director denied that the majority of AT&T-C's PR were investor related. He testified that:

> "The mission of the AT&T Communications' Public Relations Department is to establish and maintain communications with many groups including customers, the media, consumer groups, employees, the general public and special interest groups, such as the handicapped and the elderly. To establish effective two-way communications with these groups, we provide complete, timely and accurate information about AT&T Communications' services, products, rates, policies and procedures. Equally important, we ensure that the needs and concerns of these groups are heard and considered by the management of the business in its decision-making process. This mission is clearly directed at more than just investors' interests."

Noting that the staff had repeated that it had not been provided with a full explanation of AT&T PR, he described the major functions of the PR Department as media relations, employee communications, consumer relations, community relations, executive communications, research and planning, and executive briefings. He then broke the PR budget into the following percentages:

Media Relations	29%
Employee Communications	25%
Consumer Affairs	10%
Community Relations	20%
Executive Communications	2%
Research and Planning	2%
Executive Briefings	2%
Miscellaneous	10%

The Director then went on to describe the activities in detail. In addition to press agentry, the activities include employee publications and videotapes, participation in consumer group functions, preparation of speeches for delivery by company officers for internal and external audiences, handling of customer complaints, briefing of national and local power structures, and "research, employing recognized behavioral and social science techniques

conducted to ascertain the views, position, reactions, and attitudes of customers and employees on subjects relating to provision and use of long distance services."

AT&T Public Relations -
Commission Discussion

By its own testimony, AT&T-C makes clear that most of its public relations program is directed at areas traditionally considered "below-the-line" by this Commission. We will disallow these expenses for AT&T-C following our prior precedents. AT&T-C may well believe that public relations expenses are in its corporate interests, however, unless a clear benefit to ratepayers is demonstrated, ratepayers should not be required to pay these expenses.

CMO Adopted Allocations

Table 20 summarizes the Commission's adopted reasonable 1984 total California allocations of AT&T's CMO expense. The adopted $148,915,000 allocated to California Intrastate Operations becomes $51,317,000.

Table 20

AT&T COMMUNICATIONS

Central Management Organization

Commission Adopted Allocations

1984 Estimated Total California Operations

	AT&T-C Nationwide Forecast	AT&T-C California Allocation	Staff California Allocation	Commission Adopted Total California Allocation
		($000)		
Marketing	$1,190,940	$135,460	$ 38,000	$ 67,500
Advertising	409,050	46,590	15,000	
Finance	324,010	28,570	19,280	25,305
AT&T Corp. Head.	268,400	23,370	9,390	9,390
BTL (Fund. Research)	139,500	10,420	4,910	4,910
Public Relations	20,000	1,740	0	0
Systems Engineering	280,000	20,910	10,250	10,250
Subtotal	2,631,900	267,060	96,830	117,355
Other (Uncontested)	N/A	31,560	31,560	31,560
Total	N/A	298,620	128,390	148,915

N/A - Not available

The elements of results of operations that are dependent on the CMO allocation will be shown in the section of this decision dealing with adopted results for AT&T-C.

Rate of Return for AT&T-C

In D.83-12-025, the Commission, after considering voluminous testimony and discussing the matter at length, found that a reasonable rate of return to be applied to PT&T's California intrastate base was 12.70%. In the companion access charge decision, D.83-12-024, the Commission applied a 2% increment to the 12.70% reasonable rate of return for the purpose of calculating the revenue requirement associated with intrastate access charges.

In recommending "a surrogate rate of return 2% above the return authorized for Pacific's overall operations" the staff noted that "the effect would not be to increase Pacific's overall rate of return but rather to shift revenue requirement to the higher risk access services and away from the more stable local services." (D.83-12-024, p. 101.)

The Commission observed that: "The appropriate rate of return for Pacific's access services investment may not be the same as that for AT&T's toll services, but should probably reflect the risk of all participants in the toll service market " (D.83-12-024, p. 105) and concluded that discussion by stating:

> "Staff proposed its 2% increment as a surrogate for interim purposes. We will approve that proposal on an interim basis pending further consideration of the appropriate rate of return for Pacific's access services investment in the subsequent phase of this proceeding." (D.83-12-025, p. 105.)

In all of the recasts and revisions of its showing, AT&T-C consistently used the 13.49% rate of return that PT&T requested in Phase I of these proceedings. It also used 13.49% in the revenue requirement summary tables that it presented in the brief. In the text of the brief, however, AT&T-C discusses the risks it now faces,

new risks that include, but are not limited to, the risks of being a new organization, the risks of competition, technological risks, regulatory risks, and the unique risks inherent in AT&T-C's financial structure. AT&T points out that, because of its small ratio of rate base to revenues, an increase of 2 percentage points over the PT&T return would only increase AT&T-C's revenue requirements by approximately .4%. This increase would result in a very small cost increase to the customer but AT&T-C believes it would be given significant consideration by investors. According to AT&T-C the provision of an adequate return for the risks inherent in the business to the investors would result in making equity, and indirectly debt, more readily available to AT&T-C.

In making this proposal in its brief, rather than by evidence in the proceeding, AT&T-C has again demonstrated that it is evidently unaware that this Commission's decisions are required to contain separately stated findings of fact and conclusions of law by the Commission on all issues material to the decision (PU Code § 1705). There must be assurance that the Commission, as an administrative agency, has made a reasoned analysis of the facts before it and reached valid and logical conclusions. (California Motor Transport v PUC (1963) 59 Cal 2d 270.) At a very minimum, before it can make a proper finding as to a new rate of return, the Commission must receive evidence concerning the Hope (Federal Power Commission et al. v Hope Natural Gas Co. (1944) 320 US 591, 605, 88 L.Ed. 333, 346) and Bluefield (Bluefield Water Works and Improvement Company v West Virginia Public Service Commission (1923) 262 US 679, 692, 693, 67 L.Ed. at 1176) factors, as discussed in D.83-12-025 (p. 133). No such evidence for AT&T-C has been presented in these proceedings.

The staff, in its showings of AT&T-C revenue requirement, used the Recast 3 12.70% established for PT&T in Phase I of these proceedings. The Commission agrees that this is the correct rate of return for both PacBell and AT&T-C's Recast 3 1984 results. PacBell

and AT&T-C are both successors to PT&T's telephone operations. The same 1984 attrition mechanism is being applied to their intrastate operations, and these operations are the share of each of the new utilities in the old PT&T operation. D.83-12-024 made it crystal clear that the 14.70% was merely a surrogate rate of return used in internal cost allocation. It was accepted by the Commission on the recommendation of a witness nationally recognized as most skilled in the practice of the arcane art of telephone separations. Although that witness, a staff engineer of long experience and outstanding reputation, is preeminently qualified in the separations field, his testimony was confined to his field of expertise, separations, and it would not become the Commission to construe his recommendation of an appropriate separation factor as indicative of a duly qualified financial expert's opinion on the overall rate of return that would be sufficient to enable a utility to maintain its financial integrity, to attract capital, and to compensate investors for the risks assumed.

Until such time as it is in a position to make a reasoned and definitive finding based on financial evidence regarding a new reasonable rate of return for AT&T-C, the Commission finds it reasonable to apply the D.83-12-025 rate of return of 12.70% to AT&T-C's Recast 3 results and then reduce the revenue requirement thus determined to reflect D.84-04-104.

The Commission further finds the revenue requirement thus determined to be reasonable.

Underutilized Plant Adjustments

In D.83-12-025, the Commission found that PT&T had $483.5 million in its intrastate rate base that will be underutilized in 1983. The Commission further found that the underutilization resulted in part from imprudent management and that PT&T should be allowed to earn only half of the authorized rate of return, or 6.35%, on this underutilized plant.

In Phase II, the staff allocated 92% the underutilized plant penalty to PacBell and 8% to AT&T-C and carried the annual gross revenue effects forward into 1984, for recommended gross revenue reductions of $41,737,000 for PacBell and $3,750,000 for AT&T-C. Although not conceding the issue, PacBell did not contest the penalty adjustment in Phase II. AT&T contested both the concept and the amount, which AT&T claims should only be $1,400,000.

As to the concept, AT&T-C, in its brief, argues that the staff has failed to show inefficiency, imprudence, or bad faith in AT&T's role in PT&T's construction budget. AT&T-C also states that the staff incorrectly assumed that plant assets transferred to AT&T-C were part of PT&T's underutilized plant.

AT&T-C did not offer any rebuttal testimony in support of its contentions, nor, in its brief, did it explain why an imprudent investment immediately becomes prudent upon being separated from the imprudent investor. Neither did AT&T-C produce evidence to show that none of the underutilized plant was transferred to AT&T-C pursuant to the divestiture, but rather AT&T-C asserted that claim in its brief where it was not exposed to the test of cross-examination.

As to whether the transfer of ownership somehow cleanses the investment of the taint of imprudence, the Commission has found, long ago, that the mere existence of underutilized plant is sufficient reason for exclusion of plant from rate base. Commissioner Edwin O. Edgerton, in a Report of the Commission, said:

> "Obviously, in determining what rates are proper and reasonable under the conditions existing at the present time, it will be necessary to exclude the nonoperative property and the excess plant capacity over and above that which is necessary at this time to provide proper and adequate service to the present consumers of the consolidated company, after making adequate provision for reserve facilities to take care of operating contingencies, and prospective increases in business." (D.3624, dated

September 1, 1916, in A.1625 and C.675, 676, 677, and 711, In re Northern California Power Company, Consolidated, 11 CRC 37, 61-62.)

If the plant is not utilized at a reasonable and proper level, and if it has been conclusively shown the plant investment was, at the time incurred, an obviously wasteful or imprudent expenditure, it is not reasonable to call upon the ratepayer to provide a full rate of return on it, regardless of the innocence of the subsequent owner.

In the absence of competent expert testimony to the contrary, the Commission reaffirms its Phase I finding that a portion of the former PT&T plant now held by AT&T-C is underutilized. The Commission again finds that the underutilization of plant results in part from imprudent management by its former owner, and finds the rate of return applied to the underutilized plant should be reduced by one-half to 6.35% and the amount thus determined adjusted to accommodate D.84-04-104.

The question remains as to whether the PacBell staff computation of the amount of the penalty is correct. The staff, in its final AT&T-C California intrastate revenue requirement determination, merely allocated to AT&T-C 8% of the $47,588,000 PT&T intrastate penalty determined by D.83-12-025. The 8% is the percentage of PT&T's total plant assets that were transferred to AT&T-C.

AT&T claims that this disregards the fact that, whereas 74.07% of PT&T's plant was intrastate, only 25.35% of AT&T-C's is. Under cross-examination by AT&T-C, the staff witness seemed to concede this fact and concluded that only 3% of the penalty should go to AT&T-C, the remaining 97% to PacBell. The penalty to AT&T-C under this allocation would be $1,400,000.

Although the staff has apparently agreed with AT&T-C, the Commission is of the opinion that neither AT&T nor staff is correct.

What must be allocated is the underutilized plant causing the penalty, not the penalty itself. The penalty follows the plant. There is no evidence that the transferred plant's usage has changed; the separation factors for the plant categories remain the same. The plant that usage indicated was intrastate remained intrastate, regardless of ownership. The mix of the plant changed, however, 16.4% of PT&T's COE is being transferred to AT&T-C but only 1.2% of outside plant. By computing the penalties associated with each of these plant categories, and combining them, the Commission determines that the $483,500,000 of underutilized PT&T intrastate plant should be allocated $461,700,000 to PacBell and $21,800,000 to AT&T. The associated penalties at 6.35% then become:

PacBell	$45,439,000
AT&T-C	2,149,000
PT&T	47,588,000

The Commission finds these penalties in harmony with its intentions in D.83-12-025 and, when modified per D.84-04-104, to be reasonable.

Adopted 1984 AT&T-C Results and Incremental Revenue Change Indicated

Table 21 shows the combination of Commission adopted California Recast 3 intrastate divested AT&T-C and allocated CMO results to obtain the jurisdictional Recast 3 results of operation.

Table 21

AT&T COMMUNICATIONS

Adopted 1984 Results of Operations

California Intrastate Operations

Recast 3

	Divested AT&T-C	Central Management Organization	Recast 3 Total
		($000)	
Total Revenues	$1,819,385	$	$1,819,385
Expenses and Taxes			
Depreciation	17,585	11	17,596
Relief and Pensions	20,455	6,341	26,796
All Other Expenses	1,584,447	51,317	1,635,764
Operating Taxes - CCFT	15,799	(5,698)	10,101
FIT	71,968	(24,680)	47,288
Social Security	4,852	1,681	6,533
Other	2,466		2,466
Total Operating Expenses & Taxes	1,717,572	28,972	1,746,544
Balance Net Revenues	101,813	(28,972)	72,841
Rate Base			
Average Plant in Service	353,413	302	353,715
Average Plant Held For Future Use			
Working Cash	47,020	1,679	48,699
Material and Supplies	1,461		1,461
Less: Depreciation Reserve	64,400	41	64,441
Less: Deferred Tax Reserve	35,433		35,433
Total Intrastate Rate Base	302,061	1,940	304,001
Realized Rate of Return	33.71%		23.96%

( ) Denotes negative amount.

Table 22 shows the determination of the reasonable revenue requirement for AT&T on a Recast 3 basis and the $73,128,000 Recast 3 reduction in AT&T-C's revenues indicated by the determination.

Table 22
AT&T-COMMUNICATIONS
Adopted 1984 Incremental Revenue Requirement
California Intrastate Operations
Recast 3

Revenue Requirement Calculation	($000)
Intrastate Rate Base	$304,001
Times: Proposed Rate of Return	.1270
Equals: Net Revenue Requirement	$ 38,608
Minus: Balance of Net Revenues	72,841
Equals: Inc. in Net Rev. Reqt.	$(34,233)
Times: Div. Net-to-Gross Multiplier	2.0734
Equals: Inc. in Gross Rev. Reqt.	$(70,979)
Underutilized Plant Adjustment	(2,149)
Indicated Incremental Gross Revenue Change	$(73,128)

( ) Denotes negative amount

The Commission has discussed all of the contested issues involved in this revenue change determination. There are, of course, relatively minor estimating differences that were not contested. After giving consideration to the unusual format of the AT&T-C portion of these proceedings, and the consistency and stability of the staff showing, as compared to the fluidity of the AT&T-C showing, the Commission adopts the staff versions of uncontested figures.

As with the PacBell revenue change, AT&T's Recast 3 results will be affected by the D.84-04-104 change in rate of return. The following calculation makes the adjustment required by D.84-04-104:

Recast 3 Revenue Change	$(73,128,000)
D.84-04-104 Revenue Effect	(375,000)
Final Revenue Change	$(73,503,000)

The Commission finds this final ongoing revenue change of $73,503,000 to be reasonable.

V. ATTENDANT REVENUE REQUIREMENT MATTERS

1985 Attrition - Issues

The issue of 1985 attrition was raised on September 23, 1983, when a PT&T Assistant Vice President - Financial Assurance distributed an exhibit and supporting prepared testimony revising PT&T's previous 1984 attrition proposals and, in addition, proposing that a 1985 attrition mechanism be implemented for PT&T's successor (which had not yet been named PacBell). The 1985 attrition mechanism proposed for PacBell is similar to the mechanism proposed for 1984 by PT&T but with modifications for expected discontinuities due to divestiture.

Although the staff initially had some reservations about the relevancy of a 1985 attrition mechanism, the staff, after considering the issue, came around to a position of support of PacBell's concept but differed on the specific mechanism to be used.

PacBell explained, in justification of its proposal, that the test period for the current rate case is 1983. Under the two-year minimum filing interval provided by the Commission's RCP, PacBell would be able to file again using a 1985 test period. For

rates to be effective on the first day of 1985, the filing should have occurred before PT&T's proposal. Such a filing obviously had not been made, and, with the work load then facing the Commission, the PT&T witness considered it doubtful that a 1985 test year filing could be thoroughly reviewed in the immediate future.

On January 6, 1984, after the effective date of divestiture, the staff distributed prepared testimony and an exhibit presenting the staff's 1985 attrition mechanism. The staff witness, a Supervising Utilities Engineer from the Commission's Revenue Requirements Division, concurred with the utility's appraisal of the chances of getting formal rate relief and gave five major considerations which he maintained favor the use of an attrition mechanism rather than a general rate case:

1. A 1985 attrition year filing is the only hope for a timely 1985 decision. Should PacBell decide to proceed with a rate case on the January 6 date of the staff exhibits, no decision would likely be rendered until about the fourth quarter of 1985.

2. A 1985 test year filing would be based on insufficient information. A decision to proceed on a 1985 test year filing would enable PacBell to use recorded data through approximately the end of 1983 and thus no recorded data on actual post-divestiture operations would be considered. Beside not having recorded data, PacBell's management and other personnel would not have experience in post-divestiture operations. With a 1985 test year the Commission staff would likewise have little surveillance experience in post-divestiture operations. In contrast, use of a 1985 attrition mechanism would allow both company and staff to consider about seven or more months of recorded data in processing an advice letter filing.

3. A 1985 test year might lock in inefficiencies. Even if recorded data were available through much of 1984, it might be

prudent not to rely on such data for a 1985 test year. Any company could be expected to be considerably less efficient during the start-up period following a reorganization as complex as divestiture, and it would probably be advisable not to lock in that inefficiency for test year 1985 and a subsequent 1986 attrition year. A 1985 attrition approach would project the Commission's 1984 adopted results for only one more year.

4. PacBell's 1985 (and perhaps 1987) NOI[14] would not reflect the effects of preceding decisions. A final decision on PacBell's 1984 attrition year is expected in May 1984. PacBell would be unable to reflect that decision in an NOI filing for 1985 unless it considerably delayed the NOI tendering. Likewise, assuming that PacBell goes ahead with a 1985 test year as soon as possible and that it gets back on schedule with a 1987 NOI filing, the 1987 filing would be tendered at about the same time a decision is rendered in 1985. The 1987 filing would thus likely be delayed or not reflect results of the 1985 decision.

5. A PacBell 1985 test year filing would critically strain staff's resources. GTC is the other major communications utility covered by the Commission's RCP. The Commission is currently hearing GTC's 1984 test year and 1985 attrition year general rate application. Should GTC tender a 1986 test year NOI about September 1984 on the schedule contemplated by the RCP, it would generate a heavy staff work load from about September 1984 through July 1985. Additionally Continental Telephone of California filed a general rate increase application on December 29, 1983. Should PacBell file a 1985 test year NOI, these overlapping work loads would impose a critical strain on the resources of the Commission's technical staff.

[14] NOI is an acronym for Notice of Intention, the first step under the Commission's RCP of the rate increase seeking process.

Although the staff agreed with PacBell's concept of an attrition mechanism for 1985, it differed in several of the major components of the mechanism. These differences were: (1) a base year adjustment for labor and labor overheads; (2) the method used to project plant in service; (3) the imputation of additional interest expense for tax calculations; and (4) "above the line" treatment of contracts for facilities leased to AT&T.

The third and fourth of these differences have been discussed and resolved elsewhere in this decision and at this point are now moot. As to the second, the staff projection used the same plant in service component advocated by PT&T and accepted by the staff for use in determining 1984 attrition, but modified it for divestiture-caused discontinuities. PacBell, however, proposed use of its construction budget. This the staff would not accept because of its opposition in principle to any mechanism that could enable the utility to affect its attrition award by manipulating inputs. Additionally, as the staff's underutilized plant study showed, prior years' views of the construction budget have not historically been accurate predictors of levels subsequently realized.

PacBell's attrition witness testified that he had no strong objection to the staff's plant projection method and this position was confirmed in PacBell's brief.

PacBell objects most strenously to the staff's proposal for a base year adjustment. The staff recognized that the Commission, in recent decisions, has embraced the concept of a base year adjustment, that is, revising the adopted base year to reflect later information on labor and nonlabor escalation in the determination of the attrition year final revenue requirement.

The staff advocates base year adjustment to the degree feasible in this case. For the labor and labor overheads component, the staff believes that it should be possible to make such an adjustment to whatever 1984 level is adopted by the Commission in this decision. The staff proposes that the labor and labor overheads component be determined by backing out the 1984 over 1983 escalation in the figures adopted by the Commission in this decision and reinflating the result by a factor representing the most recent estimate at the time of the company's filing in about October 1984. This factor would be determined by using actual wage and salary increases (per worker) through the first part of 1984, and the existing labor contracts and the latest labor escalation and CPI projections for the remainder of 1984. Labor escalation and CPI projections would be supplied by the Economics Unit of Revenue Requirements Division.

The staff does not propose adjustment of the other components of the mechanism because a nonlabor base year adjustment from 1983 to 1984 would not be possible because a uniform escalation method for the various cost elements was not used. In future PacBell rate cases, staff states that it will attempt to ensure that estimating methods are employed which facilitate a nonlabor base year adjustment.

PacBell contests application of this selective base year adjustment for the labor component. The utility contends that it is fundamentally unsound to isolate a single element in the adopted results and to adjust that item exclusively without adjusting other items. The changes in the economy which would account for the labor rate base year adjustment would affect all components of PacBell's adopted results, not just the labor component in isolation. The staff witness acknowledged the fact that these economic changes would

be reflected in changes in such items as volumes, access line growth, etc. To adjust the adopted labor expense to incorporate later data would, PacBell argues, produce a mismatch of revenues and expenses. To ensure internal consistency either the labor rate base year adjustment should not be adopted by the Commission, or the attrition mechanism should be based on the use of all actuals for the test year.

The staff submits that the reliability of 1985 attrition projections will be crucially dependent on the availability of recorded data on post-divestiture operations. Accordingly, the staff recommends the following timetable:

Late July and August 1984: Staff and company meet to review company's proposed attrition calculations prepared with preliminary results through June. Work out any differences.

September 1984: Company finalizes advice letter using actual data through July.

October 1, 1984: Company files advice letter.

October 1984: Staff evaluates advice letter with company provided August data for reference, and prepares Commission resolution.

Late November 1984: Presents to the Commission for action.

The staff maintains that its recommended procedure is consistent with the idea that an attrition mechanism should not contain controversial elements requiring lengthy evidentiary hearings. Since this is the first time an attrition mechanism procedure would be applied in the case of PacBell, and given the upheavels following divestiture, the staff suggests that the Commission may wish to hold brief hearings to satisfy itself of the advice letter filing.

TURN and the Cities objected to any provision for 1985 attrition at all. On January 12, 1984, TURN and the Cities moved to strike the 1985 attrition proposal of the Commission staff. Denial of this motion by the ALJ left the disposition of this issue to the Commission.

The Cities argue that the Commission did not specify 1985 attrition as an issue in Phase II of these proceedings and the Commission has never recognized attrition beyond a single year. The allowance has always been limited to the year following the test year. The Cities do not take the position that granting a 1985 attrition allowance is necessarily wrong. This issue can only be handled in a separate proceeding where the Commission for the first time can have the advantage of a competent evidentiary record. The Cities contend that, if PacBell believes that an attrition proceeding is preferable to a general rate case in 1985, the company should file for an attrition allowance for 1985.

1985 Attrition Discussion

The Commission has three 1985 attrition issues before it: should there be an attrition mechanism provided for 1985; if one is provided, should it have a base year adjustment for labor and labor overheads; and, are elements of the proposed 1985 attrition mechanism reasonable?

As to the notions that the Commission is somehow constrained from establishing a second attrition year merely because it has never done so before or because it did not specify attrition as a Phase II issue, the Commission rejects both these contentions. Counsel for the Cities cited no authority for his arguments. The Commission is attempting to modify its procedures to provide flexibility to accommodate turbulent times. Attrition mechanisms are but one of these attempts. The statutory requirements for notice to customers, and also those that any change in revenues be based on findings supported by a showing remain just as effective for an attrition mechanism filing as for a general rate case.

Under the circumstances of divestiture a mechanism for 1985 attrition, for the reasons advanced by the staff, is reasonable, and the Commission so finds.

Having decided to proceed with an attrition mechanism for 1985, the Commission must next decide whether to make a base year adjustment for labor and labor overheads. The staff notes that the Commission has, in recent decisions, revised the adopted base to reflect later information on labor and nonlabor escalation to determine the final year revenue requirement. In making its proposal, the staff is conforming to a practice recently adopted by the Commission in an attempt to find a practical method for recognizing economic changes between general rate cases.

The Commission finds the staff's proposal to incorporate a base year adjustment for labor and labor overheads is reasonable and adopts it for use by PacBell in 1985. The remaining portions of the 1985 attrition proposals contain the same high escalation factors which we reject for the 1984 attrition calculation. We likewise cannot accept their use in 1985.

As discussed above, we will order further hearings on the appropriate methodologies which should be used in setting a 1985 attrition allowance.

If AT&T-C wishes to request a 1985 attrition adjustment, it should do so in this forum. Should PacBell or AT&T-C not file for a 1985 attrition adjustment, the Commission may examine the need for rate changes, up or down, on its own motion.

Female and Minority Business Enterprise - Issues

By D.82-12-101 issued December 22, 1982, in C.10308 (filed April 12, 1977), the Commission directed major utilities, including PT&T, to include information regarding costs and programs for doing business with F/MBE in their next rate case NOI filing. On January 31, 1983, PT&T filed a report in compliance with D.82-12-101.

In the course of Phase I, PT&T presented a Division Staff Manager - Procurement, who supported the utility's F/MBE program. Subsequently, a staff research analyst recommended long-term procedures for a consistent method of reporting and monitoring PT&T's accomplishments in the F/MBE program. A substantial amount of cross-examination took place, including examination of the staff proposed form to be filled out by those vendors qualifying as F/MBE wishing to do business with PT&T. After some discussion, it was concluded by the ALJ that the differences between the company and staff could best be worked out through informal conferences and some common resolution reached outside the adversary hearing process. Should such a

resolution be reached, a concurrent staff-company recommendation would be presented on the record during the couse of hearings in Phase II. The Commission accepted the ALJ's conclusion, but noted in D.83-12-025:

> "We intend to address the F/MBE issues in the divestiture phase. Staff should report on the status of its discussions with Pacific and present any resolution on the record at that time. The parties should not interpret our deferral of this matter as a lessening of our commitment to ensure equal opportunity in Pacific's F/MBE program. Last December, we established a procedure for reviewing such programs in the context of each utility's general rate case. Pursuant to this procedure, we are now examining the programs for Pacific Gas & Electric Company, San Diego Gas & Electric, Pacific Power & Light Company, and General Telephone. We intend to do the same for Pacific Telephone."

The staff, in response to this directive, proceeded to draft a "tracking" form acceptable to PT&T's successor, PacBell, and the research analyst presented it at the January 9, 1984 hearing. The form classified the utility's procurement expenditures into four categories: commodities, services, construction, and miscellaneous. These categories were then, in turn, classified into total, female, and minority.

The sum of female plus minority procurement expenditures was then divided by the total to get the expenditures with female plus minority companies as a percent of total.

Counsel associated with Law Offices of Public Advocates (PA), representing several minority ethnic groups, protested the tracking procedure's lack of a breakdown into specific ethnic classifications and into specific types of contracts. Counsel requested that a future hearing be scheduled for a presentation by minority groups and that PacBell and the staff also be required to supply witnesses. His request was reinforced by individual letters

from PA's clients. Upon concurrence of the assigned Commissioner, the ALJ set a special hearing for February 21, 1984, for the purpose of receiving recommendations from the clients of PA. Because the date of the special hearing was scheduled only three days before the scheduled date for filing of briefs, the ALJ, as representative of the assigned Commissioner, excluded the F/MBE issue from the written briefs, substituting instead oral statements at the oral replies scheduled for March 2, 1984.

At the special hearing, counsel for PA presented the president of the San Francisco Black Chamber of Commerce, the executive director of the Sacramento Urban League, the national president of the League of United Latin American Citizens (ULAC), and a student at the Hastings College of Law, University of California. PacBell recalled PT&T's Division Staff Manager - Procurement who now continues his duties for PacBell as Division Staff Management, Procurement Support. The staff did not volunteer, nor did the ALJ require, the recall of the staff witness as requested by PA.

Although naturally differing in details, the main thrust of the testimony of the witnesses called by PA was to the absence of a breakdown by ethnic groups. The lack of data prevents comparison of the progress of the several minorities in receiving a share of PacBell's procurements. In addition, the lumping together of majority group females with ethnic minorities tends to mask the progress of ethnic minorities. According to one witness, where such a tracking practice is used, the preponderance of contracts goes to majority group females rather than to ethnic minorities.

The ULAC national president[15] described his efforts and negotiations with large corporations (including PT&T), financial institutions, and governments of the southwestern states regarding equal opportunity

[15] The ULAC national president had been Secretary of Health and Welfare for the State of California from 1975 to 1982.

for minorities. The ULAC president testified that the Hispanic community would find it beneficial to have specific information as to where its people stand in regards to being given opportunity. In addition, it would be helpful to have more specific information as to contract categories, such as for legal, accounting, real estate, or insurance services, so that his group and the Mexican-American Legal Defense Fund, which he also represented, could affirmatively seek out and recruit people for work or economic opportunities. Generally he has been successful in these efforts.

The ULAC president also testified that his groups disputed the absence of any short- or long-term goals by PacBell, or the other utilities. He saw goals and timetables as a measure that can be looked upon for achieving desired results. As an example of specific goals, he described an agreement that he, the president of Operation PUSH,[16] and the president of the National Hispanic Leadership Conference concluded with the management of the nation's largest chain of convenience stores. This agreement called for minorities to receive generally 23% of total employment opportunities, purchase of goods and services, and new store franchises.

The ULAC president concluded by suggesting that, for ethnic reporting categories, PacBell should adapt the categories used by the state Office of Economic Opportunity and that affirmative action be the responsibility of the company's chief executive officer.

The law student from Hastings, who was serving as a student intern at PA, testified regarding the results of a telephone survey he had made of large publicly owned facilities. These agencies, although falling short of their goals, reported substantial amounts of purchases from minority vendors. The witness, however, was unsure whether very large capital item purchases were included in his survey.

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[16] The president of Operation PUSH, an ordained minister, is presently an active candidate for the Democratic Party nomination for President of the United States.

The PacBell witness was called by PA and at this point on the record presented no direct testimony. He said that, of 1983 $1.8 billion of purchases of goods and services, minorities and females received $77 million. (This $1.8 billion of purchases excluded fuel, payments to other utilities, and franchise fees but did include payments to Western Electric.)

According to the PacBell witness, the reporting forms used by the utility indicate the minority status of bidders but no data regarding successful contractors. The company was, however, developing a format to accommodate those data. The witness did not believe that this information would be of value unless it could be compared with the number of available minority vendors and contractors.

The PacBell witness saw difficulties in having more than the four purchase categories now being proposed by the company. A more detailed breakdown would require more judgment determinations by clerical personnel and would be more costly. He questioned the value of that procedure relative to the cost of only providing four categories.

To a question by PA counsel, the witness responded that he did not favor setting specific minority contract goals for managers because they are held accountable for obtaining the products that they are responsible for at the lowest overall cost. As for large purchases, such as switching machines, there are no minority vendors available. He knows of three minority cable vendors, however, and in 1983 PacBell did business with two of them. Because of the difficulty of finding minority vendors, he is experiencing difficulty in expanding a minority business program.

At the conclusion of his examination of the PacBell F/MBE witness, counsel for PA stated the position of his clients as follows:

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[16] The transcript of September 20, at pages 1[illegible] contains an offer of proof by counsel for PA concerning the testimony of witnesses to be called behind that statement.

1. These minority classifications should be accepted:
   a. Black
   b. Hispanic
   c. Asian
   d. Native American.
2. Contract and purchase categories should be established for each natural category in which $1 million or more of business was done in the prior years.
3. Each utility should be required to develop specific goals and objectives for a five-year period to provide a mechanism for measuring progress. Objectives would not be separately stated for each minority but one objective set for all minorities and another objective set for women. Reporting, however, would be quarterly or semi-annually by minority ethnic groups. The decision to specify goals for specifc minority groups should be deferred for five years.

At the conclusion of the special hearing, counsel for AT&T-C reviewed how AT&T-C became drawn into the hearing and thus into this issue. She said that the company and its predecessor have maintained an active minority and female business enterprise program. This program includes outreach efforts to identify minority and female vendors and to encourage them to participate as suppliers and contractors. Counsel questioned whether additional reporting requirements were appropriate now that AT&T-C is a competitive business that is experiencing competition from five other interLATA carriers. If the Commission were to impose additional reporting requirements on AT&T-C, it should impose them on the competitors also, although AT&T-C suggests that it would be appropriate to move in a direction of more flexible regulation and reduced reporting requirements.

F/MBE Discussion

The joint staff-PacBell tracking form would provide no specific ethnic information that would permit the representatives of the specific groups to track their constitutents' interests. Thus, the proposed "tracking" form would fail in its stated intentions. In order to have anything to track, there must be goals and there must be data to measure progress towards the stated goals.

The ethnic classifications proposed by PA seem generally reasonable but they are imprecise. The staff, at the ALJ's instructions, introduced the ethnic classifications and codes specified by the State for use by its agencies, including this Commission, to collect and report data on contracts or subcontracts for property and services placed with small business, minority, and women-owned business enterprises. The Commission has experienced no difficulty with these reporting classifications and is confident that PacBell will not either. The Commission finds them reasonable for use by PacBell.

As for the reporting categories, the four used by PacBell are obviously overbroad. The $1 million purchase criterion proposed by PA is, on the other hand, too narrow. We will adopt a $5 million purchase criterion subject to changes which may be required.

Reporting quarterly is too frequent. The Commission finds semi-annual reports to be reasonable.

Goals are a must if progress is measured, after meeting and conferring with authorized representatives of recognized minority and women's groups, PacBell should establish F/MBE goals for year 1986 and include them as part of its 1986 general rate case filing.

The joint staff-PacBell sponsored tracking form provides a starting point for designing the expanded reporting procedure contemplated by the Commission. The Commission will, in the order which follows, direct PacBell to meet with F/MBE groups and devise a tracking procedure that is in harmony with the criteria discussed in this section.

In ordering an expanded procedure, the Commission recognizes PacBell's argument that there may presently be insufficient F/MBE businesses to permit achievement of stated goals. A start must be made somewhere, however, and a concerted effort by a large utility to purchase goods and services from qualified minority suppliers is bound to generate additional F/MBE sources of supply. Failure to realize a supply would indicate that the premises upon which this nation is attempting to restructure its social structure to provide equal status and opportunity to all its citizens will need further examination and modification to devise other procedures that will be successful. The force of this argument is even greater when consideration is given to the fact that many of the business people are also PacBell ratepayers.

The Commission will not, for the time being, prescribe similar procedures for AT&T-C. This declination to act is in recognition that AT&T's status is that of respondent, along with the other California telephone companies. It would not be appropriate to single out AT&T-C and not impose similar requirements on the other interLATA carriers. This is but one of the many regulatory issues that confront AT&T-C, the competing interLATA carriers, and the Commission as a result of their charged stati occasioned by divestiture. This question will be discussed in a later section.

The Service Employees International Union, Local 87

D.83-12-025 discussed briefly a dispute between the Service Employees International Union, Local 87 (SEIU) and a building service contractor concerning the provision of janitorial service at a San Francisco building occupied by PT&T. Any Commission action was deferred until Phase II of these proceedings.

SEIU subsequently decided to pursue its case before the Division of Labor Standards Enforcement as provided by PU Code §§ 465 and 466 and indicated that it did not wish to continue the subject in these proceedings. Accordingly, the subject was not considered in Phase II.

Modification of D.84-04-104

In D.83-12-025 signed December 7, 1983 we imposed a penalty on PacBell for their underutilized plant. We authorized the company to file for relief when it could show that the plant in question was being utilized according to established criteria. In response to Applications for Rehearing in that case we issued D.84-04-104 on April 18, 1984 which modified D.83-12-025 and denied rehearing. One of the modifications was to delete the language that allowed PacBell to come before us to show the plant in question was being utilized and stated instead:

> "We will consider a normal rate of return on this plant if, in the course of future general rate application proceedings, PT&T can show that it is in use."

Finding of Fact 32 was also modified to reflect the above language.

On May 16, 1984 PacBell filed an Application for Rehearing. Among other issues raised, PacBell urged the removal of the restriction on their ability to come before us prior to their next general rate case to show that the plant in question is now being utilized.

Upon reconsideration of the matter, we are now of the opinion that PacBell should not be precluded from coming before us prior to its next general rate case now scheduled for 1986 under the new three year rate case plan (Resolution ALJ-151). We will modify D.84-04-104 to delete the above-language including Finding of Fact 32 (mimeo p.6), leaving the language as to under-utilized plant of D.83-12-025 intact. As to the other issues raised by PacBell in its Application for Rehearing, they remain open for further consideration by this Commission.

VI. RATE DESIGN: INTRODUCTION

Rate design issues in Phase II of this proceeding occupied 29 days of evidentiary hearing, all devoted to considering rates proposed for PacBell except for two hearing days directed to the rates for AT&T-C. Rate design issues also were the major focus of attention by most of the nearly 400 PacBell subscribers who spoke for the record during the 15 days of public witness hearings held in the course of this proceeding at various locations in PacBell's service territory.

A. Participation in Rate Design Hearings

Sworn testimony on issues related to PacBell's rate design was presented by seven witnesses for PacBell; four witnesses each for staff, Western Burglar and Fire Alarm Association (WBFAA) and Deaf Counseling Advocacy and Referral Agency (DCARA); two witnesses each for Telephone Answering Services of California (TASC) and a group composed of American Broadcasting Companies, Inc., CBS, Inc., Bankers Clearing House Association, and the Tele-Communications Association (Large Users); and one witness each on behalf of TURN, Sonitrol Alarm Companies (Sonitrol), and Direct Marketing Association (DMA). In addition, three individual subscribers, Dr. Robert Brylawski, Ron Herrold, and Raymond Horton, testified on their own behalf. Issues related to rate design for AT&T-C were explored by two AT&T-C witnesses, two staff witnesses, one witness for PacBell, and Dr. Brylawski again testifying on his own behalf. Testimony also was received into the record, after the close of hearings, on behalf of General Telephone Company of California (General), Continental Telephone Company of California (Continental), and Citizens Utilities Company of California (Citizens), respectively, concerning Optional Residence Telephone Service (ORTS).

Parties actively participating in the cross-examination of rate design witnesses included PacBell, AT&T-C, staff, Large Users,

WBFAA, Sonitrol, TASC, TURN, the Cities of San Diego and Los Angeles and the City and County of San Francisco (Cities), DCARA, and Dr. Brylawski. All these parties (except San Diego and San Francisco) as well as Farm Bureau addressed rate design issues in their briefs.

In its testimony and argument staff addressed most rate design changes proposed by PacBell and AT&T-C. Farm Bureau expressed its views on a wide range of issues, as did the witness for DMA, although DMA's brief addressed solely proposed changes in PacBell's Zone Usage Measurement (ZUM) plan and charges. TURN also addressed a number of issues, including the level of access line rates, treatment of local measured service, the level of the local coin service rate, terms for a toll discount plan, pricing of Touch-Tone service, and the broader question of the adequacy of PacBell's service-specific cost studies. Large Users, WBFAA, Sonitrol, and TASC devoted most of their attention to criticizing PacBell's cost studies for private line services and challenging PacBell's and staff's rate proposals for those services. In addition, TASC proposed a restructuring of Direct Inward Dialing (DID) rates, and Large Users analyzed the ZUM plan, opposed PacBell's proposed ZUM and service connection charges, and opposed TASC on the subject of DID rates. Los Angeles addressed its attention solely to PacBell's proposed changes in the ZUM plan and charges. DCARA proposed a discount toll rate plan for users of telecommunication devices for the deaf (TDDs). Dr. Brylawski addressed some of the proposed changes in ZUM, access line, service connection, and directory assistance charges. Herrold testified regarding PacBell's practices and charges for repair services, especially as to private lines. Horton addressed rate levels for foreign exchange service.

B. Revenue Objective

As noted at the conclusion of our discussion of PacBell revenue requirement, supra, the combined Phase I and Phase II

adopted revenue increase, reduced to reflect effects of D.84-04-104, on the test year revenue requirement, is $570.9 million. This figure must be adjusted to determine the revenue objective to be met by the rate design adopted in this proceeding. Adjustments are necessary (1) to recover the revenue increase authorized effective May 1, 1984, by D.84-04-043; (2) to refund the overcollection of revenues since January 1, 1984, pursuant to D.84-04-104 corrected by D.84-05-003; and (3) to recognize the net revenues derived from advice letter filings which have become effective in the course of this proceeding, as set forth in Exhibit 190.

D.84-04-043, issued April 18, 1984 in A.59849 et al., authorized increased annual revenues of $61.0 million "effective May 1, 1984 and continuing to the effective date of the next decision in A.83-01-22," with that decision to authorize recovery of the authorized increased revenues. Based on a July 1 effective date for tariffs filed pursuant to the present decision, PacBell is entitled to recover 61 days worth of the $61.0 million annual increase over the 185 days remaining in test year 1984. This produces an equivalent annual revenue requirement increase of $20.1 million, which must be terminated December 31, 1984.

D.84-04-104, issued April 18, 1984 in this proceeding, reduced PacBell's authorized rate of return from 12.70% to 12.64% as of the January 1 effective date of D.83-12-025. This meant that rates since January 1 had been set to recover an excess $11.1 million in annual revenues. Based on a July 1 effective date for tariffs filed pursuant to this decision, 182 days of overcollection must be recovered over 184 days remaining in 1984. This produces an equivalent annual revenue requirement decrease of $11.0 million, which must be terminated December 31, 1984.

Exhibit 190 indicates the estimated test year 1984 revenue requirement impact of PacBell advice letter filings which have taken effect during the course of this proceeding. The most significant impact, a $13.3 million contribution toward PacBell's revenue requirement, results from Advice Letters 14603 and 14653, which established a new 976 Information Access Service Tariff effective September 9, 1983. The need to reflect in the 1985 attrition adjustment changes in revenue generation from this and other new PacBell services is discussed infra. At this time we note simply that the total estimated test year 1984 revenue requirement impact of advice letter filings shown in Exhibit 190 is a reduction of $14.8 million. This does not include any impact from Advice Letter 14678, which has not become effective, nor of A.83-05-45, because the Commission determined in D.84-04-016, approving a modified version of PacBell's proposed Centrex Rate Stability Plan, that it was unnecessary to try to reflect revenue impacts of that decision in the present proceeding. (D.84-04-016, mimeo. at p. 41.)

The total of adjustments to the combined Phase I and Phase II adopted revenue increase is thus $20.1 million, minus $11.0 million, minus $14.8 million, or a negative $5.7 million. The revenue objective to be achieved through the adopted rate design is therefore $570.9 million minus $5.7 million, or $565.2 million.

C. General Approach to Rate Design

Before embarking on a detailed examination of the many specific rate design issues presented for decision in this proceeding, it is fitting that we set forth our general approach to the determination of telephone utility rates. This is particularly appropriate in this proceeding, in which we consider that a number of

parties have exaggerated the importance of one factor - service costs - among the many which are relevant to the setting of rates. As we hope to make clear in this general discussion, and in the detailed analysis of specific rates which follows, cost of service is an extremely important factor in setting rates, always relevant but seldom the only relevant consideration, and sometimes not the predominant one.

In the principal decision in PacBell's most recent general rate proceeding, we stated our intention, subject to exceptions, to set rates commensurate with costs. (Pacific Tel. & Tel. Co. (1981), D.93367, 6 CPUC 2d 441, 542.) We also set forth a litany of other relevant factors, which sometimes complement and sometimes compete with the interest in cost-based ratesetting. We stated as follows:

> "Our first objective in rate design is to develop a spread of rates which will meet the revenue requirement found appropriate in this proceeding. Our second objective is to provide a fair distribution of any rate increases among customers and classes of service....
>
> "...In determining particular rates we must consider factors such as cost of service, rate history, rate relationships, proposals of the parties, elasticity of demand and related revenue repression, settlements with connecting companies, and general effects on customers. For instance, in assessing the effects of a rate structure on customers we must consider total customer billing by class, the portion of a customer's bill affected by a particular rate change, whether the service is essential or discretionary, what options to the service are available, and the benefits of the service." (Id. at 543-44; see also General Tel. Co. of California (1969), 69 CPUC 601, 673-74, 682-85.)

The first objective noted is of critical importance, and is often overlooked by parties whose attention is focused on the rates for particular services. Once we have found that a certain revenue requirement is appropriate, we must set rates adequate to produce those revenues. In a case such as this one, where revenue requirement is found to exceed substantially the revenues generated by current rates and where we seek, in addition, to eliminate current rate surcharges, it becomes a difficult but necessary task to assign significant rate increases to many particular service offerings. Even if a demonstration of costs is inadequate to justify increasing the rates for a service, our second objective of a fair distribution of rate increases among customers and classes of service may dictate that the service at issue share the burden borne by the rest.

Other considerations of particular importance in assigning the burden of a substantial increase in revenue requirement are the avoidance of unreasonably drastic, cumulative rate increases for particular customers or classes of customers, consideration of the likely effects of cross-elasticities of demand, and the maintenance of reasonable relationships among rates. We also must consider the potential effects of the rate changes we authorize upon competition. (Northern California Power Agency v PUC (1971), 5 Cal 3d 370, 379.) We have done so in this proceeding, especially with respect to rates for private line and message toll services.

Generally speaking, we set rates for a particular service based on one of three distinct models: (1) setting rates to recover the full costs of service, including an appropriate factor for return on invested capital; (2) setting rates to recover the full costs of service plus an additional contribution toward common costs or the costs of other services; and (3) setting rates residually to recover revenue requirement not achieved from other services. The first model of fully cost-based rates is our general standard. We apply

the second model to optional, discretionary services where considerations of demand elasticity, value of service, and historical rate relationships justify setting rates above cost. The third model, residual pricing, is reserved for basic exchange services and related essential services which the Commission historically has sought to protect from the impact of drastic rate increases in the interest of promoting the goal of universally affordable telephone service. We note, as discussed in our decision in D.84-06-113 issued today, in OII 83-06-01 et al., that the marginal cost of service rather than embedded cost of service may bear greater consideration in future rate design determinations. However, lack of information regarding such marginal costs minimizes our possible reliance on this factor at this time.

VII. PACIFIC BELL RATE DESIGN

We have applied the ratemaking standards described above to the task of setting rates to recover an increased revenue requirement for PacBell of $565.2 million in this proceeding and to generally replace the revenues now generated by rate surcharges. The following table summarizes the increases by category of service:

PACIFIC BELL

Summary of Net Revenue Generated by Adopted Rates
(Dollars in Millions)

PacBell Tariff Schedules	Description	Revenue	Increase (%)
4-T,9-T, 13-T,117-T, 121-T	Basic Exchange Services		
	Increase Residence Rates	$119.8	22.2
	Increase Business Rates	39.0	17.8
4-T	Semipublic Coin Service		
	Increase Monthly Rate	5.4	49.2
4-T,6-T	Local Usage		
	Convert SMRT to ZUM Zone 1	(2.6)	(2.0)
	Revise ZUM Rates	47.2	16.9
4-T,26-T	Rate Banding		
	Authorize Coincident with Measured Service	(.4)	-
4-T	Verification/Interrupt Service		
	Increase Charges and Apply to Coin Calls	6.1	113.8
4-T	Nonpublished Number Report Charge		
	Establish New Charge	.3	-*
4-T,11-T	Public and Semipublic Coin Telephone Service		
	Increase Local Coin Rate	59.8	72.2
12-T,26-T, 28-T,45-T through 51-T,104-T, 115-T,134-T, 139-T	Private Line Services		
	Increase Monthly Recurring Rates	71.0	52.9
	Increase Nonrecurring Charges	16.8	144.7
17-T	Directory Listing Service		
	Increase Monthly Rates	6.2	62.0
28-T	Service Connection Charges		
	Adopt Dual Element Structure and:		
	Revise Residence Charges	41.1	62.4
	Revise Simple Business Charges	8.9	86.0
	Revise Complex Business Charges	7.8	26.3
	Revise Premises Activity Charges	42.0	158.6
	Revise Maintenance of Service Charges	(1.2)	(8.1)

(Decrease)

*No charge under present tariffs.

PACIFIC BELL
Summary of Net Revenue Generated by Adopted Rates
(Dollars in Millions)

PacBell Tariff Schedules	Description	Revenue	Increase (%)
28-T,36-T	Late Payment Charge		
	Establish New Charge	20.4	-*
31-T	Vacation Rate Service		
	Withdraw Service	1.0	27.4
34-T	Foreign Exchange Service		
	Increase Monthly Rates	13.2	37.0
	Increase Nonrecurring Charges	4.5	85.3
36-T	Returned Check Charge		
	Increase Charge	.7	33.3
36-T	Billing Surcharges		
	Eliminate 5.4% Surcharge	(38.7)	-
	Reduce Billing Surcharge	(104.6)	-
53-T	Message Toll Service		
	Revise Toll Rates and Charges	90.6	7.2
	Adopt Discount Plan for Large Users	(13.6)	-
	Adopt Discount Plan for TDD Users	(0.2)	-
131-T,149-T	Optional Residence Calling Plans		
	Revise Optional Residence Telephone Service	22.2	28.4
	Revise Optional Calling Measured Service	4.7	13.2
	Extend ORTS Calling Routes	.3	-
148-T	Custom Calling Service		
	Revise and Simplify Monthly Rates	13.8	21.1
154-T	Remote Call Forwarding Service		
	Increase Monthly Rate	.8	12.5
159-T	Directory Assistance Service		
	Reduce Call Allowances and Increase Charge	82.9	304.1
	Total Revenue Spread (Decrease)	$565.2	

*No charge under present tariffs.

A. Private Line Services

In the principal decision in A.59849, PacBell's last general rate proceeding, issued August 4, 1981, the Commission found serious weaknesses in the cost studies submitted by PacBell to support substantial rate increases proposed for customer premises equipment and private line services. The Commission ordered further hearings to determine equitable costing procedures for use in setting PacBell's rates. (D.93367, supra, 6 CPUC 2d at 538-40.)

On April 6, 1983, the Commission issued D.83-04-012, an opinion on Revised Costing Procedures, in A.59849. D.83-04-012, generally known as the "Cost Manual Decision," established costing procedures "for the purpose of developing cost of service studies for telephone utilities under the jurisdiction of the Commission." The costing procedures are set forth in two attachments to D.83-04-012, one for CPE services and the other for private line services. PacBell was given the option of submitting revised cost studies in A.59849 based on the new "Cost Manuals" or presenting such new cost studies in this proceeding, which was already underway in April 1983.

In D.93367 the Commission had indicated its intention to continue to move toward cost-based rates for most services, but affirmed a general policy of limiting increases to "about 50% per year for any class of service or equipment." (6 CPUC 2d at 543, emphasis in original.) In D.83-04-012, to encourage PacBell to submit its revised cost studies in this proceeding rather than in A.59849, the Commission indicated that it would amend the 50% maximum to 100% "should Pacific choose to adopt the new costing procedures in the current application and forego any recalculation of the A.59849 studies."

This proceeding has been something of a reenactment of A.59849, with attention focused this time on Pacific's cost studies supporting its private line rate proposals. Those proposals are for

a thorough restructuring of recurring private line rates, for increases in the principal recurring rates of about 90 to 100%, and for increases in nonrecurring private line charges ranging from 900 to over 3,000%. The magnitude of these proposed increases has drawn vigorous criticism from the Large Users, WBFAA, Sonitrol, and TASC.

1. PacBell Cost Studies

PacBell asserts that its studies demonstrate that revenues from its private line services are far from covering their costs. It contends that these studies conform with the D.83-04-012 Cost Manual and have been validated by internal reconciliation and by Commission staff audit. PacBell argues that the intervenors' raising of many "small issues" has very little effect on the bottom-line conclusion that private line rates "are egregiously below cost and must have dramatic increases."

PacBell performed various cost studies to support its rate proposals. These begin with a so-called "category analysis," similar to the Bell System's embedded direct analysis (EDA), used to disaggregate the company's projected revenue requirement by broad categories of service. These studies employ a "tops-down" technique using projected average embedded, fully allocated costs to capture the entire projected revenue requirement. The category analysis assigns the dollar amounts in each revenue, investment, and expense subaccount to one or more service categories by allocation rules described in the testimony of PacBell witness John Gueldner. In response to this Commission's demands for more reliable cost studies, PacBell has introduced numerous "refinements" to the Bell System EDA since about 1979 and for this rate case has sought to modify its category analysis to reflect the costing methods required by the D.83-04-012 Cost Manual for private line services. PacBell's category analysis for private line shows total costs of $1,053 million and revenues of $273 million, producing a negative $780 million contribution and a 0.3 revenue to cost ratio, the lowest ratio indicated for any service category except customer premises work.

PacBell then used a subcategory analysis to disaggregate private line costs and revenues between recurring and nonrecurring (service connection) categories. This analysis also is conducted on a tops-down basis, and indicates a 0.4 revenue/cost ratio for recurring rate services and a very low 0.1 revenue/cost ratio for service connection activities, which generate only $24 million in annual revenues but are assigned $457 million in annual costs.

As required by D.83-04-012, PacBell also studied the costs of specific private line services. For the recurring costs associated with each service, witness Gueldner presented two cost studies, one based on the Cost Manual issued with D.83-04-012 and another described as an "embedded fully allocated recurring unit study." Studies of the latter type reconcile with the corporate books; the studies based on the Cost Manual do not, leaving a $44 million shortfall. (PacBell's rate proposals were derived from the cost studies based on the Cost Manual.) Both types of studies applied a bottoms-up apportionment of private line costs using data from a mechanized system for tracking and assigning circuit facilities. The facilities used for each service were identified along with their unit investments, permitting the calculation of relative investments for each service type. This allowed apportionment of tops-down category results to the individual services. As explained by PacBell witness Richard Scholl:

> "The total of the bottoms-up unit investments was not expected to equal the total category investments. This is because examining the unit investments would not capture the investment for items such as Land, Buildings, and Vehicles, and spare equipment, whereas the category totals reflect these investments."

With the category investment assigned to specific services, appropriate expense/investment ratios were applied to identify the unit recurring cost of each service. According to PacBell these unit cost studies comply with the Cost Manual in their disaggregation of

category costs, except in one instance where strict adherence to the Cost Manual would have inflated all private line costs.

The circuit facilities tracking system used for the unit studies does not include data regarding local subscriber loops. PacBell, therefore, performed a separate study to disaggregate the costs of local loops by service offering group. The Cost Manual differentiates private line services into seven such groups, such as those primarily serving alarm systems, telephone answering services, and Centrex customers. PacBell's disaggregated local loop study, completed in November 1983, distributed the book investment for private line loops among the seven service groups based on a detailed analysis of the characteristics of a random sample of individual loops drawn from throughout PacBell's service area.

As in the case of the unit recurring cost studies, the local loop study developed a "relative factor" for each service group for use in distributing the total investment shown by the tops-down category cost study. The loop study does not capture all the tops-down loop costs; in fact, it falls nearly 50% short. Witness Gueldner explained this shortfall as due to three factors: (1) actual line fill is lower than the main frame fill factor used in the loop study; (2) tops-down investment per foot is higher than used in the loop study; and (3) the loop study necessarily overlooked some building cable.

PacBell asserts that the imperfect match between tops-down and bottoms-up studies is irrelevant, because the purpose of the latter studies was only to provide a finer disaggregation of the private line category results. PacBell sees these studies as having accurately determined the major forces differentiating the costs of the services studies, such as service density, loop length, type of investment, and terrain characteristics. According to PacBell,

> "These driving forces have been effectively incorporated in the relative weight factors discussed above, and their consistent use in further disaggregating the private line category results is entirely reasonable."

PacBell also conducted bottoms-up studies of the costs of private line nonrecurring activities, such as installation or rearrangement of private line facilities. The costs of these activities were calculated by multiplying estimated work times by labor rates. The work time estimates were based on tracking reports, time and motion studies, and reports by panels of estimators. PacBell asserts that the study results were "validated" by the Service Costs Department and then by the department which had prepared the estimates, and thereafter reexamined by Service Costs for consistency with the budgeted employee count for each department. PacBell considers the study method to have been conservative, consciously seeking to avoid overstating the nonrecurring costs.

2. PacBell Rate Proposals

PacBell witness Richard Normington presented proposed rates and charges for private line services. Based on PacBell's category cost analysis, he testified that to achieve parity of private line revenues and costs would require a 140% increase in recurring rates and a 1,804% increase in nonrecurring charges. He proposed to increase recurring rates by up to 100%, consistent with D.83-04-012, but proposed "full cost-covering prices for nonrecurring activities." He stated that it was "not clear" to him that the 100% cap on rate increases was meant to apply to nonrecurring charges and,

> "Absent a clear mandate to the contrary, I cannot in good conscience propose non-recurring charges which, if set using the 100% delimiter would still be at only about 10% of Pacific's costs.

Normington expressed a preference for market-based pricing of private line services, aimed to optimize total economic contribution, i.e., total revenue less total costs, considered in light of the cross elasticity among alternative service offerings. PacBell's proposed rates are not market-based, however, because

> "private line rates in general, at least for analog transmission services, are so far below costs, and below the level of value received, that it is almost impossible to assess the market's true willingness to pay, i.e., the economic value to the user."

At this point PacBell seeks simply to bring private line rates closer to cost.

PacBell proposes not only to increase but also to restructure its recurring private line rates. The restructuring would more accurately measure interoffice mileage and would unbundle the charges for distribution facilities included in private line circuits between customer premises and the serving central office. Absent rate increases, these structural changes will scarcely affect total revenues, but will increase or decrease significantly the charges for services provided to specific customers. In combination with PacBell's proposal to increase many recurring rates by close to 100%, the restructuring proposals would cause charges for some existing service configurations to increase by significantly more than that amount. Witness Normington urged these changes in rate structure as

> "Congruent with the concept of charging the cost causer for expenses and investment incurred pursuant to his/her own special requirements."

Normington forecast that PacBell's rate proposals would increase private line revenues net of settlements from $115.1 million to $379.5 million, prior to consideration of repression. Repression effects are calculated as a $51.4 million loss in revenue and a $101.1 million reduction in expenses, resulting in a net revenue gain from the rate proposals of $314.1 million. It will be noted that private line service repression is calculated as increasing net revenues.

3. Staff Position

The staff analysis of private line pricing was presented through the testimony of staff witnesses Daljit Singh and Dean Evans. Witness Singh analyzed PacBell's private line recurring and nonrecurring cost studies and proposed private line rates consistent with a rate design policy set forth in the testimony of witness Evans. That policy is to set rates and charges for private line services equal to cost while minimizing abrupt rate changes. Witness Evans testified that the 100% increase limitation was "an outgrowth of the 50% rule which was not a hard and fast rule but rather a rule of thumb or guideline." Evans recommended that the Commission increase nonrecurring charges up to cost subject to a ceiling of 200% of the present rate per year. Alternatively, he recommended compounding increases of 100% per year.

Witness Singh based his analysis of private line costs on the studies sponsored by PacBell witness Gueldner. He relied on the D.83-04-012 Cost Manual in estimating recurring costs. He generally agreed with PacBell's costing methods, but made certain relatively slight adjustments, particularly the use of lower growth factors to calculate 1984 levels of average original cost and various expenses from 1983 levels, and the use of a lower rate of return factor. Singh concluded that the work times calculated in PacBell's nonrecurring cost study were within a reasonable range. However, based on staff adjustments to PacBell's overall results of operations studies, Singh estimated nonrecurring private line costs by applying a factor of 0.8193 to PacBell's estimates.

Witness Singh endorsed PacBell's proposed restructuring of private line charges. The recurring rates he proposed are in many cases identical to those proposed by PacBell, because the staff adjustments did not bring the calculated costs below the 100% increase level which constrained PacBell's proposals. Exceptions are

the local channel rates for 1001 and 1009 circuits used for alarm services, for which PacBell proposes 96% and 91% increases, which staff would reduce to 70% and 69% respectively. Similarly, PacBell proposes 38% and 85% increases in local channel rates for 2001 and 3002 circuits, which staff would reduce to 30% and 77%, respectively.

For nonrecurring charges, staff's 200% annual increase constraint would produce rate levels far below those sought by PacBell. For example, the charge for installation of a 1001 alarm circuit is now $45, would be $835 under PacBell's proposal, and would be set by staff at $135 in 1984 and $225 in 1985. A telephone answering service 6A secretarial line now costs $23, would cost $149 under PacBell's proposal, and would be priced by staff at $69 in 1984 and $115 in 1985.

Witness Singh calculated that his recurring rate proposals and his proposed 200% annual increases in nonrecurring charges would produce a net revenue gain in 1984 of $117.2 million and in 1985 of $142.4 million. As compared to PacBell's estimate of a $314.1 million net increase from its rate proposals, the major differences in Singh's estimates are drastically lower increases in revenues from nonrecurring services and much lower repression of those services, with correspondingly lower cost savings from cutting back these money-losing services. Over 95% of the difference in revenue generation between the PacBell and staff proposals is due to the differences in proposed nonrecurring charges and the associated service repression.

4. Positions of Private Line Customers

Various representatives of private line customers offered detailed criticism of PacBell's and staff's cost analyses and rate proposals for private line services. The principal critics were the Large Users, WBFAA, Sonitrol and TASC.

These parties point out that despite the weakness of past private line cost studies, private line services have borne substantial rate increases in recent years - recurring rates having

risen by over 140% since 1979. WBFAA and TASC emphasize the essential nature of alarm services and telephone answering services, respectively, the dependence of these services on PacBell, and the overwhelming impact which the proposed rate increases would have on the viability of these mostly small businesses. They, as well as Sonitrol, note the critical impact of nonrecurring as well as recurring charges, because alarm and answering services must pay nonrecurring charges every time they offer service to new customers or their existing customers' needs change. As explained by Sonitrol,

> "In order to stay in business, alarm companies must regularly purchase the installation of new private lines. Sales can't remain at zero; some customers will discontinue their service, while new customers will hook up to alarm service with new private lines. Therefore, just to stay even, there is a regular, foreseeable number of new installations that will be required. The nonrecurring charges of Pacific Telephone are as much of a regular, recurring type of rate to alarm companies as are the monthly recurring charges."

These parties assert that the 100% limit on rate increases decreed by D.83-04-012 should apply to nonrecurring as well as recurring rates.

The customer groups challenge PacBell's cost studies as inaccurate, biased, and inconsistent with the requirements of the D.83-04-012 Cost Manual. They assert that PacBell has failed to sustain its burden of proof. Their specific criticisms are directed to the tops-down category cost studies, the bottoms-up unit studies and disaggregated loop study of recurring costs, and the bottoms-up study of nonrecurring costs.

a. Critique of PacBell's Category Analysis

Large Users see PacBell's category analysis as just a rerun of the EDA-based cost showings which the Commission rejected as inadequate in two prior rate decisions. (See D.90642 (1979), 2 CPUC 2d 89, 191-93; D.93367 (1981), 6 CPUC 2d 444, 538-39.) They contend

that the category analysis grossly overstates private line costs and its use to support specific rate increases is inappropriate. They see PacBell's reliance on the tops-down category analysis as inconsistent with the Cost Manual.

Large Users note that the category analysis is based on PacBell's proposed test year budget, thereby always overstating investment and expense. PacBell's "refinements" to the Bell System EDA are criticized as having, in virtually every case, increased the indicated cost of private line service. They particularly note the increase in costs assigned to private line in the 1980 study ($500 million as compared to $150 million in 1979), which reflected a reassignment of costs from switched access and toll service to private line, and the $282 million increase in 1983 state private line expenses due to a restatement of such costs based on special studies. According to Large Users witness William Montgomery,

> "The Company's unilateral decision to select a few subaccounts for special studies, and then to 'study' them primarily in terms of effects on the private line category, raises serious questions concerning this treatment. If Pacific is now allowed to selectively change the results of this general study for private lines in this case, it would appear, in principle, that they would be free to perform selective adjustments for any other type of service in the future."

WBFAA also condemns PacBell's "manipulation or 'refinement' of the EDA, [all] directed at driving private line costs up." Sonitrol likewise attacks the accuracy of the EDA and PacBell's "ad hoc adjustments" to it, asserting that their intent was to reassign as much of the company's total cost as possible to the state private line category.

The private line customers all criticize PacBell's "forced closure" of its bottoms-up unit cost studies with the tops-down category analysis. WBFAA argues that the indicated recurring costs cannot be reconciled with any auditable historic or test year cost

data. Sonitrol points to evidence of "sloppy, unreliable clerical work" which calls into question the usefulness of PacBell's bottoms-up calculation of central office equipment investment and, by implication, all the unit studies of recurring costs.

Large Users note that the unit costs calculated, on a bottoms-up basis, for all private line plant other than local loops amounted to $440 million less than indicated by the tops-down category analysis. Instead of determining why such a discrepancy exists, PacBell simply adjusts the unit costs by applying "distribution factors." This leads Large Users witness Montgomery

> "to question whether the scaling process applied to the embedded unit private line costs simply perpetuate[s] erroneous adjustments to the EDA category study."

b. Critique of PacBell's Loop Study

Large Users, WBFAA, and Sonitrol also challenge the statistical validity of PacBell's disaggregated loop study. WBFAA asserts that PacBell's statistician, who defined the sample used for this study, misunderstood its purpose, and that the study method thereafter was changed without considering effects on its statistical validity. While the total number of loops sampled may suffice to establish average results for all private line loops, the samples for specific loop types were inadequate - especially for alarm patron loops. According to WBFAA witness Charles King, a sample ten times as large as was used was needed to provide 95% confidence that the sample mean was within 10% of the real cost of patron loops. Sonitrol interprets the loop study as offering only 95% certainty that investment in an alarm patron loop is "somewhere between $83 and $265.12," and for alarm sponsor loops, "somewhere between $102.50 and $386.98." Sonitrol urges that such "unbelievably sloppy, unreliable cost information has no place in the rate setting process." Large Users point to a similar range of uncertainty ($173.43 to $280.85) for voice/data loops, asserting that such a range offers inadequate evidentiary support for the recurring rate increases PacBell seeks.

Even assuming the accuracy of PacBell's statistically unreliable results, the intervenors assert that the loop study does not justify increased rates. According to Large Users, based on a $208 average original cost (AOC) calculated for voice/data loops, the loop study indicates a monthly loop cost for these loops of $6.74, less than the present rate of $9.00 which PacBell seeks to double. WBFAA points out that despite the unreliability of the loop study for specific service types, the indicated overall AOC of $200 "is probably a statistically reliable estimate of the company-wide loop cost." Rather than apply the investment costs shown by the loop study, PacBell assumed that the much higher ($440.71 on average) figures shown by the tops-down-category analysis more accurately represented loop investment.

Large Users contend that PacBell's refusal to use the bottoms-up AOC figures violates the Cost Manual.

> "The company has not 'reconciled' or in any way explained the difference in the two investment figures; it has simply eliminated the discrepancy by application of a factor."

This discrepancy, argue the Large Users, amounts to $2.6 billion, over half the investment shown by the category analysis, and Pacific cannot account for this $2.6 billion in plant. PacBell's explanations for the discrepancy are that the main frame fill factor used for the loop study overestimated actual utilization of loops, that the loop study underestimated investment per foot of loop plant, and that the study overlooked investment in building cable. Large Users attack the latter two claims as "bogus," arguing that if the entire discrepancy must be attributed to a lower fill factor the conclusion must be that nearly two-thirds of PacBell's subscriber outside plant stands idle and unused.

Large Users urge that ratepayers should not have to pay for such an excess of spare capacity.

"Whether the Commission should disallow entirely any earnings on such plant is a difficult policy question and one that probably should not be answered without a rigorous investigation of the extent and causes of this problem. However, it is absolutely clear that no customer, private line, business or residential, should have his rates established explicitly on the basis of unused investment. Its inclusion in private line costs is contrary to the Cost Manual, and rates based on it must not be approved. If the company is to be allowed to recover return, depreciation and other expenses associated with this investment, such costs should be treated as common overheads and spread across all services."

WBFAA takes a similar position, noting that loop investment is a residual calculation arrived at by subtracting the amount of interoffice plant from total booked outside plant per the category analysis. Thus, according to WBFAA witness King, the loops pick up all errors in the property records for outside plant. This misallocation has "a devastating effect" on multipoint circuits, commonly used by alarm services, because the bulk of their costs relate to the local loops.

As summarized by Sonitrol,

"the forcing of the bottoms-up cost development into Pacific's pumped up EDA has resulted in an enormous overstatement of private line loop costs. As shown by the analysis of alarm patron loops, even if you disregard sampling errors and grant Pacific an actual fill factor of .5, loop costs would still have to be reduced by 67% of those identified by the Company. However, such sampling errors infuse an additional uncertainty into the whole process. And nowhere in these adjustments has any additional factor been used to account for Pacific's underutilized loop plant."

c. Critique of PacBell's Nonrecurring Cost Study

The private line consumers are, if anything, even more critical of PacBell's nonrecurring cost study than of those discussed

above. This is not surprising, for PacBell proposes increases in new connection charges of up to 2,000% and in move and change charges exceeding 3,000%.

Based on testimony by their witness Montgomery, Large Users summarize their criticisms as follows:

> "Pacific's proposed private line non-recurring rate increases should be rejected because the cost study on which those rates rest is unauditable, does not reconcile to historical or test year results of operations and presents work times which have not been tested for reasonableness or efficiency by a panel of estimators. These deficiencies put Pacific's 'study' in noncompliance with the Commission's Revised Costing Procedures. Pacific's study overstates its costs for additional, unrefuted reasons: it has failed to recognize productivity improvements; it has excessively disaggregated work functions for purposes of determining work times; and it has not complied with standard guidelines for time and motion study."

Very similar criticisms were lodged by WBFAA witness King and Sonitrol witness Edwards and were detailed in those parties' briefs.

Large Users note that the work time estimates upon which PacBell's nonrecurring cost study is based were made in 1981, the original documentation of these estimates was in many cases discarded, and in some cases changes in the estimates were not documented at all. Large Users assert that these breaks in the "audit trail" violate the requirements of the Commission's Cost Manual, which provides as follows:

> "So that interested parties may effectively analyze and audit cost studies presented by the utilities, detailed documentation shall be made available for review which includes algorithms describing all procedures and separation processes, workpapers, input data sources, and reports used to prepare the cost studies." (D.83-04-012, Attachment B, Section I, para. 7.)

Large Users assert that without the missing workpapers, the Commission cannot be sure that PacBell's studies accurately portray its nonrecurring costs.

Another inconsistency with the Cost Manual pointed out by Large Users and WBFAA was PacBell's failure, in 11 out of 14 operating departments, to use panels of estimators to test work time data for reasonableness and efficiency. Instead, most of PacBell's work time estimates, the basic building blocks of the nonrecurring cost study, were based on time and motion studies.

The intervenors criticize these time and motion studies on various grounds. PacBell's service cost department failed to instruct the operating departments on how to conduct proper studies; evidence is lacking that the personnel involved were properly trained. In fact, these employees could have been inclined to exaggerate their own work times. In any event, the intervenors assert that PacBell excessively disaggregated work activities in its determination of work times, leading to inflated time estimates.

WBFAA offers examples of exaggerated work times, such as an estimate of 27 minutes for customer negotiation of every service order despite evidence that such marketing activity does not occur at all in the case of alarm services and that the entire process of placing an order takes no more than 10 minutes. Similarly, PacBell calculates marketing representative travel times for alarm service orders of 17 and 18 minutes, although such service orders never require a premises visit. Another example of work time exaggeration cited by both WBFAA and Sonitrol is PacBell's estimate of 123 minutes to sketch manually a bridged alarm circuit, a task which PacBell's own rebuttal witness testified would be accomplished typically in three minutes using in-place automated equipment. Sonitrol notes similar examples of exaggerated work time estimates, such as 37 minutes to type a form of at most two pages and 5 to 35 minutes for unpacking and shelving plug-in equipment.

The intervenors also assert that PacBell overstates its costs by failing to account for efficiency improvement. There is no evidence that the 1981 work time estimates used in the study were ever corrected for efficiency gains achieved or planned since that time, including installation of new, electronic Main Distribution Frames using modular plug-in equipment, and the use of computerized systems for line testing and recordkeeping which can substantially diminish the time required to install private lines and channels.

Finally, Large Users, WBFAA, and Sonitrol all assert that the nonrecurring cost study fails to comply with the Cost Manual's requirement that either cost estimates should reconcile to historical costs or test year estimated results of operations or an explanation should be provided. (Cf. id., Section I, para. 4; Section VI, para. 4.) PacBell's only reconciliation, the intervenors claim, was to work force budget forecasts, which are entirely hypothetical. Recurrent work time increases over iteration of the study suggest that work times were forced up to balance the budget.

WBFAA raises a special concern about the pricing of the addition of a new loop to an existing circuit. This occurs only in the case of multipoint circuits such as the 1009 A circuits used by alarm companies. Both PacBell witness Scholl and staff witness Singh stated that the addition of a loop to an existing circuit should be treated as a change service order rather than a new installation, resulting in a lower charge.

TASC offers a further set of criticisms of PacBell's nonrecurring cost study. TASC challenges the inclusion of costs of removal in installation charges; alleges improper expensing of costs associated with secretarial line installations, which should be capitalized because they produce "benefits which will be enjoyed for years;" and criticizes PacBell's use of panels of estimators to determine work times because "participating employees have a built-in bias toward the suggestion of longer work times."

d. Critique of Staff Report

Large Users, WBFAA, and Sonitrol criticize the staff's study of private line costs as well as the company's. Large Users assert that the staff has not met its responsibility under the Cost Manual to review PacBell's work time estimates which underlie its drastic proposed increases in nonrecurring charges. They describe staff's review of these estimates as "very inadequate", and [illegible] "superficial," pointing out that most of the staff witness's reasons for private line costs being higher than those for ordinary service "are simply paraphrases of conclusions presented to the staff during a telephone conversation with Pacific."

WBFAA alleges that staff failed to perform an investigation or validation of PacBell's private line cost studies. According to WBFAA the staff witness "made limited field visits, and asked very general questions," lacking the time necessary to validate the work times for 39 product groups. He did not review the input data, the time and motion studies, or the sampling procedures, but relied on a "feel of estimates." WBFAA contends that the Cost Manual and the magnitude of PacBell's rate request demand more specificity.

Sonitrol faults staff for failing to question PacBell's upward adjustments in recurring costs or the discrepancy between tops-down and bottoms-up study results, and because it "faithfully accepted" PacBell's nonrecurring cost estimates. Sonitrol asserts that, due to a lack of critical staff analysis, staff's [illegible] recommendations deserve little weight.

e. Recommendations

In comparison to their criticism of PacBell's and staff's cost studies, the intervenors' rate proposals appear moderate. Large Users recommend a percentage increase for private line recurring [illegible]

rates equal to the overall increase in revenue requirement authorized in this proceeding. They also urge the Commission to provide for a "qualified, independent organization" to study PacBell's private line nonrecurring costs by product type and to evaluate the efficiency of PacBell's nonrecurring work operations. If the study finds PacBell's operations efficient and its costs within 10% of those it alleges in this proceeding, then the private line users would bear the study costs; otherwise PacBell's shareholders would do so. In the interim Large Users recommend a 100% increase in nonrecurring charges. Their witness Montgomery suggested a second 100% increase upon Pacific making substantial progress toward completing a proper cost study which indicates that such a further increase is warranted. An advisory panel might assist in formulating and conducting such a cost study. Montgomery also offered an alternative proposal for recurring private line rates -- that these rates be increased by a proportion of the amount PacBell proposes which equals the proportion of PacBell's proposed overall revenue increase which the Commission authorizes. Sonitrol objects to this recommendation as "completely arbitrary."

WBFAA opposes most of the proposed restructuring of private line rates. Like Large Users, it opposes a percentage increase in recurring charges greater than the overall percentage increase awarded to PacBell, and likewise opposes an increase in nonrecurring charges exceeding the 100% guideline of D.83-04-012. Sonitrol, too, accepts the necessity for increases in recurring private line rates proportionate to the overall rate increase, and "a significant raise" in nonrecurring charges.

TASC opposes increased service connection charges for secretarial lines. In no event, according to TASC, should these charges be raised above PacBell's alleged service-ordering costs for such lines, which would produce rates between 15 and 26% of those proposed by PacBell.

5. Response of PacBell

PacBell responds to the intervenors' criticisms by defending its category analysis, disaggregated loop study, and nonrecurring cost study, while attacking its critics, particularly WBFAA, for hypersensitivity to minute points of dispute and "nit-picking." The implicit theme of PacBell's rebuttal is that the intervenors have willfully misunderstood the purpose of PacBell's bottoms-up studies of recurring and nonrecurring costs, including the loop study. The purpose of these studies, avers PacBell, was not to verify the private line category costs indicated by the tops-down category and subcategory analysis, but rather to establish appropriate factors by which to allocate the category costs among specific private line services.

PacBell asserts that this Commission has accepted past category and subcategory cost studies, using them to measure contribution among PacBell's lines of business. PacBell notes staff's description of these studies as "the best we are going to have."

PacBell defends the "refinements" which it has made to the Bell System EDA, quoting its rebuttal witness Scholl:

> "These refinements are thus not unilateral adjustments involving only LATA Private Line, nor are they 'manipulations' of cost. Each of the refinements represent[s] major efforts of research on alternative information sources and extensive logic development work. These refinements are the results of a continuing in-depth analysis of existing logic systems and methods for improving them."

According to PacBell, its improvements to the EDA are based on detailed knowledge of its own operations, such as "how private line type activities differ from switched network activities." PacBell answers a number of specific criticisms of its category analysis and its recurring cost studies based on contrary evidence in the rebuttal testimony of witness Scholl.

PacBell defends the statistical reliability of its disaggregated loop study. It reaffirms that underestimation of building cable is one source of the discrepancy between the loop study and tops-down investment figures.

Regarding the nonrecurring cost study, PacBell defends its estimates of work times against the claim that they are overstated, because this claim "completely ignores the multitude of activities and the detail required in provisioning of a private line circuit." PacBell notes that the results of the nonrecurring cost study have been used in internal management decision-making, which attests to their accuracy. The study properly weighed all possible private line circuit arrangements, contrary to the claims of WBFAA. PacBell defends its expensing of installation costs which TASC contends should be capitalized, distinguishing these activities from new construction and noting that Commission policy favors recovering such costs up-front.

Pacific concludes its argument by reaffirming its goal of bringing nonrecurring charges to full cost:

> "To not do so only continues to provide an economic incentive for users to 'churn' private line services without regard to the true economic cost to Pacific and other ratepayers who must subsidize the below-cost installation and rearrangement of private line service circuits."

6. Discussion

The process of rate design and the cost studies which underlie it are never as precise as might be wished. The complexity of telecommunications services, the difficulty of ascribing responsibility for fixed or common costs to particular services, and the uncertainty of customer behavior in response to substantial changes in rates, among other factors, make it futile to expect a high degree of precision from a private line service costs study. Nonetheless, costs must be one of the fundamental building blocks for rate design. It is essential that substantial rate increases such as PacBell proposes for private line services be supported by competent evidence of service costs.

PacBell's proposed restructuring and disaggregation of private line rate elements appears to promote equitable pricing of private line services by more accurately assigning costs to those who are served. No substantial objections have been raised to the proposed restructuring, except to the extent that recurring charges for some service configurations will be increased by more than 100% by the proposed combination of rate increases and restructuring. Because we will be setting recurring rates significantly below proposed levels few, if any, service configurations will experience increases in recurring charges exceeding 100%. We find the proposed restructuring of private line rates reasonable.

We also find PacBell's general approach to the study of private line costs acceptable and consistent with the D.83-04-012 Cost Manual. The tops-down category and subcategory analysis is an appropriate means of disaggregating overall revenue requirements among classes of service and between recurring and nonrecurring costs. Further cost disaggregation is properly achieved by means of allocation factors developed through bottoms-up studies of investment and operating costs for particular service offerings, such as PacBell's unit cost studies and its disaggregated loop study. We

agree with PacBell that it is unreasonable to expect closure between the tops-down and bottoms-up analyses. The purpose of the bottoms-up studies is not to validate the category analysis but to carry it one step further through cost-based apportionment of the category costs to specific service offerings.

Even so, the extent of inconsistency between PacBell's category analysis and its bottoms-up studies is cause for concern. The explanations PacBell has offered for a $2.6 billion step-up in loop costs from the disaggregated loop study to its category costs surely can account for the difference, but only with the assumption of an alarmingly low percentage utilization of private line loop investment. The $440 million step-up in other unit costs goes completely unexplained. The alternative explanation for the magnitude of these discrepancies is that PacBell has overestimated its private line category costs. In any event, the intervenors are correct in their contention that PacBell has not adequately explained the lack of reconciliation between its service specific cost estimates and test year estimated results of operations, as required by the Cost Manual.

The intervenors also have alleged numerous defects in PacBell's category analysis, the disaggregated loop study, and the study of nonrecurring costs. These claims and their implications require careful evaluation.

As Large Users note, the category analysis is derived from the Bell System EDA, which this Commission has strongly criticized in several prior decisions. However, PacBell has modified the EDA in response to the Commission's concerns and to reflect advances in analytic techniques and the particular cost characteristics of its intrastate services. Its derivation from the EDA is not sufficient grounds to condemn PacBell's category analysis.

The intervenors have failed to provide sufficiently detailed criticism to discredit most of PacBell's refinements and

modifications to its category analysis. The mere fact that PacBell has conducted special studies of selected subaccounts does not [illegible] indicate bias; it would be impractical to require PacBell to overhaul its study methods completely with each rate case. Despite a chorus of general criticism of PacBell's modifications to the EDA, the record lacks specific grounds for finding any such "refinements" to be unreasonable. [illegible]

The intervenors have raised a significant question about the fluctuations in the overall assignment of costs to the private line category from year to year. They particularly challenge the increase in this assignment from $150 million in 1979 to $500 million in 1980. $131 million of this increase was accounted for by the Bell System-wide transfer of both costs and revenues of tie-line, off-premises extension, and other services resembling private line from the vertical services to the private line category. A further $184 million was explained in Exhibit 607, a PacBell response to a data request, as being due to (1) increased loop cost assignments reflecting a lower Centrex loop cost determined by a special study, (2) reassignment of loop circuit investment in proportion to the total number of designed loops, (3) direct assignment of trunk testing expenses, (4) assignment of certain maintenance expenses on a work time rather than investment basis, (5) direct assignment of interoffice facility assignment expenses, and (6) assignment of certain interest expense based on net investment. [illegible]

The intervenors criticized several aspects of the cost reassignments detailed in Exhibit 607, but those criticisms were effectively answered by PacBell rebuttal witness Scholl. This leaves unaccounted for only $35 million of the 1980 increase in costs assigned to the private line category, a 23% increase over the 1979 level which is slightly less than the 27% increase in total intrastate category costs from 1979 to 1980.

We commend PacBell for what appears to be a sincere effort to comply with the Cost Manual in performing a disaggregated local loop study. However, we are persuaded by the intervenors' criticisms that the study results are of limited value, primarily due to PacBell's failure to assure adequate statistical reliability of the study results for their intended purpose. Changes in the survey sample and failure to correct for unobtainable data were not reviewed by PacBell's statistician. The result was a study defining loop costs for certain service types, particularly alarm services, which was statistically reliable only within an exceedingly broad spectrum of costs. It is nearly useless to be informed that investment in alarm patron loops averages somewhere between $83 and $265; alarm sponsor loops between $102 and $387; and voice/data loops between $173 and $281. Little reliance can be placed on witness Gueldner's avowal of cost allocation factors of .90, .78, and .92, respectively, for loops serving these customer types. On the other hand the [illegible] substantially higher sample of telephone answering service loops in studies permitted a narrower range of certainty for the cost of such loops, a range from $91 to $147 at the 95% confidence level, [illegible] justifying a substantially lower cost allocation factor than for other service types.

Another valid concern expressed by WBFAA was that the [illegible] residual determination of loop costs in the category analysis leaves the loops to pick up all errors in the property records for outside plant, which disproportionately affects rates for loop-intensive multipoint alarm circuits. PacBell failed to rebut this criticism. [illegible] Staff's modest adjustments to PacBell's recurring cost [illegible] estimates to reflect lower growth factors and a lower rate of return [illegible]

are warranted. Staff's proposed private line recurring rates provide a reasonable starting point for determining the appropriate level for such rates.

PacBell's failure to reconcile its tops-down category studies with its bottoms-up unit cost and loop study results, or to explain the lack of reconciliation in other than very general terms do not discredit the category study results, but provide grounds for caution in setting rates based on those results. The broad range of statistical reliability of the local loop study confirms the need for caution in setting rates for particular private line services.

Once again PacBell has failed to conduct cost studies which permit this Commission to set rates for private line services upon a precise cost basis. Staff has lacked the resources to make up for the deficiencies in PacBell's studies. Progress has, however, been made toward a more accurate and finely disaggregated category analysis and toward the development of bottoms-up studies to facilitate differential pricing of specific private line services. These cost studies are adequate to justify substantial increases in private line recurring rates.

Weighing the clear need for substantial rate increases against the serious range of possible error implicit in PacBell's cost studies, we find it reasonable to reduce the private line recurring rate increases proposed by PacBell, as adjusted by staff in Exhibit 624, by an additional 20%. Thus, for example, the monthly local channel rate elements for a 1009 B alarm circuit, presently $6.75 and proposed to be set by PacBell at $12.92 and by staff at $11.22, will be set at $6.75 + (.8)($11.22 - $6.75) = $10.33, an increase of 53%. Similarly, the $3.00 rate for interoffice channel mileage for a 1009 B circuit, proposed by both PacBell and staff to be doubled to $6.00 will be set at $3.00 + (.8)($6.00 - $3.00) = $5.40, an 80% increase. As is evident, no recurring rate will be increased by more than 80%. Where, as in the case of the local channel rate

elements, the restructuring of private line rates has disaggregated rate elements, the difference between the staff-proposed rate and the adopted rate should be distributed proportionately among the rate elements.

In no event will the recurring rates be set lower than the present rates including the present 5.4% rate surcharge. This limit will have a negligible revenue effect.

In regard to nonrecurring rates for service connections and related activities, the need for substantial rate increases is even more evident but so are the weaknesses in PacBell's cost study. PacBell has proposed increases of from 900 to more than 3,000%; staff favors recurrent 200% annual increases for most services; even the intervenors concede that at least a doubling of rates is warranted. Yet they are sharply critical of PacBell's cost study and propose that an independent audit be undertaken of PacBell's private line nonrecurring costs.

We find many of the intervenors' criticisms warranted. The nonrecurring cost study fails to comply with the D.83-04-012 Cost Manual on several important points. Detailed documentation necessary to permit interested parties to analyze and audit the cost study is lacking. PacBell failed to use panels of estimators in most operating departments to test work time data for reasonableness and efficiency. And, as in the case of the unit cost and loop studies, PacBell has failed to provide adequate explanation for the lack of reconciliation between the bottoms-up nonrecurring cost study and test year results of operation.

As noted previously, work time estimates are the basic building blocks of the nonrecurring cost study. Most were determined by time and motion studies, but it is evident that those who performed these studies were inadequately instructed and liable to provide biased results. Moreover, the structure of the study tended

to exaggerate its results by excessive disaggregation of work activities and failure to take account of recent improvements in operating efficiency. Further, evidence suggesting that PacBell's service costs department repeatedly adjusted work times upward without seriously consulting operating department personnel calls the accuracy of the cost study further into question.

On the other hand, the basic structure and formula employed in the nonrecurring cost study is reasonable. We reject TASC's challenges to inclusion of costs of removal in installation charges and to the expensing of costs associated with secretarial line installations. In this era of increasing competition, it is important to facilitate prompt recovery of all reasonable expenses associated with installation of service, including its eventual removal. (Cf. Revision of Accounting for Station Connections (1981), D.93728, 7 CPUC 2d ____.)

In response to the concern expressed by WBFAA, we find that the addition of a new loop to an existing private line circuit should be treated as a change service order rather than a new installation. This will moderate the impact of nonrecurring charge increases for some alarm service customers.

The defects in PacBell's nonrecurring cost study make it impossible at this time to determine with precision the cost basis for private line nonrecurring charges. However, PacBell's study and the testimony of expert witnesses on behalf of PacBell, staff, and other parties provide ample basis for finding that present nonrecurring charges are drastically below cost and that fairness requires substantial increases in such charges.

The lowest limit advocated by any party to nonrecurring charge increases was the 100% guideline set in D.83-04-012. Despite the view of PacBell and staff, we consider that guideline properly applicable to PacBell's nonrecurring charges. We note that the 100% limit was intended as a one-time exception to our customary limit of

"about 50% per year" referred to in D.93367, 6 CPUC 2d at 543. We set the limit at 100% in D.83-04-012 in recognition that, by deferring its cost study revisions from the extended 1981 test year rate proceeding to its then pending 1983 test year proceeding, PacBell would forego the opportunity for cumulative 50% increases in rates for which such increases were cost-justified. Due to the structure of this proceeding, another year has now passed. Therefore, we find it reasonable and consistent with the intent of D.83-04-012 to authorize increases in private line nonrecurring charges up to cost or by 150% of present charges, whichever is less. We also find it reasonable and consistent with D.83-04-012 to authorize further increases in these charges for 1985 of a further 50% compounded upon the 1984 rate level or up to cost, whichever is less. We further find that for purposes of defining cost, in the limited instances where it is material to setting rates in this context, it is reasonable to apply staff's 0.8193 factor to the costs shown in PacBell's nonrecurring cost study, as indicated in Exhibit 624, Appendix D. We will employ as a cost ceiling for each rate element the cost level estimated by staff reduced by a further 10% to reflect the imprecision of the basic PacBell cost study. At this time the only rates constrained by this cost ceiling are those for bridging and channel conditioning.

Except where increases are constrained by cost (as indicated in Exhibit 624, minus 10%) each private line nonrecurring charge, including the present 5.4% surcharge but not the interim 10.32% surcharge, will be increased by 150% in 1984 and a further 50% in 1985, subject to rounding to the nearest dollar. Examples of the authorized nonrecurring charges are shown in the following table:

PACIFIC BELL

Private Line Nonrecurring Charges

Service	Installation Charges			Move/Change Charges		
	Present*	1984	1985	Present*	1984	1985
1001/1009A/B/C	$45.00	$119.00	$179.00	$15.00	$ 40.00	$ 60.00
1002/1005/1006	45.00	119.00	179.00	15.00	40.00	60.00
2001/2002	45.00	119.00	179.00	15.00	40.00	60.00
3001/3002A/B/C	45.00	119.00	179.00	15.00	40.00	60.00
6000-60 to -72	10.00	26.00	39.00	10.00	26.00	39.00
2/2A/6	25.00	66.00	99.00	25.00	28-T Labor	28-T Labor
4/4A/4B	63.00	166.00	249.00	63.00	166.00	249.00
6A/6B/27B	23.00	61.00	92.00	23.00	28-T Labor	28-T Labor
7/29	-	119.00	179.00	-	28-T Labor	28-T Labor
3009	45.00	119.00	179.00	15.00	40.00	60.00
Bridging	-	14.00	14.00	-	-	-

Channel Conditioning	Present	1984	1985
C-1:P2W	$ 25.00	$ 66.00	$ 99.00
P2X/P3G	60.00	104.00	104.00
P3E	27.00	71.00	104.00
C-2:P3H	45.00	119.00	125.00
P3J/P3W/PH9	90.00	125.00	125.00
P3B	27.50	72.00	108.00
C-4:P4G	97.50	132.00	132.00
P4H	45.00	119.00	132.00
C-5:UHD	127.50	148.00	148.00
D-1:QHA	650.00	650.00	650.00

*Effect of 5.4% surcharge not shown in present rates.

We estimate the cost savings and revenue effects of the adopted private line rates by taking 80% of the recurring cost and revenue items shown for the staff rate design in Exhibit 626 and by applying the adopted percentage increase limits to present nonrecurring charges. The results are an estimated $87.8 million increase in net revenues for test year 1984 and a further $14.4 million for attrition year 1985. The latter revenue increase will be taken into account in determining PacBell's 1985 attrition adjustment.

We recognize the magnitude of the rate increases we are authorizing for private line services. These increases are justified by substantial evidence that private line services are priced well below their cost. In the face of increasing competition in nearly all aspects of telephone utility operations and in the wake of the Bell System divestiture, the general body of ratepayers can no longer afford to have the public switched network carry a substantial portion of the costs of providing private line services. Moreover, permitting great discrepancies between private line rates and costs to persist may inhibit the development of beneficial competition.

PacBell's cost studies are deficient and do not support rate increases to the levels requested by either PacBell or staff. However, we find that, subject to the adjustments proposed by staff as well as further adjustments to protect against the imprecision of those studies, PacBell's studies of recurring and nonrecurring private line costs provide a sufficient and compelling basis for the increases we will authorize in private line rates and charges.

Concerns have been expressed, particularly by the alarm companies, about a so-called private line migration strategy, by which the Bell System allegedly has been seeking to migrate alarm system subscribers to the switched network in order to enhance the future market for alarm products suited to the switched network. WBFAA expressed concern about the unavailability today of practical alternatives to private lines for alarm services. Possible alternativ not explored on our record are the use by alarm companies of a

service analogous to direct inward dialing (DID) service or a subscriber line multiplex service. PacBell does not now offer these services for use by alarm companies, but DID service is widely used by telephone answering services. These may be economical alternatives to private lines at the higher rates we are authorizing. Accordingly, we will instruct both PacBell and General to study and report back to the Commission staff on the feasibility and merits of offering DID-type or subscriber line multiplex service to their respective alarm company subscribers. These reports should be submitted no later than November 30, 1984, and should be served on those parties to this proceeding interested in private line issues, including WBFAA, Sonitrol, Large Users, TASC, and Mr. Herrold.

We reject Large Users' proposal of an independent audit of private line costs. We doubt whether the results of such an audit would be worth its considerable costs. Our staff's limited resources would be better expended reviewing PacBell's future cost studies than in arranging and coordinating the performance of an outside audit. However, we caution PacBell that the cost studies submitted on the present record, while sufficient to justify the substantial rate increases we are imposing on the private line services, will not justify further increases.

PacBell is advised to undertake new studies of private line recurring and nonrecurring costs to accompany its next rate application, such studies to be fully consistent with the D.83-04-012 Cost Manual. In particular, we expect PacBell to explain in detail the specific reasons why bottoms-up cost estimates do not reconcile to test year estimated results of operations and to provide a complete, unbroken audit trail from initial input data through final cost estimates. We expect PacBell to provide personnel conducting time and motion studies with uniform and sufficient instructions and to assign to the panels of estimators required by the Cost Manual employees not personally responsible for the specific work subject to study.

B. Directory Assistance Charges

By D.92708, issued August 19, 1980, the Commission authorized PacBell to implement a charge for directory assistance (DA) calls within a caller's home area code. The authorized charge was 15¢ for each directly dialed DA call beyond a 20-call free calling allowance. This charge was to be implemented gradually, exchange by exchange, to be effective systemwide by the end of 1982. By D.82-09-025, issued September 8, 1982, the Commission extended that deadline to June 30, 1983.

The 20-call free calling allowance had been mandated by Section 776 of the Public Utilities Code, enacted in 1978. By its own terms Section 776 remained in effect only until April 1, 1983. In the absence of a later enacted statute, the law no longer requires a free calling allowance. By OII 83-03-02, issued March 16, 1983, the Commission required that any formal application by a telephone corporation to change an existing DA charge plan should be accompanied by provision of certain information regarding the costs and volumes of DA calling.

In this proceeding PacBell has proposed substantial changes in its DA charge plan. In testimony received in October 1983, PacBell witness Dennis Evans proposed to increase the charge for directly dialed DA calls from 15¢ to 30¢ and to reduce the monthly free calling allowance from 20 calls to three for residence customers while eliminating it entirely for business subscribers. He also proposed to eliminate existing exemptions from DA charges for hotels, motels, and hospitals, and to reduce from three to two the number of information items to be furnished per call. The revised charges still would apply only to DA calls within the caller's home area code.

Evans' proposals were supported by the cost studies presented by witness Gueldner, as well as by Gueldner's supplementary testimony on the DA charge plan, Exhibit 563, which met the requirements of OII 83-03-02. Gueldner's studies show a test year revenue shortfall from DA service under the current plan of $229

million ($11 million in revenues less $240 million in costs). According to Gueldner the average cost of a local DA call is 34¢, and the higher proposed charges would not only generate added revenue but would reduce DA calling, thereby eliminating $64 million in annual costs. The estimated net revenue increase from PacBell's proposed DA charging plan is $104.8.

Staff also proposes changes in DA charges, but staff would cut the free calling allowance for residence and business only to 10 calls per month, with each Centrex line to be allowed only one free call per month, and staff's proposed charge for calls beyond the free allowance is 20¢. Staff would continue to permit up to three information requests per DA call. Staff concurs in the proposed elimination of exemptions and in the modifications of charging plan details proposed in PacBell's December 1982 compliance filing pursuant to D.92108. Staff's differences with PacBell reflect the lower revenue requirement on which the staff rate design is based, but staff does not dispute PacBell's cost figures. Staff estimates that its proposals would generate $46.9 million in additional net revenue. Farm Bureau also supports elimination of the exemptions for hotels, motels, and hospitals.

In further supplemental testimony offered in January 1984, PacBell witness Evans adjusted his rate proposals to be consistent with a lower revenue requirement reflecting D.83-12-025 issued last December. His adjusted proposal is for a 20¢ charge and a monthly free calling allowance of 10 calls for both residence and business customers, while still eliminating the special exemptions noted above. In effect, PacBell has adopted the staff proposal except for PacBell's continuing desire to limit each DA call to two information requests.

Dr. Robert Brylawski, an interested member of the public, contributed constructively to the discussion of DA charging by his proposal to distinguish among "published," "unlisted," and "to be

published" telephone numbers, levying charges only against DA requests for numbers in the first category and also exempting requests for numbers no longer in service. He also proposed higher charges (50¢ vs 20¢) for requests for numbers within the caller's local directory area than for other published numbers, based on the greater availability of directories in the former case. He suggested that PacBell could more quickly convert "to be published" numbers to the "published," chargeable category by periodically publishing supplemental directories. Brylawski's proposal was based on the premise that phone subscribers have a right of access to all current number listings as part of their basic service without additional charges.

In rebuttal testimony PacBell witness Evans contended that Brylawski's proposal is not economically feasible because the DA operator does not control charging for DA calls, which are recorded automatically for billing purposes as soon as connection is made to the DA operator. To implement Brylawski's proposal would require replacement of the Automatic Call Distributor equipment used today, at a capital cost of at least $125 to $150 million. PacBell does, however, "recognize the concern raised by Dr. Brylawski," intending to consider this in the future when DA facilities are due for replacement.

On brief Brylawski recounts the testimony regarding his proposal and concludes reluctantly that it would not be advisable for the Commission to order its immediate implementation, because vital information needed to determine its economic impact is not now available. He urges that PacBell be ordered to institute a study on the feasibility of implementing a DA rate structure along the lines of his proposal. Otherwise, he urges the Commission to direct PacBell to include the elements of his proposal in its DA service planning process.

Dr. Brylawski's proposal has theoretical merit if one accepts his premise that a right of access to all current number listings should be considered part of basic service at no extra charge. We do not accept that premise. For many years this Commission has endeavored to maintain basic exchange service charges at the lowest feasible levels in order to promote the goal of universal service at affordable rates. To further this policy we have gradually unbundled aspects of service such as equipment rental and DA service from basic exchange rates. In the great majority of cases it is not PacBell's fault that a number is unavailable in the local directory; rather, it is because the party to be called has chosen to have an unlisted number or has recently moved. It is reasonable, under our system of imposing costs on the calling rather than the called party, that the caller bear the costs which arise from the called party being "hard to reach."

We recognize and share Dr. Brylawski's concern that PacBell be encouraged to keep the directory listings readily accessible to subscribers as up to date as possible. We encourage PacBell to make that goal a primary consideration in its planning for future improvements in directory services. We will direct PacBell to file a report within 12 months of the effective date of this decision describing its current plans for future "white pages" directory services or their replacement and for changes in the facilities or procedures used to provide DA services. If PacBell considers publication of this information to threaten its competitive position, it may request that the report be filed under seal.

We note that AT&T-C has proposed a 90¢ per call charge, with no free calling allowance, for interLATA directory assistance, due to the high level of access charges it must pay the local exchange carrier for use of its DA service. We intend to approve a relatively high rate for AT&T-C. In this context we believe it reasonable to approve a substantial increase in charges for local area DA calling as well.

Exhibit 575 indicates that approximately 80% of residence customers average five or fewer intraLATA DA calls per month and 60% of business customers average two or fewer calls monthly. PacBell's estimate that the average cost of a DA call is 34¢ is undisputed. We consider that a modest free calling allowance is appropriate for residence customers as an element of residually priced basic exchange service, but that a lesser allowance should be given to business subscribers, who should properly expect to pay for value received. On this basis we find it reasonable to decrease the free calling allowance for residence customers from 20 to five calls per month, and for business customers from 20 to two calls per month, except for Centrex customers for whom the monthly allowance per line will be reduced from two to one. We also find it reasonable to increase the charge from 15¢ to 25¢ for each call exceeding the allowance. We adopt PacBell's and staff's proposals to eliminate exemptions and modify details of the charging plan. We agree with staff that a customer should continue to be permitted up to three information requests per call. We estimate the net revenue effect of the adopted DA charging plan as an increase of $82.9 million for test year 1984.

We note that the adopted DA charging plan applies only to requests for information concerning subscribers within the home calling area (area code) of the calling party. In future proceedings we will entertain proposals to charge for intraLATA DA calls beyond the home calling area as well. We will, however, expect proponents of further DA charges to consider the possible effects of such charges upon toll calling volumes and toll revenues.

C. Service Connection Charges

PacBell proposes both structural changes and increases in the charges associated with residence, business, and complex service connections. The most fundamental change recommended is that the current multi-element structure for simple residence and business be eliminated and a dual element structure be adopted.

PacBell's dual element plan would establish a service specific charge for activities associated with service ordering, service provisioning and line connection costs, and a further, time-sensitive charge for all premises-related activities.

PacBell contends that this structure, basing charges on the specific services desired and coupled with a time-sensitive hourly rate in the event of premises activities, provides a simplified and straightforward pricing concept.

PacBell's current and proposed charges for simple service connections are shown on the following table:

PACIFIC BELL

Service Connection Charges

Service Related Multi-Element	Current Charges Residence	Business
Service Establishment	$10.00	$21.00
Additions, Moves & Changes	9.00	12.50
Record Work	6.00	12.50
Central Office Connection	13.00	13.75

Service Specific	Proposed Charges Residence	Business
Access Line - Flat	$35.00	$53.00
Access Line - Measured	25.00	53.00
Semi-Public	-	53.00
Custom Calling/RCF	5.00	6.00
Touch-Tone	3.00	5.00
Number Change	20.00	30.00
Temporary Denial	20.00	40.00
ORTS/OCMS	5.00	-
Directory Services	5.00	7.00
Network Intercept	20.00	30.00
Network Non-Intercept	20.00	30.00
Billing	5.00	7.00

Premises Related Multi-Element	Current Charges Residence	Business
Station Handling	$ 8.00	$10.00
Premises Visit	7.75	7.75
Premises Wiring (per connecting point)	16.75	21.50

Premises Activity Time Sensitive	Proposed Charges Initial ½ hr.	Subseq. ½ hr.
Normal	$35.00	$12.00
Overtime	40.00	14.00
Premium Time	45.00	16.00

PacBell also proposes a $35.00 "Maintenance of Service" charge for premises visits where trouble is found in customer-provided facilities. This charge is the same as the first 1/4-hour premises activity rate and is a slight reduction from current charges.

PacBell proposes substantial increases in charges for complex service connection activities, ranging between 28 and 81%, as shown in the following table:

PACIFIC BELL

Complex Service Connection Charges

	Present	Proposed
Access Line & Trunk	$66.40	$85.00
Centrex Line	26.35	45.00
Number Change	22.10	40.00
Network Intercept	22.10	30.00
Network Non-Intercept	22.10	30.00
Outward WATS	66.40	85.00
Inward "800" WATS	66.40	85.00

Even greater increases are proposed for Secretarial Lines, Tie Lines, Concentrator Identifier-Trunks, Centrex, Off-Premises Extensions, Non-PBX Off-Premises Extensions, and PBX Off-Premises Extensions. These services and the revenue effects associated with rate changes were treated under the private line service category by both PacBell witness Normington and staff witness Singh. The adopted charges for these services are based on the principles enunciated in the discussion of private line services above.

PacBell witness Evans testified in support of the restructuring of and increases in other service connection charges. Based on cost studies sponsored by witness Gueldner, Evans urged approval of the proposed increases so as to recover more of the costs of these services from the customer served. Regarding the proposal

to restructure service connection charges, Evans explained that the present multi-element structure provides customers little information to compare service choices and costs. The dual element structure will help the customer make informed decisions concerning new or enhanced service. Evans estimated that his proposals would generate $85.1 million in revenues and expense savings.

Staff witness Shantz based his testimony on an earlier version of PacBell's service connection proposals, which would have produced $158.2 million in increased net revenues. Staff generally concurs in the proposed dual element structure and supports increases in charges calculated to produce $99.5 million in increased net revenues. He proposes different charges than PacBell for many activities, especially access line installations.

Shantz testified that the dual element structure makes it possible to apply different service connection charges for optional services such as Custom Calling or Touch-Tone dialing than for basic service, thus permitting recovery of increased service connection costs while maintaining reasonable charges for provision of a simple exchange access line. Also, in view of the increasing competition for inside wiring work, staff supports the proposed time-sensitive charges for premises activity, which will eliminate the present competitively disadvantageous flat charges.

Staff differs with only one element of PacBell's proposed residential service connection charges. Staff favors a $34.50 charge for installing either a flat or a measured residence service access line, in contrast to PacBell's proposal of $35 and $25, respectively. Staff notes that there is no cost basis for the differential. Staff's proposed $34.50 charge represents a 50% increase from the present level, and is justified by evidence that the present charge covers barely one-third of the costs of such routine installations. Staff contends PacBell underestimates the

cost savings from its proposed increases in residence charges by some $3.0 million.

Similarly, staff favors a higher service connection charge for simple business access lines than PacBell has proposed, $70 versus $53. PacBell's $53 proposal already represents a 50% increase from the typical current charge, but staff witness Shantz contends that

> "a larger increase in service connection charges for simple business exchange access lines is required because the portion of the service connection costs associated with simple business exchange access lines recovered from Pacific's proposed Dual Element Service Charges is less for simple business services than for simple residence services."

Again, staff asserts PacBell has underestimated cost savings from increases in simple business charges, but otherwise endorses the remainder of the proposed changes in these charges.

Staff also opposes PacBell's proposed $85 service connection charge for a complex business access line, contending that the same $70 charge should apply to both simple and complex installations. Staff is concerned that differential charges will cause PacBell to incur unnecessary expense to police their administration. Staff also notes that PacBell has shown no cost basis for different charges. The $70 charge would apply to WATS lines as well.

The other side of the proposed dual element rate structure is the labor charges applicable to customer premises activity. Staff supports PacBell's proposed charges in this regard, including the proposed $35 "Maintenance of Service" charge.

In his January 1984 revised rate design, PacBell witness Evans decreased his proposed installation charges for both residence flat and measured rate service to $24, from $35 and $25

respectively. He also reduced the proposed residence Touch-Tone service installation charge from $3 to $2. He estimated his revised service connection charge proposals would generate $61.4 million in added net revenues.

Several intervenors commented on PacBell's service connection charge proposals. These include DMA, Farm Bureau, Dr. Brylawski, and Large Users.

DMA witness Philips Patton supported the dual element plan, and urged that the service connection charge for a customer's first two simple business lines be limited to the PacBell-proposed $53 per line, with the staff-proposed $70 charge applicable to line installations beyond the first two. Patton also suggested that service connection charges are a suitable place to look for added revenues in the event of a higher revenue requirement, and that impacts on low income families could be mitigated through lower installation charges or 12-month installment payment arrangements.

Farm Bureau also supports the dual element plan, as a means of giving customers the option of saving expense by do-it-yourself installation and requiring the customer responsible for added cost to bear a fair share. Dr. Brylawski objects to proposals by both PacBell and staff to charge a $20 fee for service regrade from residence measured to flat rate service, with no charge for the reverse. He sees no cost justification for this difference and considers it an attempt "to seduce users into shifting to measured rate service." He also favors free regrades from lifeline to either measured or flat rate service.

Large Users object to the scale of PacBell's proposed increases in service connection charges. Their objection is based on the failure of PacBell's cost study to recognize any efficiency improvements between 1980, the study's base year, and 1984,

> "despite the fact that Pacific agrees that its operations are becoming more efficient as a result of ever-increasing automation."

Large Users recommend that service connection charges be increased by no more than the percentage increase authorized for PacBell's overall revenue requirements.

PacBell, on the other hand, contends that present service connection revenue covers only 20% of cost, and that the more stable customers are being required to contribute toward the recovery of costs caused by those who are more mobile. PacBell wants the latter to shoulder more of the burden of these costs.

PacBell witness Gueldner's cost studies do indicate that service connection activities generate costs far in excess of revenues. Broken down on the dual element principle between access line service connection and customer premises work, his Exhibit 562 shows revenues of $570 million versus costs of $329 million for the former and revenues of $30 million versus cost of $180 million for the "current installations" element of the latter. While PacBell may well be overestimating its costs due to failure to account sufficiently for efficiency gains, Large Users have failed to show that such overestimation is so great as to prevent the conclusion that PacBell's service connection activities are priced substantially below cost. Large Users have not challenged the propriety of any specific proposed service connection charge. We find that PacBell's cost studies provide a sufficient evidentiary basis for service connection charge increases in the range proposed by PacBell and staff.

In reviewing this issue we have not considered the letter of March 27, 1984 and enclosed copy of a "Pacific Bell Business Office Modernization Report," sent to ALJ Mattes by James Blaszak, counsel for Large Users, nor have we considered the responsive letter to the ALJ of April 12, 1984 from Randall Cape, attorney for PacBell. We advise Mr. Blaszak to review Rule 84 of our Rules of Practice and Procedure.

There is general support for PacBell's dual element plan. It will simplify rates, better informing the subscriber of the source of his charges and better matching costs incurred with service received. Moreover, as testified by staff witness Shantz, the dual element plan permits differentiation among charges for basic and optional services. In this connection we note the statement of Christa Webb, a witness at our June 16, 1983 public hearing in Red Bluff:

> "Inasmuch as we do not need any high-speed data transmission, nor access to the vast market of information service, ...nor do we need to do our banking by phone or pay our bills by phone, not to mention the experiments that are now carried out in several areas, as turning on the air conditioner by phone, or dialing to have a movie on TV.
>
> "These services we do not need. But the basic phone service we need.
>
> "As I understand it, all these extended services are carried by a different line available only to customers with a pushbutton phone instead of the old-fashioned dial phone.
>
> "This is a demarcation line where the rate increase could be adjusted in a fair way...."

Ms. Webb suggested a valuable nuance in rate design, which is made concrete in the dual element plan. We find it reasonable to establish separate installation charges for Touch-Tone, Custom Calling, and other optional service features, whereby the no-frills, basic exchange service installation charge may be held to an affordable level. We will approve the dual element plan.

PacBell has reduced its proposed residential Touch-Tone service installation charge from $3 to $2. Staff continues to favor the $3 rate. For the same reason just stated for our approving the dual element plan, and because PacBell witness Gueldner showed a $36 cost for Touch-Tone capacity, we find reasonable a $3 charge for equipping a residence access line for Touch-Tone service.

The only proposed service connection charges which have been specifically debated on the record are the residence and business access line installation charges and the differential regrade charges for measured and flat rate residence service. Staff witness Shantz's criticisms of PacBell's proposed access line installation charges and his calculations of resultant cost savings have not been refuted. We are persuaded that (1) access line installation charges should be substantially increased to recover a greater share of associated costs, (2) business line installation charges should recover as great a proportion of costs as residential line charges, but increases in such charges should not exceed 100%, and (3) simple and complex business line installation charges should not differ markedly. We find staff's proposed service connection charges, including those for simple and complex business and residence service installations, reasonable. We will authorize PacBell's proposed dual element tariff with the changes proposed by staff. We also find reasonable staff's calculations of cost savings expected to result from the authorized rate changes.

In our recent D.84-04-053, issued April 18, 1984, in OII 83-11-05, we determined that subscribers eligible for "Moore Act Universal Telephone Service" would be charged only one-half the tariffed rate for residence service installation, subject to a limit of one installation per year, and would be permitted three months to pay the installation charge. This arrangement responds to the concern expressed by DMA witness Patton. We note as well that Rule 9 of PacBell's Tariff 36-T allows all residential customers up to three months to pay new installation charges free of interest or late payment charges. We will require PacBell to inform customers routinely of this installment payment option.

Finally, we agree with Dr. Brylawski that differential regrade charges should not be used to bias customers' choice between

measured and flat rate service. Rather than the proposed $20 charge for regrades to flat rate service only, we will authorize a $15 charge for any regrade between residence measured and flat rate services. As will be noted in the subsequent discussion of access line rates, we will provide a grace period for free regrades among residence services.

D. Ancillary Charges and Services

There are a number of service options and other tariff items which are ancillary to the principal elements of telephone access line service and usage. It is appropriate to set charges for these tariff items at or above the indicated costs wherever reasonable, in order to generate contribution toward meeting the costs of basic service.

1. Late Payment Charge

PacBell proposes to establish a late payment charge of $1 or 1.5% of the total unpaid balance, whichever is greater, to be applied to any account having an unpaid balance of $10 or more carried forward from one month to the next. PacBell asserts that this will reduce the burden these late payments cause for the entire customer base, the vast percentage of whom pay on time, and instead attribute it appropriately on the few late payers.

According to PacBell this charge would be "neither a finance charge nor interest, but rather an incentive for customers to reduce their unpaid balance." PacBell analyzed the propriety of this late payment charge in relation to the usury laws and explained its position in a letter of January 13, 1984 to ALJ Mattes which was served on all parties and appended to PacBell's brief.

PacBell witness Gueldner testified that the proposed late payment charge would generate increased revenue of $35.8 million as compared to cash funding costs of $22 million attributable to late payments. PacBell witness Evans estimated that the charge would

generate only $29.3 million, and later revised that figure downward to $28.6 million to reflect a lower total revenue requirement.

Staff concurs in the late payment charge proposal, but offers a lower revenue estimate of $27.9 million, assuming a $500 million revenue requirement increase. Staff witness Shantz noted that Gueldner's higher revenue estimate improperly included customer billings associated with terminal equipment which has now been transferred to AT&T. Staff proposes slightly different tariff language, including requirement of customer notice during a 45-day period prior to implementation of the late payment charge. DMA witness Patton and Farm Bureau also support the proposed late payment charge.

The only opposition to a late payment charge comes from TURN. The concerns TURN raises are that PacBell bills for its basic monthly charges in advance, that the late payment charge would raise more revenue than the costs late payments create, and that the burden on customers with relatively small balances due would be substantial. TURN considers the proposed late payment charge especially inequitable because its burden would fall most heavily on customers already facing economic difficulties. According to TURN the charge "will operate as a penalty for being poor." TURN's concern arises especially from the $1 minimum charge, which would apply to overdue balances as low as $10, thus amounting to as much as 10% per month or a 120% annual rate. TURN notes that $1 million of the $1.13 million to be generated monthly by the $1 minimum charge will come from residence customers.

In Bernsley v General Telephone Co. (1983), D.83-07-022, as modified by D.83-10-088, the Commission found a late payment charge in effect for General Telephone Company of California (General) to be ambiguous as to the time from which the charge would be effective and required General to clarify it. In that case the Commission also noted a prior decision (D.82-01-90) which concluded that the usury provisions of the California Constitution apply to a pipeline

utility's late payment charges. The Commission ordered General to limit its late payment charge to levels allowable under the usury provisions until the Commission had resolved issues relevant to those provisions in the pending OII 83-08-02, which has been consolidated with General's rate case now awaiting decision.

PacBell's January 13, 1984 letter to the ALJ regarding the late payment charge provides a cogent analysis of the usury law issue, contending that the usury provisions do not apply because PacBell's proposed charge is not interest but an incentive for timely payment of an amount due, and because in any event the Commission has full authority to find the proposed charge reasonable and lawful. No party has sought to refute PacBell's analysis of this issue, which will be more fully addressed in our pending decision in OII 83-08-02. Meanwhile, uncertainty as to the applicability of the usury provisions need not bar tentative approval of a late payment charge on this record.

We are more concerned about the other Bernsley issue: ambiguity as to the time a late payment charge takes effect. PacBell's proposed customer notice states that the late payment charge applies when "an unpaid live balance" is carried forward from one month's bill to the next. This leaves some doubt as to when a customer must submit payment to avoid such a "carryforward." Staff's proposed notice also is imperfect. It states that the late payment charge applies to such an "unpaid live balance" if the customer is "delinquent in paying the balance due," but does not clarify when delinquency occurs. A clearer message to the customer would be provided by combining elements of both the PacBell and staff proposed notices, as follows:

Rule No. 5, Special Information Required on Forms.

B. Bills

Each bill for telephone service will contain the following notations:

WHEN TO PAY YOUR BILL

Your bill is due and payable the day you get it.

It becomes delinquent the day after the "Due By (date)" shown on your bill.

If payment is not received prior to the bill becoming delinquent, your service may be interrupted.

If your service is interrupted for non-payment, reconnection will require payment in full of the amount owed and of the restoral charge. A deposit may also be required.

If your bill becomes delinquent in an amount of $10.00 or more, a late payment penalty of 1.5% is applicable to the total unpaid live balance carried forward from one month's bill to the next and is included in the total amount due on the current bill. Neither the billing nor payment of late charges relieves you of the obligation to pay all charges prior to the due date of the bill.

It will be noted that this notice language does not mention the proposed $1 minimum late payment charge. We are persuaded by TURN that such a minimum charge would be inequitable and burdensome to needy residential ratepayers. There is no evidence that it is infeasible to apply the 1.5% charge to amounts due under $67. We will not authorize such a minimum charge.

We find, however, that a late payment charge of 1.5% on delinquent unpaid live balances due is reasonable as a penalty to encourage timely payment of amounts due and owing. We tentatively will approve the late payment charge tariffs proposed by staff, subject to elimination of the $1 minimum charge and inclusion of the

notice language set forth above in Schedule Cal. P.U.C. No. 36-T, and conditioned upon a consistent result being reached on the usury law issue in OII 83-08-02. We estimate net revenues from the authorized charge at $20.4 million, $8.2 million below PacBell's estimate to reflect the adopted revenue requirement and elimination of the minimum charge.

2. Returned Check Charge

PacBell proposes to increase its returned check charge from $5.25 to $6 per returned check. PacBell witness Evans explained that returned check volumes have increased by 65% since 1981, and that the charge increase would generate about $285,000 in added revenue.

Staff adopts PacBell's proposal, estimating a $0.3 million revenue increase. DMA witness Patton supports a higher charge of $7 to harmonize with business practices generally. TURN opposes any increase, based on an assumption that this increase will most burden those who are economically disadvantaged.

We are concerned by the rapid increase in bad checks experienced by PacBell. This customer practice burdens the utility with added costs and should be discouraged. We find that a significant increase in the returned check charge is warranted to discourage such practice and approve Patton's proposal of a $7 returned check charge with the tariff language proposed by staff. We estimate net revenues from the increase in this charge as

$$\$0.3 \text{ Million} \times \frac{7.00 - 5.25}{6.00 - 5.25} = \$0.7 \text{ million.}$$

3. Directory Listings and Nonpublished Service

PacBell proposes increases of 25¢ per month for additional business listings and of 10¢ per month for additional residence and reference type listings. PacBell also proposes to double the charge for nonpublished service, from 15¢ to 30¢ per month. These charges would increase net revenues by $6.2 million.

Staff supports these proposals, pointing out that rates for these services have not been revised for more than 10 years and that

these are optional services. In the context of a substantial general rate increase, we find the proposed increases reasonable.

4. Nonpublished Number Report

PacBell proposes to establish a charge for attempting to place a calling party in contact with a customer who has a nonpublished number where the nonpublished number is not known by the calling party. The utility will only attempt to make such a contact with a nonpublished customer if the calling party indicates that the request is of an urgent or emergency nature. The tasks involved are a nonpublished number search, contacting the nonpublished customer and reporting back to the requesting party. PacBell suggests that these tasks are similar to the tasks involved in placing a person-to-person call and proposes to apply the $3 Person Service Charge applicable under its proposed message toll service tariff. PacBell estimates that a $3 nonpublished number report charge will increase annual revenues by $0.2 million.

Staff concurs in PacBell's proposal, observing that the costs of this presently free service are now being borne by the general body of ratepayers. Staff proposes, however, to apply the present $2.50 Person Service Charge, but calculates a higher net revenue effect of $0.3 million. This is because staff estimates lower repression - 25% instead of 50% - in view of the emergency nature of the service, and because staff has corrected errors in PacBell's cost savings estimate. Staff also proposes to condition the charge upon the utility completing the requested contact. PacBell did not rebut staff's analysis.

We find it appropriate to charge for this service but, in view of its emergency character, we are concerned not to set the rate too high. We approve the staff proposal of a $2.50 charge and the staff estimate of a $0.3 million revenue increase. We also approve the staff-proposed tariff language.

5. Verification/Interrupt

PacBell proposes tariff charges for Verification/Interrupt service estimated to produce $6.1 million in added net revenue. Changes would include increasing the present 25¢ charge per request for verification or interrupt to 50¢ for verification of a busy line condition and $1 for interruption of a conversation in progress; application of the proposed verification/interrupt charges to requests originated from public and semi-public stations; and elimination of the present tariff provision requiring operator notice of the charges applicable to verification/interrupt calls at the time a customer request for verification or interruption is received. Calls to or from emergency agencies such as hospitals and police would remain exempted from the charges.

Staff notes that the verification/interrupt tariff has not been revised since its inception in 1979 and that charges for the service do not recover its cost. Staff agrees that changes in the verification/interrupt tariff are warranted, to place more of the cost burden associated with the service on customers making use of it. Staff would increase the present charge only to 50¢ for either verification or interruption of a conversation and would extend the charges to requests from public and semi-public stations, but would not eliminate the required operator notice of applicable charges. In his January rate design revisions, PacBell witness Evans agreed to the lesser rate increase proposed by staff.

DMA witness Patton supports the original PacBell proposals. He testified that operator interruption of a call "is a drastic action which clearly (1) is much more time consuming than busy line verification and (2) should be discouraged for policy reasons." He favored a steep increase in the charge because "interruption is not a basic service, an ordinary service, or even a socially desirable practice." He also disagreed with staff that there is any need for operators to continue to warn callers of the

charge for verification/interrupt service. According to Patton, "Every telephone subscriber, by now, knows that it 'costs extra' to call an operator."

We agree with Mr. Patton's reasoning and find PacBell's original proposal for changes in its verification/interrupt tariff reasonable. As noted, those changes are expected to generate $6.1 million in test year revenues.

6. Custom Calling

Custom Calling Service consists of five distinct features: call waiting, call forwarding, three-way calling, speed calling for up to 8 numbers, and speed calling for up to 30 numbers. These features are available individually or in two, three, or four-feature packages to residence and small business subscribers. Present rates vary for particular feature packages and between residence and business.

PacBell proposes to establish uniform residence and business rates for all features and packages, with Speed Calling-30 to be offered only as an individual feature. The rates would be as follows:

	Proposed Monthly Rate
Call Waiting, Call Forwarding, 3-Way Calling, Speed Calling-8	
1 Feature	$ 3.50
2-Feature Package	6.00
3-Feature Package	8.00
4-Feature Package	10.00
Speed Calling-30	5.00

PacBell notes that the proposed changes will simplify the service, facilitating administration and public understanding, and will increase net revenues by $12.2 million.

Staff concurs in PacBell's proposal, noting that Custom Calling rates have not changed in more than five years. Staff considers that these are discretionary services and should bear a portion of the increase in revenue requirement. DMA witness Patton also supports this change. Farm Bureau, too, contends Custom Calling should bear a higher portion of revenue requirement.

We agree with PacBell and staff that the proposed simplification and increases in Custom Calling rates are warranted. We are concerned, however, that the proposed combining of business and residence rates results in decreases in most Custom Calling rates for business subscribers. This violates staff's goal of having users of these discretionary services bear a portion of the increased revenue requirement. Present Custom Calling rates are between 42 and 75% higher for business than for residence subscribers. We find that some portion of the existing differential in Custom Calling rates for business and residence subscribers should be retained by adding a 20% increment to the proposed schedule of Custom Calling rates as applied to business subscribers. The authorized rates will be as follows:

	Adopted Monthly Rates	
	Residence	Business
Call Waiting, Call Forwarding, 3-Way Calling, Speed Calling-8		
1 Feature	$ 3.50	$ 4.20
2-Feature Package	6.00	7.20
3-Feature Package	8.00	9.60
4-Feature Package	10.00	12.00
Speed Calling-30	5.00	6.00

The net revenue effect of the adopted rate increases will be approximately $13.8 million.

7. Remote Call Forwarding

Remote Call Forwarding is an optional service allowing customers a local telephone number identity in a remote location without actually maintaining an office there. Incoming calls to this remote number are automatically forwarded to the telephone number where the customer is actually located. The calling party is billed for the call to this remote telephone number, while the subscribing customer is billed for the remaining portion.

PacBell's rate for Remote Call Forwarding exceeds its costs but has not been increased since the service was established in 1976. PacBell proposes an increase from $16 to $18 per month, to generate $0.8 million in added revenue.

Staff concurs in this proposal, as does DMA witness Patton. In the context of a substantial general rate increase, we agree, and find the proposed increase reasonable.

8. Touch-Tone Service

Neither PacBell nor staff proposes to change the present $1.20 and $1.70 monthly rates for residence and business Touch-Tone Service. TURN, however, proposes to eliminate these charges.

TURN contends that because a growing majority of residential customers have Touch-Tone Service - forecast as 63% in 1984 - Touch-Tone has become "a standard element of telephone service." TURN sees the Touch-Tone rate as nothing more than a surcharge on most customers' basic monthly bills.

TURN sees logic in reassigning the revenue requirement now met through Touch-Tone Service charges to the enhanced services that depend on Touch-Tone and electronic switching. According to TURN,

> "This cost reallocation is made even more appropriate by the changes in the telecommunications industry created by Computer Inquiry II and Divestiture. It is only fair that proliferating optional services should at least pay their costs to the basic system."

We have previously discussed, in the context of approving PacBell's dual element service connection charge plan, the suggestion of a public witness, Christa Webb, that Touch-Tone Service is an appropriate "demarcation line" between basic service and access to optional features and information services. TURN's proposal would ignore, indeed eliminate, that demarcation line.

The Touch-Tone rate has remained at the current level since its introduction in 1967. Witness Evans testified that PacBell continues to believe this increment an appropriate additive charge for those customers who wish access to the technological advances that require this service. PacBell views Touch-Tone as an optional, premium service and urges that customers who use this service should pay for it. Evans pointed out that Touch-Tone Service is expected to generate approximately $107 million in revenues in 1984, and that if the Touch-Tone charge were eliminated, approximately $1.05 per month would be required from all basic exchange customers to replace the lost revenue.

Evans testified to a trend of continuing increase in the usefulness of Touch-Tone Service to customers, and that this trend would support increases in the Touch-Tone Service rate. He noted that an increase of just 10¢ in the residence rate and 30¢ in the business rate would generate $10 to $12 million in additional revenues.

We share TURN's desire to draw contribution from enhanced services for the support of basic local service. Unfortunately, TURN fails to offer a clue as to where, specifically, that contribution is to be found. We are increasing rates for various optional services such as Custom Calling, even though such services are already priced well above their direct cost. We must be careful not to kill the goose which lays the golden egg.

We disagree with TURN's contention that the changes wrought by Computer Inquiry II and the Bell System divestiture support shifting costs from the Touch-Tone service charge to enhanced service. In fact, these decisions by the Federal government have placed the pricing of most enhanced services beyond our control and have made it impossible for us to require a contribution from them for the support of basic service.

While we may wish to reconsider the pricing of Touch-Tone Service at a later date, we see no compelling reason to either increase or decrease it at this time. Therefore, we will leave it at its present price.

9. Vacation Rate Service

PacBell proposes to eliminate Vacation Rate Service (VRS). This service provides a 50% discount on all exchange-related monthly rates for both business and residence customers, but permits outgoing local service only at the local message rate or Zone Usage Measurement (ZUM) rate. PacBell witness Evans testified that most exchange-related monthly rates are already below cost and that further subsidy is inappropriate. Elimination of VRS would produce about $1 million in additional revenues.

Staff supports elimination of this service because the vacation rate discount is not matched by any reduction in access line costs. Staff witness Shantz considers it "inappropriate to sustain VRS at a time when severe upward pressures are being placed on basic exchange access line rates." He notes that the Commission has authorized General to withdraw its VRS.

Farm Bureau raises a concern that in areas without measured service elimination of VRS will force customers onto flat rate service, whereas customers in measured service areas have a lower-priced option. Farm Bureau suggests that where measured service is unavailable VRS should be retained, at a rate commensurate with the "access portion" of the flat rate charge. This is an attractive suggestion, which would make sense were there any evidence that the flat rate charge is priced above the "access portion" of its cost. There is, however, no such evidence.

In order to eliminate a discount which is no longer appropriate, we find it reasonable to authorize the elimination of VRS. The resultant increase in net revenue is estimated at $1 million.

E. Toll and Toll-Related Services

Numerous proposals have been made respecting toll and toll-related services by PacBell, staff, and interested parties. These include changes in the Message Toll Service (MTS) rate schedule; new discounts from the MTS rate schedule for large users, off-peak users, and the deaf; changes in existing discount plans; and revisions to Foreign Exchange (FEX) Service. Some of these proposals must be considered in the context of other proposed changes in rates and calling areas for local usage, but those topics will be addressed later in this decision.

1. Message Toll Service

PacBell has proposed a variety of changes in its MTS tariffs, including (1) implementing Rate Period Specific Billing (RPSB); (2) increasing the operator handling surcharge for person-to-person calls; (3) revising coin toll rates and rate structure; (4) implementing an operator surcharge for conference calls; and (5) reducing and restructuring message toll rates. PacBell initially calculated a negative annual revenue effect of $71.4 million for

these changes, but staff witness Shantz found numerous errors and inconsistencies in these calculations. In his October testimony PacBell witness Evans showed the revenue effect of his MTS proposals as a negative $13.7 million.

RPSB would affect calls carrying over into a different time-of-day rate period, changing the applicable rate at the time the rate period changes. The operator handling surcharge for person-to-person calls would be increased from $2.50 to $3. Coin toll calls would be charged on the same rate schedule as other MTS calls, except that a surcharge would be added to the regular usage charge, set at 25¢ for calls of 25 miles or under and 50¢ for calls over 25 miles. The proposed conference call operator surcharge would be $3.75. The MTS rate structure would be changed by reducing the number of mileage bands from 18 to 10 and reducing the rates for calls of less than 17 or more than 50 miles. The short-haul rate reductions are intended to equate these MTS rates with proposed increased Zone Usage Measurement (ZUM) rates for the corresponding mileage bands.

In his further supplemental testimony filed in January, witness Evans proposed lesser increases in ZUM rates and correspondingly greater decreases in MTS rates. He recalculated the net effect of his proposed changes in the MTS tariffs as a $38.3 million decrease in test year net revenue.

Staff concurs in the proposals to implement RPSB, to revise coin toll rates and rate structure, and to implement a conference call operator surcharge. Staff points out that the first two of these changes are consistent with actions taken by the FCC with respect to interstate calling. Staff calculates that adopting RPSB will decrease annual revenues by $0.6 million, the coin tariff changes will increase annual revenues by $3.6 million at staff-proposed MTS rates, and the conference call surcharge will generate $1.2 million.

Staff opposes PacBell's proposal to increase the person-to-person operator handling surcharge, which PacBell expects to generate $4 million in additional revenue. Staff witness Shantz testified:

> "The present person operator handled surcharge exceeds cost by 40% based on 1983 data. Pacific's proposed person operator handled surcharge exceeds cost by 70% based on 1983 data."

Shantz noted that the only support offered by PacBell for the proposed increase is testimony that revenue from this discretionary service would contribute toward the basic exchange service "subsidy," but that this is inconsistent with the same witness' testimony that "continuation of substantial toll increases as the principal revenue source to offset other below cost services is not sustainable."

Staff opposes PacBell's proposal to revise the MTS rate structure and decrease MTS rates. Shantz asserted that this proposal would disadvantage many of the independent telephone companies (ITCs) which provide MTS under PacBell's toll schedule and rely on MTS for a large proportion of their revenues. Shantz also noted that upward revisions in this proceeding in PacBell's depreciation rates affected MTS earnings, thus justifying slight increases in MTS rates. Shantz proposed to increase MTS rates for rate mileage up to 16 miles by 1¢ per minute, thereby generating an estimated $11.9 million in additional annual revenue. He testified that it was not reasonable to increase MTS rates further, "because of the constraints and/or unknown effects of competition, divestiture, and the FCC-mandated reconfiguration of the message toll network."

DMA witness Patton and Farm Bureau support the staff proposals for a total of $16.1 million in revenue increases from MTS service.

In testimony received in January 1984, staff witness Paul Popenoe, Jr. proposed a discount plan for high-volume users of MTS service. This plan was intended to respond to the risk of bypass of the local network by such large users to avoid the burden of

nontraffic sensitive (NTS) costs of local exchange plant which have been allocated to toll rates by the interstate separations process and an analogous intrastate procedure. According to Popenoe approximately 39% of the average intraLATA MTS billing is now attributable to NTS costs, but that proportion is likely to decline in the future. This Commission's interim access charge decision, D.83-12-024, stated the intention to limit the revenue requirement to be recovered through access charges. Popenoe sees this action as having placed potential bypassers on notice that the Commission intends to reduce the allocation of fixed costs to the toll operation, with a consequent reduction in toll rates. He sees this as making substantial investment in a bypass system less attractive for many potential bypassers. His toll discount plan is proposed as an interim measure for high-volume users who now feel they are picking up a disproportionately large share of local exchange overhead costs.

Popenoe offered four variations on a discount plan for large users of MTS. His preferred plan is a 20% discount on all intraLATA MTS usage (excluding WATS, ORTS, and OCMS) above $100 for each separately rendered bill. He considers this an appropriate discount to signal to potential bypassers the Commission's intent to reduce the amount of NTS costs included in toll bills. He opposes as unconscionable ever reducing to zero the NTS cost assignment to toll. In his view

> "a 20% discount represents a reasonable balance between the cost of a discount plan and a signal to potential bypassers of the Commission's objective of reducing the overhead burden on large users."

Popenoe estimated the cost of his proposed plan as $80.9 million in reduced annual MTS revenue. He proposed to make up for this reduction through an increase of 2¢ per minute in MTS rates for rate mileage up to 50 miles and 1¢ per minute above 50 miles, subject to applicable discounts and surcharges. Roughly 12.6% of business

subscribers and 0.4% of residence subscribers would be eligible for the discount for a portion of their MTS usage; resellers would be ineligible. Staff argues that to allow resale of discounted MTS would extend discounts beyond the target group, reducing revenue and requiring further increases for small users of MTS.

PacBell responded positively to the intent of staff's proposal but offered an alternative discount plan. According to PacBell witness Evans,

> "Adoption of a toll rate block discount plan would be an important first step to ameliorate the bypass problem. [T]he strong signal suggested by Mr. Popenoe is most appropriate since I believe the impact of this signal, although temporary in nature, may indeed cause business customers to delay investment in bypass systems pending resolution of the NTS issue."

PacBell proposes closer targeting of a more limited discount to those customers most likely to bypass, proposing a 10% discount on the amount of monthly intraLATA MTS charges per bill between $350 and $1,350, and a 15% discount for such charges beyond $1,350. PacBell proposes to offer the discount as an optional plan requiring payment of a $15 monthly subscription charge. The revenue loss from the discount plan would thereby be reduced from $80.9 million to $22.5 million, with the number of customers receiving a discount reduced from 108,000 to about 13,500. PacBell proposes to recover the shortfall either through a billing surcharge or by 1¢ increases in initial minute rates for MTS calls of 17 to 30 miles and final additional minute rates for MTS calls of 17 to 25 miles.

PacBell argues that this less generous tapered discount plan

> "will more narrowly target this important signal to customers most likely to consider bypassing. In addition, the number of customers estimated to actually receive the discount would be significantly reduced.... [I]t is estimated that the revenue deficiency would be substantially less than that originally estimated for the staff's proposal.... [A]nother advantage to this more targeted approach will be the preservation

of Pacific's OUTWATS customers during the time in which this temporary plan is in effect."

In the face of suggestions that the Commission might look to toll rates as a substantial source of increased revenues, PacBell argues that continued increases in toll rates are inappropriate in view of the changing market conditions PacBell and the ITCs face. According to PacBell,

> "Further increases can only exacerbate the potential bypass problem in that large business customers will see no end to price increases in toll services and thus continue to contemplate providing their own means of communications."

In late-filed testimony received into evidence April 6, 1984, staff witness Popenoe reinforced this position with special regard to substantial increases in short-haul intraLATA MTS rates. He stated that such increases would unfairly burden residential customers in areas with limited extended service, would give the wrong signal to potential bypassers, would give rise to demand for more Extended Area Service, and would complicate extension of ZUM service.

TURN also favors a discount for large-volume users of toll service, consistent with a general suggestion of a two-tier rate design for MTS offered by TURN witness Sylvia Siegel in the initial access charge phase of this proceeding. Like PacBell, TURN sees the staff-proposed discount threshold as unnecessarily low. In addition, TURN urges that the combined effects of intraLATA billing by PacBell and interLATA billing by AT&T-C (or a competitor) should be considered in setting a discount threshold. TURN also agrees with PacBell that the impact of an MTS discount on WATS usage should be considered, and sees a 20% discount as risking diversion of WATS customers.

TURN also opposes PacBell's proposed three-tier discount plan with its $15 monthly-subscription charge. TURN urges that this plan is unnecessarily complex, especially for a "short-term mechanism."

TURN proposes a two-tier plan, with a 15% discount for intraLATA usage over $1,000 per month. TURN favors increases in MTS rates rather than a general surcharge to make good the revenue lost by a discount plan.

In addressing the various proposals for changes in PacBell's rates and rate structure for MTS we stand at a critical juncture in the regulation of telephone rates. Once again, as in its access charge application last fall, PacBell raises an alarm about the risk of bypass and the threat of competition. In our interim access charge decision, D.83-12-024, we recognized the seriousness of the bypass risk but refused to be stampeded into drastic changes in rate design, finding as follows:

> "The extent of bypass among Pacific's larger customers offers grounds for concern but does not demonstrate a serious threat to Pacific's viability in the foreseeable future.
>
> "It is important to recognize the long-term problem of uneconomic bypass and to limit future incentives for uneconomic bypass."

Scarcely was the ink dry on our access charge decision when PacBell witness Evans revised his rate proposals to reduce toll revenues by a further $25 million. At a time when this Commission is obliged to impose rate increases to generate over $700 million in additional revenues ($434 million in interim surcharge revenues, plus $137 million in incremental revenues for the 1984 test year, plus $133 million to eliminate the present rate and billing surcharges), it is clearly a drastic rate design proposal to suggest that PacBell's toll rates be significantly reduced.

Our staff experts take seriously the risks and uncertainties of bypass, competition, and Federal policymaking. Witness Shantz proposes only nominal increases in MTS revenues. Witness Popenoe, perhaps the world's greatest expert in telephone separations matters, proposes a substantial discount in toll rates for high-volume users.

We share both staff's and PacBell's concerns that there are limits to the burden of revenue generation which MTS rates can sustain in the face of increasing bypass. As in the case of access charges, however, we believe that a moderate course will most successfully navigate the perilous waters ahead. We do not look to MTS rate increases as a primary means of shielding other services from the burden of increased revenue needs. However, facing the need to spread $900 million in annual revenue requirement, we believe MTS rates must share the burden as well. We will take care to assure the viability and fairness of any changes in toll rates. We note that the increases we are authorizing in MTS rates result in lower MTS rates overall than those presently in effect, due to removal of the current 10.32% surcharge.

Witness Popenoe has well substantiated both the fairness and the value of a discount plan for high-volume users of MTS. We find it appropriate to mitigate the extent to which high-volume toll users are required to bear the allocated NTS costs of local exchange plant. We also find that a discount plan for high-volume users of MTS is an appropriate means of deterring uneconomic bypass of the local exchange network and of retaining these subscribers' contribution through toll rates toward local exchange costs.

We note that PacBell believes a more modest discount, with a higher threshold, will suffice to achieve the goals of Popenoe's proposal. According to PacBell a more narrowly targeted discount plan would retain the intended signal to those most likely to consider bypass, substantially reduce the loss of revenue, and avoid diversion of WATS customers. We find it reasonable to rely on PacBell's judgment in setting the parameters of a more narrowly targeted discount plan.

In formulating a comparable optional discount calling plan for high volume users of interLATA toll service, AT&T-C has proposed

a $10 nonrecurring service order charge. Such a charge is appropriate for an optional discount plan, including PacBell's, to cover at least a portion of service order costs and to discourage frequent customer service changes.

We appreciate TURN's concern for simplicity in an MTS discount plan, but we do not consider PacBell's proposal unduly complex. We note that the estimated $22.5 million revenue impact of PacBell's proposal will not greatly exceed that of TURN's, but will permit a greater number of customers to share its benefits (an estimated 13,500 under PacBell's proposal compared to only 2,700 under TURN's). We do commend TURN, however, for having first proposed the concept of a declining block toll structure as a means of mitigating the bypass risk, and for having aided in the development of the record on this issue.

Staff, PacBell, and TURN all view the discounted toll proposals as interim, temporary, or short term. We will not set any such condition on the discount plan we will authorize. It may be that future developments will render a large user discount on MTS rates unfair or ineffective in meeting the goals of Commission policy, just as the Commission found declining block rates unreasonable for energy utilities in the mid-1970s. However, we reach no such judgment at this time.

We find reasonable a discount plan for large users of MTS as proposed by PacBell, subject to the condition that resellers shall be ineligible to participate in the plan, for the reasons stated by staff witness Popenoe. The revenue loss from the discount plan will be recovered through increases in the MTS rate schedule.

PACIFIC BELL

Message Toll Rate Schedule

Rate Mileage	Present Rates		Staff Proposal*		PacBell Proposal*		Adopted Rates*	
	Initial Minute	Add'l. Minute	Initial Minute	Add'l. Minute	Initial Minute	Add'l. Minute	Initial Minute	Add'l. Minute
0- 8	.15	.07	.18	.10	.04	.01	.17	.08
9- 12	.15	.07	.18	.10	.08	.04	.17	.08
13- 16	.17	.09	.20	.12	.11	.07	.20	.11
17- 20	.21	.13	.23	.15	.22	.14	.23	.14
21- 25	.24	.15	.26	.17	.25	.16	.26	.17
26- 30	.27	.18	.29	.20	.28	.18	.29	.20
31- 40	.30	.21	.32	.23	.30	.21	.32	.23
41- 50	.34	.25	.36	.27	.35	.26	.35	.26
51- 70	.38	.29	.39	.30	.35	.26	.38	.29
71- 90	.42	.33	.43	.34	.35	.26	.41	.32
91-110	.44	.34	.45	.35	.41	.30	.44	.34
111-130	.47	.36	.48	.37	.41	.30	.47	.36
131-150	.50	.38	.51	.39	.41	.30	.50	.38
151-170	.53	.40	.54	.41	.50	.39	.53	.40
171-195	.56	.42	.57	.43	.50	.39	.56	.42
196-220	.58	.43	.59	.44	.50	.39	.58	.43
221-245	.60	.44	.61	.45	.50	.39	.60	.44
over 245	.62	.45	.63	.46	.50	.39	.62	.45

*Assuming adoption of respective discount plans for high volume users.

We find it reasonable to require modest increases in short-haul MTS rates, for calls up to 50 miles, to recover the revenue loss due to the MTS discount plan, to generate some contribution toward the increased revenue requirement for 1984, and to mitigate pressures on revenue sources available to the ITCs which concur in PacBell's MTS rates. We note our intent to remove the present 10.32% surcharge from MTS rates and that the increases we will authorize amount in most cases to less than 10%. In only one case, the initial minute rate for the 13 to 16-mile band, will we raise an MTS rate by more than 2¢, and in that case only as part of an effort to regularize the gradations in the rate schedule. The following table compares the present, proposed, and adopted MTS rate schedules.

As can be seen, the adopted rates are, in every case, less than or equal to those proposed by staff in the context of the staff-proposed large user discount plan. We estimate that our changes in the MTS rate schedule, together with the adopted large user discount plan, will generate $71.3 million in increased net revenues to PacBell.

We find reasonable the other changes proposed by PacBell in MTS rate design, including RPSB, revised coin toll rates and rate structure, an operator surcharge for conference call, and an increased person operator handling surcharge. Only the last of these changes was opposed by staff, primarily on grounds of inconsistency between PacBell's desire to increase revenue contribution from this service and its contention that substantial toll increases are not sustainable. We doubt, however, that a 20% increase in the operator handling surcharge for person-to-person calls will exacerbate competitive pressures. The four categories of changes noted in this paragraph will generate a further $5.7 million in annual revenues.

All carriers which now concur in PacBell's MTS tariff will be subject to the changes in that tariff authorized for application to PacBell, including the terms of the authorized optional discount plan for high volume MTS users and the discount plan for TDD users discussed below.

2. Toll Rate Discount for TDD Users

A further toll service discount was proposed by Deaf Counseling, Advocacy & Referral Agency, Inc. (DCARA) for the benefit of the hearing impaired. DCARA proposes a 75% discount on all intrastate MTS calls made to or by certified hearing-impaired residential users of telecommunications devices for the deaf (TDDs). Because of the difficulty of identifying calls using TDDs, DCARA proposes that the discount be applied to all intrastate toll calls made by or to a residential subscriber household that has a certified deaf TDD user. The proposed discount would apply at all times and

would be additional to present time-of-day discounts. The proposal applies to the intrastate MTS schedule of AT&T-C as well as PacBell.

DCARA notes that California is one of only five states without some such discount and that AT&T-C offers a discount on interstate calls. Although 20% of TDDs in use in the nation are in California, DCARA asserts that the distribution of TDDs pursuant to this Commission's orders has "fallen woefully short of the goal set." DCARA attributes this to the high cost to the deaf of telephone service since TDD calls typically take four to five times longer than voice to transmit the same message. DCARA notes that deaf people typically have incomes far below the general average.

Both PacBell and AT&T-C concede that an MTS discount for the deaf is appropriate. They counter DCARA's proposal with proposals to apply the existing evening call discount to daytime calls made from certified deaf subscriber residences and to apply existing night/weekend call discounts to such evening calls. This approach is the same as approved by the FCC for interstate calling. The company proposals would not affect rates for TDD calls made during the off-peak night and weekend periods and would not apply to a call made to a TDD household unless it was made from another TDD household. Staff witness Popenoe indicated support for the AT&T-C proposal.

DCARA sees no substantial basis for not offering a discount during nights and weekends. DCARA justifies its proposed 75% discount as primarily based on the slower speed of TDD communications, while criticizing PacBell's proposed discounts as "based mostly on its view that using the interstate discount approach is 'reasonable.'" Interestingly PacBell's cost analysis showed that PacBell's proposed discounts would still result in profit being made from all TDD calls and that DCARA's discount would result in below cost charges during day and evening periods but in profitable

service during the night/weekend period. PacBell estimated that its proposed discount would result in a $437,000 annual revenue loss, increasing to $492,000 with a 75% off-peak discount, and to $1,187,000 at DCARA's proposed discounts.

PacBell is concerned that current technology does not permit it to identify economically non-TDD usage from a TDD household. PacBell considers such non-TDD usage to be the reason why calls from TDD households do not have significantly longer average holding times than other calls. DCARA itself cites the finding of a PacBell study that only 25% of calls made from certified deaf households were TDD calls. PacBell sees its discount proposal as

> "a reasonable solution which provides consistency between the intrastate and interstate jurisdictions and ... minimizes the costs associated with providing this discount."

PacBell suggests, however, that the issue of discounts for the hearing impaired is one of universal concern, which may be better considered in the context of an OII rather than as a rate design issue involving a single utility. PacBell is also concerned that any loss in revenue be recovered through contemporaneous compensating rate increases.

AT&T-C witness Kenneth Parker proposed a TDD user discount on interLATA MTS service comparable to that proposed by PacBell, but with lesser discounts, because AT&T-C is proposing to reduce to 25% and 50% the respective Evening Period and Night Period discounts, on interLATA toll rates. In late-filed Exhibit 739 Parker provided estimates of the revenues lost under three possible discount plans applied to interLATA toll, ranging between $213,000 and $969,000. AT&T-C did not address this issue on brief.

There is no opposition to establishment of discounts on toll service for the hearing impaired; there is disagreement as to the terms of such a discount. Based on the evidence submitted by

DCARA, the discount DCARA proposes is more liberal than that available in any state except Connecticut, and those proposed by PacBell and AT&T-C are about typical of what exists elsewhere in the country. DCARA's proposal to apply the discount to incoming as well as outgoing TDD household calls is matched in only three other states, Florida, North and South Carolina. Thus, DCARA's package would be a more generous discount plan that is offered anywhere today.

TDD calls take substantially longer than voice communications to transmit the same message. In view of the fact that MTS service is priced at a level intended to generate contribution toward recovery of local fixed costs, we find it reasonable to relieve the hearing impaired of a portion of the MTS charges they incur due to the relative slowness of communications using TDD facilities.

We are concerned by the fact that an MTS discount for TDD users cannot now be restricted to calls employing a TDD. We encourage PacBell and AT&T-C to explore technological means to so limit the availability of a TDD discount. In the meantime, we find it necessary to balance the interest in providing less expensive service to the hearing impaired against the loss of revenue which a TDD discount would generate through unintended benefits to non-TDD users in TDD households. We find that a significant discount in MTS rates is reasonable for calls made from residence subscriber households including at least one certified hearing-impaired TDD user, but that application of such a discount to incoming calls to such households is not justified at this time. The discounted MTS rates should not be set below cost.

Based on these findings we will approve the MTS discounts for TDD household proposed by PacBell and AT&T-C, except that a 75% discount will be provided during the off-peak night and weekend

period. This variation is justified by evidence that even at this discount off-peak service still would be provided well above cost, and that the incremental revenue loss would be slight. Therefore, we will require PacBell to provide certified TDD households the following discounts from the undiscounted schedule of MTS charges: Daytime Period service (8 a.m. - 5 p.m.) - 30%; Evening Period service (5 p.m. - 11 p.m.) - 60%; Night Period service (11 p.m. - 8 a.m.) - 75%. For reasons discussed in the context of AT&T-C rate design later in this decision, we will require AT&T-C to provide the following slightly different discounts: Daytime Period service - 25%; Evening Period service - 50%; Night Period service - 75%.

The expected annual revenue loss from the adopted MTS discounts for TDD users is $200,000 for PacBell and $300,000 for AT&T-C.

3. ORTS and OCMS

Optional Residence Telephone Service (ORTS) and Optional Calling Measured Service (OCMS) are optional discounted short-haul message toll services offered to residence one-party customers in limited portions of PacBell's and General's service areas. ORTS is offered in the San Francisco, Los Angeles, and Orange County areas; OCMS is offered on a route-by-route basis over many 9- to 40-mile routes in various areas of the state, particularly in areas with Single Message Rate Timing (SMRT) of local calls.

ORTS presently offers two options. Option 1, the Community Calling Plan, requires payment of a monthly charge, for each exchange area to which a subscriber seeks the service, of between $3.75 and $7.50 depending on the rate mileage (9 to 40 miles) between the home and target exchange area. For this payment the subscriber receives a calling allowance of between $7.55 and $23.65, again varying with the route mileage. Calls are charged against the allowance at 50% of the MTS rates or 100% of the ZUM rates otherwise applicable; once the allowance is exhausted the subscriber pays for further MTS calls at the discounted rate. The customer also may subscribe for double or triple allowances at comparable charges.

ORTS Option 2, the Circle Calling Plan, at a monthly charge of $4.75 offers a $3.00 usage allowance and the same 50% discount from MTS rates for calling to all exchange areas within 40 rate miles of the home exchange area.

OCMS offers a calling allowance calculated not in dollars of discounted usage but in hours of calling. Like ORTS Option 1, OCMS imposes a monthly charge for each exchange area to which a subscriber seeks the service. For a charge which varies between $2.25 and $4.50, depending on rate mileage (up to 40 miles), the customer receives a one-hour calling allowance per month. Two- or three-hour allowances can be subscribed for at double or triple the charge. For calling beyond the subscribed allowance the customer pays normal MTS charges. The most attractive feature of OCMS is that

only calling between 8:00 a.m. and 8:00 p.m. on Mondays through Fridays draws upon the allowance. All calling at other hours is free.

PacBell proposes drastic revisions in ORTS service and effectively the elimination of OCMS. Monthly charges for the Community Calling Plan would be decreased for short routes and increased for longer routes, to a range of $1.80 to $8.55 per subscribed exchange area. Calling allowances would be revised similarly and set at three times the monthly charge, between $5.40 and $25.65. Calls would be charged against the allowances (and charged to the customer once an allowance is exhausted) at 75% of the MTS rate otherwise applicable. This decrease in the MTS discount from 50% to 25% is the major change PacBell proposes in ORTS service. A 25% discount would also apply to ZUM routes, consistent with PacBell's proposal to set ZUM rates equal to MTS rates for the same mileage.

The same reduction in the ORTS discount applies to ORTS Option 2, the Circle Calling Plan. PacBell also proposes to eliminate the $3.00 monthly usage allowance under this plan, but would keep the monthly charge at $4.75. In effect, the new Circle Calling Plan would simply offer a 25% discount on all usage charges on calls of rate mileage up to 40 miles, at a charge of $4.75 per month.

PacBell proposes to replace the present terms of OCMS with the proposed terms of ORTS Option 1, the Community Calling Plan. OCMS would be eliminated in all but name.

PacBell also proposes to implement individual call billing detail for ORTS and OCMS calls. PacBell originally anticipated $11.4 million in additional annual revenues from the proposed changes, but adjusted that figure to $9.0 million to reflect reductions in its proposed MTS rates.

Staff proposes changes in ORTS and OCMS comparable to PacBell's proposals but with significant differences. For the Community Calling Plan staff's proposed monthly charges are higher

than PacBell's for routes of 9 to 20 miles and staff proposes calling allowances set at only two times the monthly charges. Staff, like PacBell, proposes to cut the discount on MTS rates from 50 to 25%. Consistent with its position that ZUM rates should remain lower than comparable MTS rates, staff does not join in PacBell's proposal of a ZUM rate discount for ORTS subscribers. Staff concurs in PacBell's proposals for the Circle Calling Plan and for replacing OCMS with the terms of the Community Calling Plan. The ORTS changes proposed by staff would increase statewide customer billings by $28.6 million with $20.0 million accruing to PacBell. Conversion of OCMS to ORTS Option 1 will provide PacBell a further $1.4 million in annual revenue. The major reason for these figures exceeding that calculated by PacBell is the difference between short-haul MTS rates proposed by PacBell and staff.

Staff contends that, in view of the diminution of statewide message toll earnings due to recognition of increased depreciation costs, all intrastate MTS users should no longer be required to support the present level of discount for ORTS and OCMS. Staff favors a reduction in the ORTS and OCMS discounts because these services are not available throughout PacBell's service area. Staff particularly objects to the free off-peak calling element of the present OCMS as contrary to the "pay for what you use" principle inherent in measured service rates for MTS and ZUM. Staff proposes that OCMS subscribers be provided written notice of the conversion to ORTS Option 1 at least 30 days prior to its implementation.

Farm Bureau supports the proposals to increase ORTS rates for the reasons stated by staff. DMA witness Patton likewise supports the proposed changes in ORTS and OCMS. No party opposed the general thrust of the PacBell and staff proposals.

We agree that customers of discounted services such as ORTS and OCMS should be required to bear a fair share of increased revenue requirements, particularly in view of the impact on toll separations of our recognition of higher depreciation costs for PacBell. We also

PACIFIC BELL

Optional Residence Telephone Service

Daytime Message Rates*
(First Minute/Additional Minute)

Rate Mileage	Present Rates	PacBell Proposed Rates	Staff Proposed Rates	75% of Adopted MTS Rates	70% of Adopted MTS Rates
9-12	7.5¢ 3.5¢	6.0¢ 3.0¢	12.0¢ 6.0¢	12.75¢ 6.0¢	11.9¢ 5.6¢
13-16	8.5 4.5	8.25 5.25	13.5 7.5	15.0 8.25	14.0 7.7
17-20	10.5 6.5	15.75 9.75	15.75 9.75	17.25 10.5	16.1 9.8
21-25	12.0 7.5	18.0 11.25	18.0 11.25	19.5 12.75	18.2 11.9
26-30	13.5 9.0	20.25 13.5	20.25 13.5	21.75 15.0	20.3 14.0
31-40	15.0 10.5	22.5 15.75	22.5 15.75	24.0 17.25	22.4 16.1

*For calling other than ZUM.

consider that the discounts allowed to ORTS and OCMS subscribers have been overly generous in the past, particularly in view of the fact that these services are not available to large numbers of the state's residence subscribers. In view of the dwindling sources available for contribution toward the maintenance of low basic rates, we find it necessary to diminish the preference in rate levels which has been allowed to ORTS and OCMS subscribers.

As will be discussed later, we are not adopting PacBell's proposal to set MTS and ZUM rates at uniform levels for comparable mileage. It is consistent with this result to adopt staff's rather than PacBell's proposed monthly charges and allowances for the ORTS Community Calling Plan. We agree with staff's proposal to limit ORTS Community Calling Plan allowances to a uniform two times the monthly charge, in order to impose a fair limit on the magnitude of potential discounts.

Our adopted increases in short-haul MTS rates and reductions in the ORTS discounts will have a cumulative impact on ORTS subscribers. We should avoid such a cumulative impact significantly exceeding that which was anticipated in staff's proposals. The table below compares the present ORTS message rates to those proposed by PacBell and staff and to those which result from applying a 25% or a 30% discount to our adopted MTS rates. A 30% discount on the adopted MTS rates produces ORTS message rates very close to the levels proposed by staff. We find it reasonable to adopt the changes in the structure and charges for ORTS service proposed by staff except that ORTS message rates will be calculated by applying a 30% discount to otherwise applicable MTS charges.

OCMS service poses a more difficult problem. We consider it preferable to have a common MTS discount plan available to as many as possible of the state's residence subscribers. We, therefore, find it reasonable to extend the offering of ORTS Option 1, the Community Calling Plan, to all routes on which OCMS is now available.

We are concerned, however, at the abrupt impact upon OCMS subscriber bills which elimination of OCMS might produce, especially in view of the changes in local calling areas which will result from ZUM expansion to some of the same areas now offering OCMS. We are also less persuaded than staff that it is a bad idea to offer unlimited off-peak calling at a flat monthly charge. The effects of such a service deserve careful study before it is eliminated. At the same time, OCMS clearly is even more severely underpriced than ORTS.

While it is inappropriate to discontinue the offering of OCMS at this time, we find it reasonable to authorize a 100% increase in rates for monthly calling allowances under this optional discount service.

ORTS and OCMS subscribers will be given the option to change services and/or allowance options without charge for up to three months. OCMS subscribers also will be offered free regrade to ORTS Option 1 for three months.

PacBell and General will be ordered to study subscriber usage of both ORTS and OCMS toward the goal of determining to what degree each of these services merely diverts usage which otherwise would be priced at higher MTS rates and to what degree each service generates additional usage which otherwise would not occur, and also to determine the effects of each service on intercompany settlements and separation of revenues. The results of these studies should inform this Commission's future actions relating to the continued offering of both ORTS and OCMS. Pending such action PacBell and General should not extend the offering of OCMS to additional routes.

We will not authorize PacBell to implement individual call detail billing for ORTS and OCMS calls at this time. No need has been shown for this change and we consider that avoidance of the cost associated with detail billing helps to justify the authorization of these discounted residence toll services. This denial is without prejudice to PacBell offering a better substantiated proposal for

detail billing of ORTS or OCMS in the future. In addition, we invite PacBell to submit an advice letter setting an appropriate tariffed rate for optional detail billing in conjunction with ORTS and OCMS.

We have adopted the staff proposals for ORTS and OCMS except that we have adopted different ORTS message rates which are higher by not more than one cent, we have not required detail billing, and we have doubled the monthly charges for OCMS rather than effectively eliminating the service. We estimate the revenue effect of the approved changes in ORTS and OCMS as a $38.4 million increase in annual customer billings, statewide, as a $26.9 million increase in annual revenues to PacBell, and as a $10.1 million revenue increase for General.

In D.93367 issued in PacBell's last general rate case, we ordered PacBell, General, Continental, and Citizens to submit testimony addressing the implementation of ORTS on a two-way basis over present one-way ORTS routes. Each of the four utilities filed testimony in compliance with D.93367. PacBell's filing was sponsored by its witness Evans. The submissions of the other companies were received into evidence near the close of proceedings without any party having sought to cross-examine the sponsoring witnesses.

PacBell determined that a total of 818 PacBell originating one-way intraLATA routes presently have "inward" ORTS but not return direction ORTS. There are also 172 such routes which originate in independent company exchanges and terminate in PacBell's, as well as some independent-to-independent routes. PacBell evaluates potential routes for expansion of ORTS based on community of interest indicators, specifically whether the route carries at least three calls per residence account monthly and at least 50% of residence accounts placing at least one call on the route per month. According to witness Evans only five of the 818 routes mentioned above meet both these criteria, and two already have OCMS. Nine other routes, four with OCMS, are close to meeting the criteria. Based on the

single criterion of at least 20% of residence accounts placing at least one call monthly, still only 89 of the 818 primary routes qualify, along with 103 intermediate routes.

PacBell studied the effects of implementing return direction ORTS on the 89 primary and 103 intermediate routes qualifying under the 20% criterion. PacBell estimates that this would produce 37,000 new ORTS customers, a 6% increase in ORTS subscribers, at $100,000 and $260,000 in additional expenses and customer billing loss, respectively, per year. The ORTS expansion also would require construction expenditures of slightly more than $2 million to handle increased usage.

PacBell does not support ORTS expansion on routes with low communities of interest. Witness Evans urged that expansion, though technically feasible, would be unwise because it would expend limited resources for the convenience and financial benefit of relatively few customers. He noted that expansion would increase PacBell's revenue requirement (slightly) due to increased capital expenditures and the loss of toll revenues. PacBell's major concern is whether, rather than providing ORTS to the identified exchanges, ORTS should be replaced with a suitable statewide optional calling plan. Evans suggested that in any event the Commission should not expand ORTS beyond the 89 primary and 103 intermediate routes identified in his Exhibit 573, Attachment F.

Staff witness Shantz criticized PacBell's position on return direction ORTS, noting that many specific investments benefit "relatively few customers" and that the $260,000 loss in toll revenues from ORTS expansion is far less than what would result from PacBell's proposed reduction in MTS rates. Shantz also criticized PacBell's suggestion of a "suitable statewide optional calling plan," because PacBell offered no suggestions as to the nature of such a plan or when it could be available.

Staff supports expansion of ORTS to the 192 additional routes selected by PacBell. According to Shantz, this will provide an appropriate temporary solution to a longstanding problem.

General also opposes ORTS expansion, for reasons similar to PacBell. In parallel with PacBell's suggestions, General selected 16 routes for ORTS expansion based on criteria similar to those used by PacBell in selecting its 192 expansion routes. Staff recommends that General be directed to offer return direction ORTS over these routes.

Continental opposes ORTS expansion as well, but indicates that its return direction ORTS routes with the highest demand are presently OCMS routes serving the Gilroy exchange. Since staff recommends that OCMS be made equivalent to ORTS, staff sees no further ORTS expansion by Continental as necessary at this time. Citizens does not presently offer ORTS or OCMS and opposes ORTS expansion. Staff does not propose to require ORTS on routes originating in Citizens exchanges.

Staff estimates that expanding ORTS to include the 192 PacBell routes and 16 General routes indicated will increase net revenues to PacBell by $0.1 million in 1984.

In view of the relatively low cost estimated by PacBell for ORTS expansion and our interest in making an optional toll plan available to as many of the state's residence subscribers as feasible, it is reasonable to require PacBell and General to undertake promptly the expansion of ORTS service to include the 192 PacBell and 16 General return direction routes discussed above. Such expansion of ORTS should be completed within 24 months of the effective date of this decision. We estimate the total impact of approved changes in ORTS and OCMS to be a $38.8 million increase in annual statewide billing and a $27.2 million increase in PacBell revenues.

4. Foreign Exchange Service

FEX service is primary telephone service which has dial tone and access to the network provided from an exchange or district

area other than the one in which the customer's premises are located. FEX service consists of a basic exchange access line plus network facilities connecting the customer's home central office to the remote central office of the customer's choice.

In D.93367 we ordered PacBell to:

> "...include as a part of its next major rate application cost studies which develop the costs associated with FEX access lines including Central Office costs, the line haul portion of FEX services and the costs associated with the establishment of FEX services. These cost studies should be the basis for a proposed tariff to be included in Pacific's next major rate application along with the revenue effect of the proposed tariff."

PacBell performed such cost studies, which indicated that mileage rates for most FEX services fail to cover costs, particularly for the 83% of FEX services which are between contiguous exchanges, and that FEX service connection costs drastically exceed present charges. PacBell witness Evans explained:

> "FEX service is costly to provide because it is generally both labor and facility intensive. FEX service establishment usually requires more labor because more record work is required, more internal coordination is necessary, and in most cases more craft labor is needed to connect and test the facilities. Additionally, a foreign exchange line often requires a dedicated facility - [...which is] often underutilized resulting in noneconomic facility usage and unnecessary additional network investment."

Evans proposed that FEX rates be set at full cost levels, for the following reasons:

> "FEX is a discretionary, optional, premium service, and should not be priced at levels which require subsidies from other customers. In fact, I strongly believe that a premium service like Foreign Exchange service should be priced to generate a subsidy, not receive one."

For guidance in setting monthly recurring FEX charges, Evans looked to PacBell's access line cost study, which loads in the entire cost of the local loop. Evans therefore proposed the drastic increases in monthly residential FEX rates and the more moderate business rate increase shown in the table on the following page. He also proposed even more drastic increases for nonrecurring FEX charges, also shown on that table. His proposed mileage rates, however, appear inconsistent with the cost study results.

Evans testified that demand for residence FEX service by new customers would be "essentially eliminated" at the proposed charges. He therefore proposed to "grandfather" this service to existing customers, withdrawing the offering of residence FEX service to new customers. He projected that 90% of present residence FEX customers would leave the service by the end of 1984 if the proposed rates take effect.

PacBell also proposes to restructure recurring mileage charges on a rate-center-to-rate-center basis for contiguous FEX services, as is presently done for noncontiguous routes. This is seen as a more equitable approach reflective of service costs. PacBell also proposes to apply its Foreign Prefix Service rates to all new services existing customers may add. Evans projected an annual revenue increase of $33.8 million from all the proposed rate charges for FEX service.

PACIFIC Bell

Foreign Exchange Service Rates

Type of Rate	Present Rate	PacBell Indicated Cost	PacBell Proposed Rate	Staff Proposed Rate[1]	Adopted Rate
Monthly Recurring Rates					
Residence Flat	$ 8.20 or 8.50	$ 31.00	$31.00**	$10.65[ø]	$ 15.00
Residence Measured	4.65*	22.50	22.50**	5.80*[ø]	8.50*
Business Measured	15.50	19.50	19.50	15.50	19.50
Mileage Rates					
Residence Flat	1.60/⅓ mile	30% of revenues	$2.50/mile	No	No
Residence Measured	1.25/¼ mile	contiguous	contiguous	Change	Change
Business Flat	3.20/⅓ mile	90% of revenues	$7.00/mile		
		noncontiguous	noncontiguous		
[1]Service Connection Charges					
Simple Residence					
Contiguous	62.00	287.00	øø	63.50	130.00
Noncontiguous	109.00	567.00	øø	110.50	230.00
Simple Business					
Contiguous	73.00	333.00	395.00	140.00	190.00
Noncontiguous	120.00	573.00	395.00	187.00	290.00
Complex Business					
Contiguous	104.65	333.00	395.00	140.00	190.00
Noncontiguous	151.65	573.00	395.00	187.00	290.00

*Includes a $3.60 usage allowance

**Proposed rates were revised to $13.00 flat, $7.25 measured in January 1984.

[ø]Proposed rates were revised to $12.00 flat, $6.25 measured in January 1984.

[øø]PacBell proposes to eliminate residence FEX service except on a grandfathered basis.

In his January testimony revising his proposed rate design to suit a lower revenue requirement, Evans reduced his proposed residence FEX rates from $31.00 to $13.00 and from $22.50 to $7.25 for flat and measured rate service, respectively. He retained the proposal to grandfather residence FEX service, but eliminated his proposals to restructure and increase mileage rates. The projected revenue increase was reduced to $24.1 million.

Staff criticizes various aspects of PacBell's FEX rate proposals, generally favoring substantially lesser increases. Staff witness Shantz stated that aggregate business FEX revenues cover the costs of these services, so that the "extreme increases" proposed by PacBell are unwarranted. Staff fears the viability of business FEX service may be threatened by such increases.

Staff recognizes that residence FEX revenues fall substantially short of costs, but sees an ongoing decline in residence FEX services resulting from rate increases authorized in 1981. Staff sees this gradual attrition as preferable to the severe rate increases and elimination of service proposed by PacBell.

Staff witness Shantz criticized PacBell's proposal to restructure and increase mileage rates as inconsistent with the company's cost study results and inadequately explained on the record. He testified that in many cases the proposed rate-center-to-rate-center structure would set mileage rates above cost. Shantz contended that PacBell underestimated the revenues to be generated by this and other proposed rate changes.

The staff-proposed increases in FEX rates are shown in the preceding table. The proposed increases in monthly residence FEX rates are of the same percentage as staff proposes for basic access line rates, a principle which PacBell witness Evans adopted in his January rate design revision. The staff-proposed service connection charges likewise are of the same percentage as the staff-proposed increases in such charges for basic access lines. Staff witness Shantz proposed no increase in recurring business FEX rates but

proposed to increase business FEX service connection charges by the same dollar amount as he proposed for simple basic business access line connections.

On cross-examination Shantz explained his opposition to drastic increases in FEX rates:

> "Foreign exchange has been chosen as a desirable service by the customers perhaps because the company has never studied many of the larger calling areas such as San Diego, Sacramento with the idea of perhaps expanding the--whatever program you want to talk about--extended area service where eight-mile routes are free or the ZUM service or whatever.
>
> "Foreign exchange service has been selected by the customer body as their alternative to expanding their local calling areas because the utility has chosen not to.
>
> "To come in now and literally price foreign exchange out of existence without solving what is really caused [customers] to be attracted to the service is ridiculous.
>
> *****
>
> "We've brought this problem up to Pacific and General repeatedly, and repeatedly they've refused to deal with the question.
>
> "In the rural areas you may find circumstances where foreign exchange service is the only service that customers can get at a reasonable rate. And to foreclose service in total by pricing the inward cost at $400 is unreasonable to these customers."

Staff also proposes that PacBell be ordered to provide a study of the cost of implementing and offering Remote Call Foreign Exchange (RCFX), a proposed software-based alternative to the present FEX service which would be available between exchange areas served by electronic central offices and would be less labor and facility intensive than the present service. Staff further proposes that PacBell be ordered to submit as part of its next general rate

application a revised FEX tariff which provides for application of the local exchange access rate for the exchange from which dial tone originates and a separate, incremental FEX rate. This kind of unbundling would facilitate development of "serving company billing," under which each serving company would bill the customer for that portion of an FEX service which that company provides.

DMA witness Patton supports PacBell's original FEX rate proposals because he favors "unusual efforts" to recover full costs from users of discretionary services. Patton suggested that staff's concern about customers with no alternative FEX service could be dealt with by transferring such an area to a different exchange or even a different company's serving area. Farm Bureau, on the other hand, opposes moving FEX rates toward costs as rapidly as PacBell recommends.

Raymond Horton, a retired PacBell employee who was PacBell's project manager for FEX service until July 1983 and worked on three major rate applications in that capacity, testified,

> "...representing myself and perhaps the millions of basic exchange customers who are subsidizing the thousands of foreign exchange customers."

Horton compared various FEX service configurations, pointing out that the present method of measuring contiguous FEX mileage, from the customer to the exchange boundary rather than between exchange rate centers, tends to underestimate the cost of dedicated interoffice facilities and leads to inconsistent charges. He supported PacBell's proposal to measure contiguous mileage between rate centers as simpler, more standardized, and less costly to administer. Horton also supported PacBell's initial proposals to simplify residence mileage rates, eliminate the usage allowance from the residence FEX measured rate, and "freeze" residence FEX service to present subscribers only.

As staff witness Shantz testified, there are some customers who have no practical alternative to FEX services. However, for most

FEX subscribers it is an optional service. As such, we find it reasonable to increase FEX rates to provide greater coverage of costs and, if possible, to generate contribution toward the support of basic service. We see potential merit in Patton's suggestion of exchange area or service area transfers to respond to isolated problems for individual customers, and we instruct staff, PacBell, and the independent companies to consider such transfers as options for dealing with this type of problem.

The adopted FEX rates shown on page 230 are reasonable because they are set closer to covering the cost of providing this service.

With respect to FEX service connection charges, we see great similarity to the nonrecurring charges for private line services discussed earlier in this decision. PacBell's cost studies show a disparity between costs and charges for FEX service connections of 300 to 500%, less extreme than in the case of private line services, but still excessive. We find that a 100% increase in charges for typical FEX service connections (computed including the current 5.4% surcharge and rounded to the nearest $5.00, as illustrated in the preceding table), reasonably balances the need to

set these charges closer to cost while avoiding the extreme increases which staff fears might render both residence and business FEX service nonviable. Based on our finding in the general discussion of service connection charges, supra, that simple and complex business line installation charges should not differ markedly, we will set FEX service connection charges for simple and complex business lines at the unweighted average between the indicated increase levels, rounded upward because most business FEX installations are of the complex type.

These authorized increases retain the cost-based distinction between contiguous and noncontiguous FEX services. In the unusual cases of residential customers for whom basic service is impractical and FEX service is the only service reasonably available, we encourage staff and the telephone companies to consider exchange and service area changes to accommodate customer needs.

Horton's testimony persuades us that it would be reasonable to approve the proposed restructuring of FEX mileage rates had PacBell offered a cost-based set of rates to go with it. Rather than doing so, PacBell responded to staff criticism by dropping its proposal. Therefore, we can authorize no change in FEX mileage rates at this time. We do find it reasonable for PacBell to revise its Foreign Prefix Service tariff as set forth in Exhibit 619, Appendix N.

We reject PacBell's proposal to withdraw residence FEX service for new subscribers and to grandfather the service for existing subscribers. The evidence indicates that the service will be unattractive to most residence customers and that the higher rates we are authorizing are likely to accelerate the present declining trend in the number of residence FEX subscribers. However, we see no justification for the discrimination between existing and new subscribers which would be inherent in grandfathering residence FEX service.

The proposed rates for FEX services are projected to generate $17.7 million in additional annual revenues to PacBell.

F. Local Measured Service

One of the most controversial topics in this proceeding has been the future direction of local measured service (LMS). A variety of proposals have been offered, often at cross purposes to one another.

PacBell's witnesses have spoken abstractly about the need to establish measured residence service as the norm, while proposing changes in access line rates counterproductive to that goal. PacBell also has proposed drastic increases in Zone Usage Measurement (ZUM) rates to effect equality between ZUM and MTS rates for corresponding mileage bands. PacBell has further proposed to redraw local exchange boundaries and extend the three-zone ZUM rate structure to three major metropolitan areas now subject to the Single Message Rate Timing (SMRT) plan. PacBell proposes to convert all remaining SMRT areas to the ZUM Zone 1 rate structure.

Staff supports the trend toward measured service. Staff endorses PacBell's proposals to redraw exchange boundaries and to convert from SMRT to the ZUM rate structure in the San Diego, Orange County, and Sacramento areas, and to ZUM Zone 1 rates in other measured service areas. However, staff opposes the ZUM rate levels sought by PacBell, proposing lesser increases in these charges.

TURN opposes the whole concept of LMS, contending that flat rate services are better aligned with the costs of providing service and better suited to the interests of customers. TURN would abolish rather than expand ZUM, preferring instead to expand flat rate local calling areas. TURN proposes an optional metropolitan flat-rate calling plan, priced at a premium level.

Large Users concentrate their fire on the proposed increases in ZUM rates. They oppose any such increase, except possibly an increase in Zone 1 rates balanced by decreases for Zones 2 and 3. Large Users witness Lee Selwyn contended that service within "local or metropolitan networks" is provided differently, and

more efficiently, than toll service. Large Users justify lower rates for ZUM based both on cost and community of interest considerations. Witness Selwyn criticized the expansion of LMS to additional metropolitan areas without clearer indication that its benefits will exceed its costs. However, he urged that ZUM rates be applied to longer calling distances in areas where ZUM is already in place.

DMA is less concerned with ZUM rates than with the cumulative impacts of rate changes, exchange area reconfiguration, and ZUM expansion. DMA opposes the proposed local area changes and ZUM expansion in the San Diego, Orange County, and Sacramento areas, asserting a lack of adequate public notice and pointing out the drastic increases in charges on certain calling routes due primarily to the combined effect of the PacBell proposals. DMA witness Patton also criticized and opposed the proposed ZUM rate increases as inadequately cost-justified.

Several other parties commented on LMS issues as well. Farm Bureau opposes increases in ZUM rates of the magnitude proposed by PacBell. The City of Los Angeles opposes expansion of ZUM or increases in ZUM rates without more evidence to support a finding that ZUM is in the public interest. Los Angeles calls for study of a broader substitution of ZUM for MTS rates to connect communities of interest within the Los Angeles area. Los Angeles also calls for study of whether detailed billing of ZUM calls should be made an optional service. Dr. Brylawski, on the other hand, opposes any change in the current policy of itemizing ZUM calls on customer bills.

1. Evaluation of Local Measured Service

TURN urges that LMS should be eliminated. Its argument is based solely on cost considerations. TURN contends that LMS costs more to provide than flat rate service, because LMS requires additional measuring and billing equipment. TURN points to PacBell's category cost analysis which indicates measurement costs of up to nearly 3¢ per message for day period calls. TURN misinterprets these

figures as showing a 3¢ per minute cost, which is incorrect, but the fact remains that PacBell's studies of embedded costs assign a significant portion of local switching costs to the measurement function.

TURN contends that LMS produces no cost savings to offset the costs of measurement. TURN witness Richard Gabel testified that studies in other jurisdictions indicated that implementation of LMS does not reduce "busy hour" usage, and may even increase it because lower recurring monthly access line rates encourage customers to lease more lines, thus expanding their own busy hour calling capacity. Large Users witness Lee Selwyn testified to the same effect.

TURN goes on to argue that, thus,

> "There is no cost justification to charge less for LMS than for residential flat rate service. The present discount therefore understates LMS costs, in order to attract customers to the underpriced service. Every LMS customer is being subsidized by the flat rate customers, since residual pricing forces unmet costs onto monthly flat rate charges."

According to TURN, if monthly residence rates are adjusted to match costs, "LMS will become unattractive to virtually all residential customers." In order to eliminate "a completely unjustified subsidy" for measured rate residence subscribers, TURN recommends that LMS be eliminated.

The logical implication of TURN's position is that virtually all costs of the local network, including not only the NTS costs of the local loop but also local switching and interoffice trunking costs, should be recovered through fixed monthly charges. This, in fact, was the recommendation of TURN witness Gabel, with the exception that the present allocation of a portion of these costs to toll services should be maintained. At transcript pages 12034 to 12036, Gabel expressly recommended that both the portion of NTS costs not assigned to toll and the entire cost of local usage be recovered through the recurring monthly charge.

As PacBell proceeds with its modernization of local switching facilities to install electronic switches capable of meeting its equal access obligations under the Bell System divestiture consent decree, the capacity of those local facilities both to meet busy hour demand and to measure local usage is being enhanced substantially. We could follow the procedures of PacBell's category analysis to assign all the embedded costs of these facilities among access line, local usage, and toll access cost categories. We also could undertake a detailed study of the incremental costs which demand for access lines, local usage, intraLATA toll usage, and interLATA toll access imposes on the local network. We expect that we would find a tremendous gap between incremental and embedded costs, particularly with respect to local switching facilities. To the extent that revenue requirement

resulting from the embedded cost of these facilities exceeds the incremental costs caused by demands for specific services, we must allocate that revenue requirement based on considerations other than cost. Most prominent among those considerations is the achievement of an equitable balance among customers making modest use of telecommunications services and those who make greater use of these services. This is the justification for assigning some of these costs to other services, especially optional services. It is also the justification for LMS.

LMS has existed in California since the earliest days of regulation of the predecessors to PacBell. Even prior to this Commission's authority over exchange telephone services, local governments had authorized measured rates for services within the San Francisco-East Bay Exchange of The Pacific Telephone and Telegraph Company (PT&T). In D.21766, issued November 7, 1929, the Commission's first decision reviewing PT&T's rates for service within that exchange, the Commission reviewed an existing "transbay rate" for "service between the San Francisco zone and East Bay zone of the San Francisco-East Bay exchange area," which was then set at 10¢ for the first three minutes and 3¢ per minute thereafter. The Commission authorized a revision in that intraexchange rate to 10¢ for the first five minutes and 5¢ for each additional three minutes. (Pacific Tel. & Tel. Co. (1929), D.21766, 33 CRC ~~737, 776, 795~~.) In that decision the Commission also required that the flat rate business service of the East Bay be replaced by measured rate service. (Id. at 776.)

The Commission had previously set forth its rationale for LMS in a 1924 decision concerning a PT&T-affiliated company serving Southern California. In D.14420, issued December 31, 1924, the Commission ordered Southern California Telephone Company to establish an optional measured service rate for business subscribers and for that service to be made mandatory as soon as feasible. The Commission explained its action in the following terms, suggestive of the present concern over maintenance of universal service:

"With the enormous growth of Los Angeles, the differentials in charges of the present rates applying to these classes of service have become such that the residence subscribers are paying more than their proportionate share, and the business and private branch exchange subscribers--and particularly the latter--are paying much less than their proper share. As a community grows, the value of telephone service to business subscribers increases at a very much faster rate than to residence subscribers. In fact, the value to residence subscribers soon reaches a maximum at which point an increase in rates in general will result in a decreased use of service, accompanied by a decrease in revenue.

"As heretofore stated, we believe that flat rate service for individual business line and commercial private branch exchange service should be continued only until measured service can be established and the subscriber be given ample opportunity to become familiar with the new rates and their application. The measured rates herein fixed for business service will result in a reduction in charges compared with the present flat rates to a considerable number of users and to those business subscribers having a relatively small demand for service. Those subscribers having a large demand for service will have their rates increased and under the measured rates the increase will be nearly in proportion to the number of telephone calls made." (Southern California Tel. Co. (1924), D.14420, 25 CRC 721, 768-69.)

When it denied a petition for rehearing of its order mandating business measured service, the Commission instituted a detailed inquiry into the application and operation of the new measured rates. Based upon a "very complete analysis of the actual use of telephone service by business subscribers," the Commission concluded,

"...that to more equitably divide the burden of maintaining telephone service some method of proportioning charges in relation to the use of service should be made effective in which the

> small user will bear a lesser burden and the larger user will bear a greater burden than will result under the application of flat rates." (Re Operation & Application of Measured Rates Within the Los Angeles Exchange Area of the Southern California Tel. Co. (1926), D.15830, 27 CRC 409, 412.)

The same conclusion was echoed almost half a century later in Pacific Tel. & Tel. Co. (1968), D.74917, 69 CPUC 53, 82.

With exceptions such as the transbay rate within the San Francisco-East Bay exchange, LMS for many years was mainly counted but not timed. In 1974 the Commission approved the application of SMRT to local messages for both business and residence customers. As the Commission explained its action,

> "The reason for instituting the timing of local messages is that the present rate structure fails to make any allowance for the fact that a customer who makes a five-minute call is charged one message unit at 4.5 cents whereas another customer who makes a six-hour call over the same route is also charged one message unit at 4.5 cents. Business customers' holding times on a single call may in some cases last for an entire business day. Some residence customers also have extremely long duration calls." (Pacific Tel. & Tel. Co. (1974), D.83162, 77 CPUC 117, 174.)

In a 1977 decision on rehearing the Commission reviewed its reasons for authorizing SMRT:

> "Pacific has traditionally designed its local exchange capacity with adequate margin to handle calling volumes and call durations during periods of peak subscriber usage. Logically, if the growth in peak period calling volumes is slowed Pacific will not have to build as much local exchange capacity. We adopted SMRT, and ordered Pacific to use equipment that could accommodate off-peak timing, to allow reduced off-peak pricing as a means of discouraging long holding times during the peak calling period.

> "SMRT is a rate structure that is usage sensitive, which simply means that those who use something more pay proportionally more for their use. This is the most equitable way to price telephone service. We anticipate complaints about SMRT from users who routinely have long local call holding times, and who will not alter their calling habits, but they are the users who should contribute more to maintain the telephone network.
>
> * * *
>
> "It is our long range goal to implement SMRT for all of Pacific's subscribers, both residential and business, in at least Pacific's metropolitan and mini-metropolitan rate areas." (Pacific Tel. & Tel. Co. (1977), D.87584, 82 CPUC 162, 164-65.)

Finally, in 1979, the Commission began a conversion from SMRT to ZUM, which included provision for lower off-peak pricing. However, due to a lack of data reflecting experience with ZUM, the Commission maintained its commitment to SMRT implementation "as the fulfillment of our policy of achieving usage sensitive telephone rates throughout the state." (Pacific Tel. & Tel. Co. (1979), D.90642, 2 CPUC 2d 89, 176, 228.)

The purpose of this review of 60 years of Commission decisions fostering the development of LMS is to make clear that the predominant theme in those decisions has not been a quest for an exact equation of rates with costs of service but rather an interest in equitable pricing of that service. Except as necessary to assure the maintenance of universal service, we find, as we found 58 years ago, that proportioning charges in relation to the use of local telephone service more equitably divides the burden of maintaining that service than under a flat rate approach. We find, in addition, that the availability of optional measured service to residence subscribers does not unfairly burden flat rate subscribers but rather enhances the quality of all residence service by permitting each subscriber to choose the grade of service best meeting his or her

needs. We remain committed to expanding the availability of measured service, mandatory for business and optional for residence subscribers, throughout PacBell's service area.

2. ZUM Rate Levels

PacBell proposes substantial increases in ZUM rates, with the goal of eliminating the "disparity" between ZUM and MTS rates. PacBell witness Evans testified that it was difficult to justify such large differences in rates between ZUM and toll calls of the same distance. In his January 1984 revised rate design Evans decreased his proposed ZUM rates to match his proposed reductions in MTS rates. PacBell also proposes to implement RPSB for ZUM usage, just as for toll as discussed earlier.

Staff supports increases in ZUM rates, but not of the magnitude proposed by PacBell. Staff does not accept the concept that a disparity between toll and ZUM rates is necessarily unreasonable, pointing to the example of ORTS rates which are massively discounted from MTS rate levels. Because local usage is discretionary, staff does favor increasing these rates before basic access line rates are increased. Staff supports the application of RPSB to ZUM usage.

Large Users contend that PacBell's proposed increases in ZUM rates are not supported by cost data and conflict with Commission policy promoting telephone use within local communities of interest. Large Users assert that PacBell's ZUM rate proposal "apparently has very little to do with the cost of providing ZUM calling," noting that witness Evans appears not to have reviewed any cost data respecting ZUM.

Large Users witness Selwyn challenged PacBell's contention that ZUM and MTS are similar services which should be priced according to the same schedule. He noted that in D.90462 the Commission had rejected an attempt by PT&T to apply the MTS rate schedule to Zones 2 and 3 local calls and that the present proposal sought the same result. Selwyn contended that local and toll message

services are fundamentally different in character, exhibit considerably different cost characteristics, are furnished under significantly different serving arrangements, and are properly priced as entirely separate and distinct services.

Selwyn proposed that, rather than converting ZUM rates to MTS levels, PacBell should be required to extend ZUM rate treatment to certain existing message toll routes which are part of "local or metropolitan networks." According to Selwyn the characteristics of a metropolitan network permit more efficient routing of traffic than is typical of toll network arrangements, which require the use of multiple switching points. Selwyn pointed out that the New York Public Service Commission had recently ordered New York Telephone to file such a "toll elimination plan" covering toll routes between New York City and Suffolk County, Long Island.

Selwyn urged that PacBell be required to study the costs of individual messages disaggregated on the basis of the type of serving arrangement (local vs. toll) rather than the current type of pricing treatment. The study would separately identify costs associated with low-cost, high-volume routes, which might then be converted to ZUM pricing. He recommended that ZUM calling areas be defined on the basis of both network architecture and community of interest considerations.

Selwyn also pointed out numerous inconsistencies in the various workpapers relating to PacBell's ZUM service cost estimates. Making adjustments for PacBell's seemingly low revenue growth and overly high inflation assumptions, Selwyn derived his own calculation of 1984 local usage costs from PacBell's 1981 unit costs. Selwyn's calculations indicate that ZUM service now generates overall revenues in excess of cost, particularly for Zones 2 and 3.

PacBell rebuttal witness Scholl responded to Selwyn by challenging his distinction between metropolitan and toll networks. According to Scholl,

> "In a LATA configuration, there is very little difference in the basic network serving arrangement which handles equivalent distance messages whether they are local, ZUM, or LATA toll."

Scholl asserted that, while Selwyn's analysis of the network may have been true many years ago, it is not true today, especially in an intraLATA serving arrangement.

Scholl replied to Selwyn's analysis of ZUM costs by contending that Selwyn had unnecessarily relied on 1981 data when 1983 data were available to him, and that the later data confirmed that ZUM service revenues were not covering its costs. In further rebuttal to TURN witness Gabel, Scholl presented PacBell's final calculation of ZUM costs.

We agree with witness Selwyn and Large Users that there are significant differences between ZUM service provided in a metropolitan area and short-haul toll service provided elsewhere in PacBell's service area. The differences are matters of averages: The typical ZUM route is denser and provides service more efficiently than the typical MTS route of the same distance; the typical ZUM route lies within a community of interests more intense than the typical MTS route. Even PacBell's own cost data, provided in Exhibit 608 as a response to a transcript request by the ALJ, indicated significantly higher costs for MTS calls than for ZUM calls of the same distance.

We find it reasonable to maintain ZUM rates at levels substantially lower than the MTS rates for the same lengths of call. This finding is based on the fact that the costs of ZUM calling are typically less than for equivalent MTS calls and on the fact that ZUM calling serves the needs of local communities of interest.

We do not, however, share Large Users' view that ZUM rates should not be set above cost. The allocation of embedded costs can guide our determination of rates for local usage, but we find it reasonable to set these rates at levels which may generate some contribution toward the recovery of local NTS costs as well.

Present and proposed ZUM rates for the day period, together with the corresponding costs of ZUM service indicated by Large Users witness Selwyn and PacBell witness Scholl, are set forth below:

PACIFIC BELL
Zone Usage Measurement Service Costs and Rates
Initial Minute (Day Period)

Mileage Band	Costs Per Selwyn Exh. 652	Costs Per Scholl Exh. 713	Present Rate	PacBell Proposed 10/83 Rate	PacBell Proposed 11/84 Rate	Staff Proposed Rate
			Initial Minute (Day Period)			
0- 8 miles	4.48¢	4.12¢	3¢	4¢	4¢	4¢
9-12 miles	5.56	8.65	6	10	8	7
13-16 miles	6.08	9.91	8	13	11	9
			Additional Minute (Day Period)			
0- 8 miles	0.83¢	1.07¢	1¢	1¢	1¢	1¢
9-12 miles	1.24	2.13	3	5	4	4
13-16 miles	1.50	2.78	5	7	7	6

As can be seen PacBell is now proposing increases of from one to three cents in each per minute ZUM rate except the Zone 1 additional minute rate. Staff proposes to increase all except that rate by one cent.

The costs developed by witness Scholl suggest that increases close to what PacBell proposes are appropriate for the initial minute rates, but that no increases at all should be made for the additional minutes. Scholl's exhibit indicates similar results for the discounted and lower cost off-peak periods. Selwyn's cost calculations also indicate an increase is needed in the Zone 1 initial minute rate, but that other initial minute rates slightly exceed cost and the additional minute rates far exceed cost, especially for Zones 2 and 3. The two cost studies are consistent in

showing it more appropriate to increase rates for the initial minute than for additional minutes.

We find it reasonable to increase initial minute rates for calling in ZUM Zones 1, 2, and 3 to 4¢, 8¢, and 10¢, respectively, but that it would not be reasonable to authorize any increase in additional minute rates at this time. We also find it reasonable, as in the case of MTS, for RPSB to be applied to the calculation of ZUM charges. The revenue effect of these changes in ZUM rates for the test year is estimated as a net increase of $47.2 million for PacBell.

We find merit in witness Selwyn's proposal to study the costs of individual messages within metropolitan regions disaggregated by type of serving arrangement rather than by current pricing treatment. We will order PacBell to undertake such a cost study of calling routes in the San Francisco-East Bay Extended Area and in the Los Angeles Extended Area based on statistical samples of each area adequate to meet customary standards of statistical reliability. As part of this cost study PacBell also should disaggregate calling routes within these metropolitan areas by rate mileage and should study the relationships among serving arrangement, rate mileage, and cost of service. This study should be undertaken promptly, in hopes that meaningful results can be obtained in time for consideration in the course of PacBell's next general rate proceeding.

3. Local Area Reconfiguration and ZUM Expansion

Apart from its proposed increases in ZUM rates, PacBell also proposes to redraw local area boundaries in the San Diego, Orange County, and Sacramento areas and to substitute ZUM for SMRT as the method of charging for local calls in those areas. As explained by PacBell witness Evans,

> "Pacific proposes to expand the San Diego Extended Area to include the exchanges in Northern San Diego County, and to reorganize a number of

exchanges to establish equitable local calling areas. This will mean combining some exchanges, dividing or redistricting others, and then establishing local calling areas according to the ZUM structure. Similar reorganization will be required in Orange County.

"At the time that the current extended areas were established, Orange County and San Diego were much less populous than they are today, and one central office was capable of serving a large geographic area. The population has grown, and new central offices have been added and some exchanges have been subdivided into new exchanges. Generally speaking, most customers retained their same local calling areas through this growth process, which has resulted in some customers having much larger local calling areas than other customers. This problem is compounded by the development of new communities outside the boundaries of the extended area because these new communities have a smaller local calling area consisting of the customer's exchange."

No such exchange boundary changes are proposed for the Sacramento area.

The Commission required in D.93367 that PacBell, General, Citizens, and Roseville Telephone Company (Roseville) submit as part of this proceeding testimony and exhibits addressing the feasibility and revenue requirement and billing effects of implementing ZUM in the three areas covered by PacBell's proposal as well as certain General exchanges in the Los Angeles area. D.93367 also required that the four utilities provide written notice to customers who would be affected by the change. (6 CPUC 2d at 556, 579.) PacBell consolidated and presented the submissions of the four utilities, as revised in the course of this proceeding, in Exhibits 687, 688, and 689.

PacBell's proposal to convert from SMRT to ZUM is intended to provide consistency and equity among local rate structures for

California's major metropolitan areas, including a consistent approach to defining local calling areas. PacBell applied the following criteria to define local calling areas: (1) the exchange in which the customer's service is located; (2) all contiguous (adjacent) ZUM exchanges; and (3) all noncontiguous ZUM exchanges less than 8 rate miles away. These are the same criteria which now apply in the Los Angeles and San Francisco areas.

Staff supports the proposed redrawing of local calling areas and the extension of ZUM to additional metropolitan areas. Staff agrees that some exchange areas, particularly in Orange County, have not been revised for many years and do not reflect current demographic conditions. As a result, according to staff,

> "The present local calling areas of many of these exchanges are inequitable when compared to other areas. Moreover, the metropolitan areas have expanded and the customer perception of local calling needs has also changed. The ZUM expansion plan provides for long overdue revisions which address the inequities in local calling areas and also provide for a rate structure which contains rates which generally reflect lower rates than present rates per call over toll routes of up to and including 16 miles. The expansion of ZUM into additional areas also will standardize the usage charges in calling areas consistent with the two major metropolitan areas of San Francisco-East Bay and Los Angeles."

Both TURN and DMA decry the impacts on some customers of the combination of local area changes and ZUM expansion. TURN's concern is an outgrowth of its basic opposition to LMS. DMA objects not to the ZUM concept but to the timing and effects of PacBell's proposal of a "one-step conversion" from SMRT to ZUM.

DMA witness Patton analyzed the cumulative impact of the proposed local area reconfigurations and ZUM expansion on particular calling routes. He found that, even without changes in present ZUM rates, the charges for certain calls along certain routes would

increase by as much as 1,580%. The largest increases were for calls now classified as local but transferred to toll by local area changes.

The ALJ required PacBell to itemize on a route-by-route basis the impact on charges of PacBell's proposals for a 5-minute daytime call at present rates. PacBell provided a study which showed that 39 calling routes, all in either San Diego or Orange County, would be transferred from local to toll, with charges increased by 1,360 or 1,580%. A further 24 routes, also in those counties, would be transferred from local to ZUM Zone 3, for a 460% increase in charge. Another 31 routes would experience increases of 260 or 300%, being transferred from local to ZUM Zone 3 or from ZUM Zone 1 to Zone 3.

On the other hand, charges on many calling routes will be drastically reduced by PacBell's proposed reconfigurations and by ZUM. On 36 routes the reductions will exceed 80%. Reductions in charges by more than one-third will occur on 220 routes, while only 116 routes will experience increased charges. We note also that the calculations were based on a 5-minute call, which shows ZUM rates at their least advantageous in relation to the 5-minute minimum charge under SMRT. Moreover, because the reconfigurations bring contiguous and nearby territory within the local calling area and exclude only more distant points, the calling routes experiencing decreased charges will be much denser in traffic volumes, on average, than those for which charges will increase.

Patton acknowledged that redistricting and ZUM would decrease charges for some calls, but he emphasized the increases, noting:

> "Businesses with established telephone locations and practices will suffer substantially higher costs on an undeterminable portion of their calls."

He argued that PacBell had not provided sufficient detail to permit full evaluation of its proposals. He urged that redistricting and ZUM conversion would have "such potentially important adverse effects" that the proposals should be denied in this proceeding and made the subject of further proceedings under a new, more detailed application which would permit affected ratepayers to participate fully on an informed basis.

On brief, DMA emphasizes that it does not quarrel with the ZUM concept. Its concern is that dramatic, sudden rate increases for essential services should be avoided. DMA contends that PacBell should have notified subscribers on routes adversely affected by proposed local area and rate plan changes of the exact increases in charges they faced, and should have provided for graduable implementation of the proposed increases.

In order to implement ZUM gradually in San Diego and Orange Counties, DMA proposes that over the short run SMRT rates either remain unchanged or be converted to ZUM Zone 1. DMA would then have the Commission require PacBell and staff submit new plans for phased implementation of the full ZUM plan. This proposal does not directly address the issue of local area reconfiguration.

We regret that PacBell did not provide more detailed notice specifically directed to subscribers affected by its redistricting and ZUM expansion proposals. PacBell did, however, accurately describe its proposals to change the size of local calling areas and to implement ZUM in the San Diego, Orange County, and Sacramento areas in four separate bill insert notices, dated January, April, July, and October 1983, respectively, and distributed in the normal billing cycle. We conclude that these notices met the requirements of D.93367 and of the Public Utilities Code.

PacBell responds to DMA's concern about the sudden impact of its proposals by noting that the ZUM expansion plan already provides for gradual implementation. Conversions from local to ZUM

Zone 1 are scheduled for late 1984. Increases from local to Zone 2 or 3 or to toll would occur in early 1985 or, if an ITC is involved, 1986. Although this is a phased implementation, drastic increases would nonetheless occur in a single step for particular calling routes.

PacBell also notes that the high-increase routes discussed by DMA "were at the extreme of the spectrum and dealt with the very low density-type routes." PacBell emphasizes the overall impact of its proposals:

> "In terms of overall impact, it is highly unlikely that customers will place calls only on those routes which will experience an increase, or a decrease. Rather, Pacific would expect calling patterns to be dispersed over all routes, increased and decreased alike."

PacBell's argument goes to the merits of ZUM conversion, not its timing. The concern raised by DMA about the suddenness of the proposed changes in local calling charges is a valid one. We find that implementation of local area reconfiguration and charge plan changes should be accomplished in phases where necessary to avoid a sudden increase in charges of the magnitude shown here on a substantial number of calling routes.

Unlike DMA, TURN's critique of PacBell's proposals goes to their basic merits. TURN opposes the proposed redrawing of local areas:

> "Non-ZUM local calling areas reflect the historical development of each area, and so the communities of interest within which people and businesses operate."

The problem in Orange and San Diego Counties, however, is precisely that local calling areas do not reflect historical development. It is fair that rural subscribers tend to have larger local calling areas to provide them equivalent value of service to that offered subscribers in denser urban areas. Some formerly rural

areas of San Diego and Orange Counties retain large exchange areas no longer consistent with their now dense urban character. Other areas, particularly in northern San Diego County, are cut off from the urban center which is now part of their community of interest.

PacBell has taken account of various community of interest considerations in its proposed local calling area revisions. School districts, hospitals, shopping zones, and natural boundaries were studied. Wire centers and their serving limitations also were taken into consideration. No party has specifically challenged any details of the proposed revisions. Therefore, we find the proposed reconfiguration of exchange boundaries in San Diego and Orange Counties reasonable as a means of achieving greater equity in the service offered to subscribers in similar metropolitan areas throughout PacBell's service area and in comparison to the service offered to subscribers in rural areas.

The proposed expansion of ZUM to the San Diego, Orange County, and Sacramento areas has drawn additional fire from several sources, including TURN, the City of Los Angeles, and Larger Users witness Selwyn. TURN opposes ZUM expansion as part of its general opposition to LMS. More specifically, TURN contends that "ZUM superimposes a rigid arbitrary structure which disregards local communities of interest." The City of Los Angeles criticizes ZUM as "a money-maker for Pacific" that should not be expanded until evidence has been provided to permit analysis of whether or not ZUM is in the public interest. Large Users witness Selwyn urged that the Commission should allow ZUM expansion "only if it is satisfied that the benefits to customers will exceed the cost which Pacific will incur."

TURN's criticism of the ZUM rate structure fails to recognize that it is based on local calling areas which have been defined with community of interest considerations in mind. TURN also ignores the fact that the local calling area under ZUM, extending to all contiguous exchanges and noncontiguous exchanges up to 8 rate

miles distant from the home exchange, is in many cases more extensive than under SMRT. There was more randomness than design in the determination of many present local calling areas; the ZUM local calling areas proposed by PacBell, and set forth in Exhibit 688, will clearly be more useful to most subscribers and more consistent with one another and with local calling areas in other metropolitan regions.

In response to the concerns of Los Angeles and witness Selwyn, we refer to our earlier discussion of LMS. We there found the offering of LMS to be in the public interest. Moreover, we do not consider it inappropriate that ZUM service should make a contribution of positive net revenues, although the extent of contribution should be limited in view of the community of interest nature of ZUM calling.

Aside from the differences in local calling areas discussed above, the major distinguishing features between the SMRT and ZUM calling plans are the following:

1. ZUM offers relatively low rates for calls beyond the local calling area of up to 16 rate miles, which are charged as toll calls if made from SMRT areas.
2. SMRT calls are charged on the basis of a 5-minute minimum call; ZUM calls on a 1-minute minimum basis.
3. SMRT calls are charged only for the initial 5-minute minimum if made off peak, regardless of duration, whereas ZUM offers shoulder-peak and off-peak discounts but charges for them for the full duration of calls.

The availability of lower rates for Zones 2 and 3 calls under ZUM obviously benefits subscribers in ZUM calling areas. It is a reasonable discount reflecting both the social value of lower rates within local communities of interest and the lower cost of transmission and switching on dense urban routes.

The 1-minute minimum charge under ZUM benefits some subscribers at the expense of others. We consider it more equitable because, if ZUM rates are set at levels appropriately reflecting costs, a 1-minute minimum will properly apply a lesser charge for a 1-minute call than for a 4- or 5-minute one. Our adoption of increases only in the initial minute ZUM rates should assure that makers of longer duration calls are not overcharged.

The shoulder-peak and off-peak discounts under ZUM are a reasonable alternative to the uniform untimed off-peak charge under SMRT. It may be that the off-peak additional minute charges under ZUM should be reduced. We will require PacBell to conduct a detailed study of time-of-day variations in the costs of providing local measured and unmeasured service and message toll service as well. That study should be submitted for entry into evidence in PacBell's next rate proceeding, to form the basis for possible adjustments in the hours defined as on-peak, shoulder-peak, and off-peak and in the percentage discounts provided for both ZUM and MTS calling. In the meantime, however, we are persuaded that ZUM provides a more flexible and appropriate structure than SMRT for implementing off-peak discounts.

The proposed expansion of ZUM will impose costs upon the four companies involved. For the years 1984 through 1986 these are estimated to total $2.9 million in capital and $6.8 million in expense for PacBell; $700,000 in capital and $1.3 million in expense for General; $520,000 in capital and $180,000 in expense for Roseville; and $40,000 in capital and $90,000 in expense for Citizens. Typically, these costs result from the conversion of toll routes to ZUM routes, with resultant higher calling volumes requiring upgraded facilities.

We conclude that the benefits of expanding ZUM to the metropolitan areas proposed by PacBell and General exceed these costs and that ZUM expansion is in the public interest.

Staff witness Shantz asserted that, due to the timing of this decision, little or none of the above-noted expenses will be incurred in 1984. PacBell witness Evans agreed. Shantz proposed that PacBell and General be allowed to recover their 1985-86 costs through billing surcharge changes, but not to exceed the forecast amounts. Witness Evans stated that revenue requirements for Roseville and Citizens can be recovered through the Extended Area Service (EAS) Settlement Agreement, an arrangement to which the smaller companies have agreed. We find these cost recovery arrangements reasonable, except with respect to General, for which cost and revenue effects of ZUM expansion will be addressed in A.83-07-02.

Counsel for Citizens and Roseville sent letters to the ALJ dated March 1 and March 2, 1984, respectively, stating that each company "believe[s] that there is no demand on the part of its subscribers for 'ZUM'," and requesting opportunity to review the rate design and means by which Citizens and Roseville may "recover the negative revenue impact associated with the expansion of ZUM." These companies did not, however, submit evidence on the ZUM issues. If, for whatever reason, it proves impractical to recompense Roseville or Citizens through the EAS Settlement Agreement for whatever negative revenue impact ZUM expansion creates, we shall certainly entertain applications by these companies for appropriate rate adjustments.

Finally, we return to the timetable for implementation of local area reconfiguration and ZUM expansion, which we will determine in light of our finding that phased implementation of such changes is necessary to avoid the sudden escalation in charges detailed by DMA. The area of greatest concern is the conversion of 59 presently local calling routes to ZUM Zone 3 or toll. These are the only conversions which would increase 5-minute call charges by more than 300%. Because we will be approving the conversion of all SMRT charges to ZUM Zone 1, an initial 60% increase in the cost of a 5-minute call will be felt as soon as this decision becomes effective. Of the 59

calling routes facing drastic increases, 51 PacBell-to-PacBell routes are scheduled for conversion early in 1985 and eight PacBell-to-General routes for the second quarter of 1986. We find that these conversions should occur in two steps, at least one full year apart, the first step to be from ZUM Zone 1 to ZUM Zone 3, and the second to be from Zone 3 to the appropriate MTS charges. We find it reasonable, for the interim, to set rates for these 59 routes lower than indicated by the ZUM and MTS tariffs.

As noted above, staff witness Shantz testified that the revenue impact of ZUM expansion in test year 1984 would be very slight, and nonexistent if this decision is not effective before July 1, because six months are required to implement the first phase of proposed changes. PacBell witness Evans agreed.

We find that the revenue impact for PacBell of ZUM expansion and the redrawing of local area boundaries will be de minimis in test year 1984 and need not be reflected in the setting of test year rate levels. Effects on PacBell revenues during 1985 will not be so great as to require separate identification in the process of adjusting PacBell's rates for the effects of financial and operational attrition. PacBell should include in its next general rate application a full analysis of the effects of the authorized local area changes and ZUM expansion upon its revenues and costs for the 1986 test year.

The cost and revenue effects of these changes upon General will be addressed in our forthcoming decision in General's rate proceeding, A.83-07-02. The effects upon Citizens and Roseville will be dealt with through the EAS settlement process or by application as indicated above.

4. Conversion of SMRT to ZUM Zone 1

Along with the proposal to convert three major metropolitan areas to the ZUM calling plan, PacBell also proposes that the numerous other areas subject to SMRT charges be converted to ZUM Zone 1 charges, without any redrawing of local calling areas at this time. PacBell states:

> "This step would help eliminate inconsistencies in local charges and provide the same framework for customers in similar situations throughout most of the state."

Staff concurs in this proposal. Staff also recommends that PacBell be authorized to implement ZUM Zone 1 service in lieu of SMRT in additional areas covered by the "Expanded Measured Service" program authorized by D.93367, as PacBell proposed to revise that program in Exhibit 569. That exhibit sets forth a revised schedule for measured service expansion through 1988. Staff's reasons for abandoning SMRT were stated by witness Shantz:

> "Conversion of SMRT to ZUM Zone 1 local service will provide for a standardization of local measured service rate structures within Pacific's exchanges. Continental Telephone Company has been authorized to implement the ZUM Zone 1 local measured rate structure as Continental initiates and expands its measured service offerings. Conversion of SMRT to ZUM Zone 1 local service by Pacific will therefore also standardize the measured service offerings on a statewide basis for the larger telephone utilities in California."

We have already found that the ZUM rate structure is preferable to SMRT in several important respects. We therefore find it reasonable to convert all SMRT calling areas to ZUM Zone 1 and to implement ZUM Zone 1 rates in the course of future expansion of measured service according to the revised schedule proposed by PacBell. The test year revenue effect of this change is estimated at a decrease of $2.6 million for PacBell.

5. Detailed Billing of ZUM Calls

Large Users witness Selwyn recommended that the practice of detailed billing of ZUM Zones 2 and 3 messages be discontinued. He stated his belief that the benefits derived from such detailed billing do not justify its costs.

PacBell witness Evans testified in rebuttal that the absence of detailed billing of multi-message-unit and ZUM calls had given rise to numerous customer complaints in the past. Evans disagreed with Selwyn's recommendation to discontinue detailed billing of ZUM calls because it "could resurface the same customer complaints" which arose in the past. Evans did, however, recommend evaluating whether to offer detailed message billing as an optional service for customers who expressly want such information. Those who do not want it would not be required to pay for it. However, Evans felt it imprudent to take such a step prior to undertaking and evaluating market research into customer reactions and cost and revenue impacts from such a change.

Large Users did not pursue this issue on brief, but the City of Los Angeles recommended that the Commission order this matter explored in the course of a broader investigation of local message calling. PacBell calls for "caution in addressing this sensitive subject." Dr. Brylawski strongly urged continued itemization of ZUM Zones 2 and 3 calls and called for consideration of detailed billing of Zone 1 calls as well.

We reject the proposal to discontinue detailed billing of ZUM messages at this time. However, in view of the significant cost of metering and billing ZUM calls, it is appropriate to investigate the possibility that these costs could be diminished through offering detailed billing of ZUM messages as an optional service priced to recover the incremental cost of that billing (but not the associated metering which must be done in any event). We will require PacBell to complete such a study promptly, in hopes that meaningful results

can be obtained in time for consideration in the course of its next general rate proceeding.

6. Proposed Metropolitan Calling Plan

TURN asks the Commission to order PacBell to prepare an optional metropolitan flat rate offering, to be priced at a premium above local rates without toll or ZUM charges. TURN sees such a metropolitan rate offering as providing a valuable option to PacBell's subscribers.

We see merit in TURN's proposal as a subject for study, but only with respect to residence customers. We note that PacBell presently has several discounted toll options available to residential customers, two ORTS plans and OCMS, as well as FEX service, which probably satisfy much of the demand which a flat rate metropolitan calling plan would serve.

We shall require PacBell to undertake promptly a study of the costs and benefits of residence flat rate metropolitan calling plans offering unlimited calling without charge throughout the San Francisco-East Bay Extended Area or the Los Angeles Extended Area or throughout substantial portions of those areas. PacBell should study the extent of residence subscriber interest in and demand for such services; the effects of such services upon PacBell's revenues and costs of service; the appropriate rate levels for such services to avoid any diminution in PacBell's net revenues; the effects on separation and settlements arrangements of such a metropolitan calling plan; cross-elasticities of demand between such a plan and other optional discounted services offered by PacBell; and other relevant issues. The results of this study should be submitted for consideration in the course of PacBell's next general rate proceeding.

7. Rate Banding

Rate Banding is one step in the present process of implementing SMRT in the smaller "metro" areas of PacBell's service area, as ordered in D.90642, 90919, and 93367. Coincident with each implementation of SMRT for an additional metro area, PacBell has submitted an advice letter to eliminate residence and business Suburban services and Special Rate Areas, and to implement Rate Banding. Each such advice letter requires Commission authorization.

Rate Banding divides the "suburban" area surrounding the base rate area of an exchange into rate zones for mileage purposes and results in significantly reduced mileage charges to individual line services provided in the suburban areas. However, customers with two-party or four-party service pay relatively low mileage charges, so imposition of Rate Banding on these customers requires Commission authorization. SMRT implementation encourages these customers to switch to individual line services, under which measured rate and lifeline service are available, as well as Touch-Tone Service, Custom Calling, and ORTS or OCMS.

PacBell now requests continuing authority (without need for advice filings which require Commission authorization) to withdraw the offering of business and residence Suburban services, to eliminate Special Rate Areas, and to implement the Rate Banding provisions of its tariffs, coincident with completing implementation of both residence and business measured exchange services in additional exchanges. PacBell would condition implementation of Rate Banding on the availability of both business and residence measured service and the elimination of Suburban service.

Staff concurs in PacBell's proposal, and further recommends that PacBell be authorized to implement Rate Banding in conjunction with implementing SMRT or, if the Commission adopts the staff-proposed ZUM Zone 1 rate, ZUM Zone 1 service. Staff urges that this

change "will lessen the administrative burden on the Commission and will benefit suburban customers." DMA witness Patton and Farm Bureau also support the Rate Banding proposal.

In light of our adoption of the staff-proposed ZUM rates, we will approve the procedure for implementing Rate Banding as formulated by staff. The test year revenue effect will be a decrease of $0.4 million.

G. Local Coin Service

The rate for local public coin service offered by PacBell and other telephone companies in California has stood at 10¢ per call since 1952. PacBell now proposes to increase that rate by 150% to 25¢ per local call. PacBell asserts that a 25¢ charge will generate sufficient revenue to cover the direct cost of providing this service plus a small contribution to support other below-cost services. PacBell also proposes to increase the monthly exchange rate for Semipublic Coin Service from $13 to $22. According to PacBell coin service "is primarily a convenience service" the users of which should pay for its cost. PacBell estimates that at the present rates local coin service suffers a $101 million revenue shortfall, and that the proposed increases would generate $86.9 million in added net revenues.

PacBell expects the proposed 25¢ rate to have "a relatively minor impact upon nonsubscribers," since more than 75% of "nonsubscribers" have access to residence or business service belonging to others. Further, PacBell proposes to implement the 25¢ charge only in those exchanges that have "dial tone first" (DTF) capability by which customers may place calls to the operator, calling card calls, directory assistance calls, repair service and 911 emergency service calls without depositing a coin.

PacBell witness Evans justified the proposed 150% increase as follows:

> "The present rate of 10 cents was established in 1952. In the intervening years inflation has impacted the costs associated with this and other goods and services. In light of increasing costs, a 30-year period without increases makes a 15-cent increase to 25 cents reasonable, especially when the user can still make a local call and talk as long as desired."

Evans also testified that, for the average nonsubscriber who makes 11 coin calls monthly, the proposed increase would cost $1.65 per month.

PacBell sees its proposed semipublic phone rate as appropriate because it is a convenience service, often used to restrict customer or employee use. PacBell considers that the present $13 rate is "far too closely aligned with basic measured business service." The service, says PacBell witness Evans, should be priced to recover a greater share of its $47 monthly cost and to better reflect the customer convenience it provides.

As part of its revised rate design to meet a revenue requirement in the range of $750 million, staff supports PacBell's proposal to increase the local coin rate to 25¢ in exchanges with DTF capability. Staff proposes to increase the semipublic coin phone rate from $13 to $20 per month. Staff calculates that these increases would generate revenue increases of $81.6 million and $5.4 million, respectively. Farm Bureau goes along with the higher proposed local coin rate, but only where DTF capability exists, so that emergency services will remain readily available to all.

Staff witness Shantz agreed with PacBell that local coin services do not cover their costs at present rates, thus burdening residually priced basic exchange service. He saw the setting of the local coin rate as a decision between increasing either it or basic exchange rates. He referred back to 1952, when the present 10¢ coin rate was first set, and noted that the staff-proposed residence flat rate and business measured rate are 131% and 167% higher,

respectively, than typical corresponding rates in effect in that year. In this light, he reasoned that a 150% increase in the local coin rate is "equitable and reasonable."

Examination of witness Shantz made clear that for staff the critical factor justifying a coin rate increase is that the alternative is a further 10% increase in basic exchange service rates. Staff also recommends that any coin rate increase for PacBell should extend to General, in view of its still higher basic exchange rates.

TURN is the only party to oppose the proposed increase in the local coin message rate. (No party opposes increasing the semipublic phone rate.) TURN notes that although PacBell's tops-down study of local coin service revenues and costs shows a deficient revenue/cost ratio of .49, total coin service results, including revenues and costs for intraLATA toll calling and NTS access charges, improve the picture to the .97 revenue/cost ratio shown in Exhibit 608 - putting revenues roughly in line with costs.

TURN further alleges, based on testimony of its witness Richard Gabel, that PacBell allocated far too much of the local loop costs of serving coin phones to local access and not enough to toll usage. By the same token, PacBell allocated all $106 million of investment in coin station equipment to local operations, although this plant is jointly used for local and toll services. With appropriate cost reallocations, Gabel and TURN see no basis for a coin rate increase.

TURN witness Gabel recomputed PacBell's cost study for local coin service by excluding investment, revenues, and expenses properly allocated to toll service according to standard separations procedures. PacBell's study excluded only toll revenues. Gabel's

revisions show PacBell earning a 13.75% rate of return on local coin net investment at the current 10¢ rate.

TURN criticizes as "spurious" PacBell's and staff's assertions that coin rates should be raised because they have not been adjusted since 1952 while other rates have risen substantially. TURN sees the $1.65 per month average cost increase to nonsubscribers to which witness Evans testified as having an impact "at least as severe as Pacific's other proposed increases would inflict on its other customer classes." TURN calculates that 250,000 people or households are prevented from subscribing to phone service by the costs of service, and that these people can best be protected by retaining a 10¢ pay phone rate.

Before any change in pay phone rates is granted, TURN urges that PacBell be required to provide bottoms-up studies of coin service costs "designed to reveal the allocation of joint costs among services." PacBell also should be required to explain its siting policy for coin stations and the resultant cost and revenue impacts.

PacBell criticizes Gabel's cost analysis as based on 1981 data without updating to reflect 1984 costs. More basically, PacBell asserts that Gabel assumes the use of access charges to subsidize NTS costs of coin phone service and that "it is improper to base a coin cost study on such an assumption." To support the latter assertion, PacBell points to the Commission's past pricing of competitive customer premises equipment based on its full cost without reduction "to reflect separation effects." (Cf. D.90642 (1979), 2 CPUC 2d 89, 181.)

We note that there is a significant difference between setting rental rates for telephone equipment and setting charges for the local use of that equipment. Rental makes possible the equipment's use for both local and toll calling; thus, it is reasonable to set the rental rate without adjustment for settlement

effects. A local usage charge by definition excludes toll usage; analysis of its cost can properly exclude costs assigned to toll.

TURN witness Gabel acknowledged that, in studying coin service costs and revenues, an alternative to his exclusion of costs assigned to toll would be to include toll revenues derived from coin stations. We accepted a comparable costing procedure proposed by PacBell in our recent decision approving PacBell's Rate Stability Plan for Centrex Service. In that decision we found reasonable a costing approach which included Centrex costs allocated to the interstate jurisdictions as well as those interstate revenues from Customer Access Line Charges (CALCs) which were "directly traceable to the provision of Centrex lines." (Pacific Tel. & Tel. Co. (1984), D.84-04-016, mimeo. at 35.)

The "total coin results" shown by PacBell witness Gueldner in Exhibit 608 indicate a .97 revenue/cost ratio, which means to TURN that "total coin revenues are roughly in line with costs." That calculation included as revenues $93 million in "Carrier NTS Access Charge (Proposed)." However, unlike the interstate CALC revenue which derives directly from the lease of Centrex access lines, there is no access charge revenue "directly traceable" to the provision of coin station service except that generated by interLATA toll usage.

Exhibit 608 tells us that, looking at all revenues derived from coin stations, their total operations nearly break even. This is consistent with witness Gabel's calculations, which suggest a healthy rate of return based on cost data three years out of date. However, Exhibit 608 also tells us that less than 27% of coin station revenues derive from local service. Of $134 million in annual coin station access costs, only $18 million are met through a surplus of local usage revenues over direct local usage costs, $15 million comes from recurring and service connection charges, $93 million comes from access charges, and $8 million must be contributed from outside revenues.

We find that local coin revenues are making an inadequate contribution toward the fixed costs of coin station service. All toll revenues from coin station service are inadequate to fill the gap, and a further estimated $8 million must be derived from other services to meet the costs of coin station service. Contrary to this situation, local and toll revenues from coin station service should come closer to covering coin station costs.

Under present separations procedures approximately 50% of PacBell's local NTS costs are assigned to interLATA or intraLATA toll and approximately 50% are recovered through monthly recurring charges or local rates. We find it reasonable to set the local coin rate at a level which, in addition to direct costs of local usage, will cover approximately 50% of the access costs of coin station service. That goal would be achieved by a revenue increase of about $50 million from the local coin rate. Based on usage and repression assumptions consistent with those on which staff based its $81.6 estimate of revenues from a 25¢ charge, a 100% increase in the local coin rate, to 20¢ per local call, is estimated to generate $53.5 million in additional test year revenue. We find that rate reasonable for both PacBell and, in the interest of statewide uniformity, for all telephone companies providing exchange service in California. This increase will be authorized only for those exchanges in which DTF capability exists, in the tariff form proposed by staff in Exhibit 668, Appendix V.

We anticipate that for the sake of convenience substantial numbers of callers will use a quarter rather than 20¢ to make a local call. We do not wish to deter that practice, but will recognize the consequent revenue as a means of restraining increases in other rates. Consequently, the staff-proposed tariff should be amended to provide that a customer may, at his or her option, pay 25¢ for a local coin call, but is not entitled to a refund of the extra

nickel. We estimate conservatively that 20% of local coin calls will be paid for by the use of quarters. This factor will generate at least 20% of the difference in estimated revenue from a 25¢ and a 20¢ charge, or $6.3 million for PacBell. The total increase in local coin service revenue from the increased charge is, therefore, estimated at $59.8 million.

The $20 monthly rate for Semipublic Coin Service proposed by staff represents a percentage increase of 54%, just slightly more than the 50% increase proposed by staff for other exchange service rates. As will be discussed below, increases in most exchange service rates will be held to levels less than proposed by staff. We agree, however, with PacBell witness Evans that the customer convenience and cost of semipublic service justify an increased rate premium over the measured business service rate. We, therefore, find reasonable the staff-proposed $20 rate for Semipublic Coin Service. We accept staff's estimate that this increase will generate $5.4 million in additional test year revenue.

E. Basic Exchange Services

In his testimony received in October 1983 PacBell witness Evans proposed more than a doubling of basic exchange rates for residence customers, with the residence flat rate to be increased from the present $6.70 or $7.00 levels to $14.25 per month. According to Evans his most important consideration was "the essential requirement to have residence customers pay a larger percentage of the costs associated with their service." He asserted that current rates covered less than a quarter of those costs. Evans explained the need for drastic increases in these rates as follows:

> "While previous operating conditions have permitted and even fostered the flow of substantial subsidies to access line services, the near-term future of an increasingly competitive telecommunications industry mandates a major change for this category. Additionally, it is important to note that the costs for new

access lines are almost 50% higher than the costs of the average embedded access line. Thus, the present rate for each new residential Flat Rate access line would only cover 18% of incremental costs. These considerations underscore the need for substantial increases in this category.

Evans also proposed to unbundle the access and usage components of local service where measured service is available. The present $3 or 60-unit local usage allowances included in the $3.75 residence measured service rate would be eliminated from the proposed $7.50 measured service rate.

Evans testified that his proposed rates sought to position the flat rate option as a "premium" service, so that this offering would be chosen by a smaller segment of residence customers than the 89% who now subscribe to it. The proposed measured service rate was designed to attract more than the present 4% of residence customers who subscribe to it.

Evans proposed to set the lifeline rate at about 50% of the measured rate where it applies, or of the flat rate elsewhere. He proposed to restrict choice of lifeline service to persons of low income subject to a certification requirement handled by an appropriate state agency.

Evans proposed much lesser increases in business basic service rates than on the residence side. The proposed business increases were generally in a range of 30 to 60%.

By his January testimony Evans revised his basic exchange rate proposals substantially downward, as indicated by the following table showing the most common basic exchange service categories:

PACIFIC BELL

Proposed Basic Exchange Rates

Service	Current	Initial PacBell Proposal	Revised PacBell Proposal	Revised as % Increase
Individual Residence Line				
Flat Rate	$7.00	$14.25	$11.50	64%
Measured	3.75*	7.50	5.75	53
Lifeline (Measured)	2.50*	3.75*	2.85*	14
Lifeline (Flat)	-	7.10	5.74	-
Individual Business Line				
Flat Rate	14.55	19.00	17.75	22%
Measured	7.00	11.00	9.25	32%

*Includes usage allowance.

As is evident, PacBell continues to seek a substantially greater increase in residence rates (except lifeline) than in business rates.

PacBell contends that its proposed unbundling of access and usage components should lead many residence customers to recognize the flat rate option "as the truly premium service it is," while others perceive a cost savings from opting for measured service. While proposing revisions in its lifeline service, PacBell also notes that in OII 83-11-05, instituted to implement the Moore Universal Telephone Service Act, it has recommended that the new service resulting from that OII "should completely replace" the present lifeline service.

Unlike PacBell, staff proposes a uniform percentage rate increase for nearly all categories of basic exchange service. Staff witness Shantz asserted that PacBell provided no basis for the difference between its proposed increases for residence and business customers, rendering that difference "unreasonable, arbitrary and discriminatory." Staff's initial rate proposal, geared to produce a

$500 million revenue increase, provided for increases of about 31% in most basic exchange rates; elimination of a 30¢ difference in the flat rate charge between ZUM and non-ZUM areas; and a standardization of advance billing of monthly rates for measured rate services. In his January 1984 testimony proposing rates to meet a $750 million revenue requirement, witness Shantz provided for rate increases of 50% for most basic exchange services, consistent with the staff position favoring uniform percentage increases.

Shantz specifically criticized PacBell's proposed increase in the residence measured service rate which, together with PacBell's proposal to eliminate the $3 or 60 message unit usage allowance now accompanying that rate, "may curtail rather than encourage growth in the number of [measured service] customers." In fact, considering the elimination of the $3 usage allowance, PacBell's proposed increase in this rate can be calculated as not just 53% ($3.75 to $5.75) but 667% ($0.75 to $5.75) or at least 133% ($3.75 to $8.75). Staff would preserve the $3 or 60 unit usage allowance with residence measured service. The measured rate would be $5.65; the flat rate $10.50.

TURN opposes any increase in residence flat rate service charges. TURN ridicules PacBell's "semantic game" of characterizing the predominant residence service as "premium" and the relatively unpopular measured service as "standard." As discussed above, TURN contends that flat rates subsidize measured service and perceives residual pricing of residence services as threatening "a spiral of rising flat rate prices."

TURN argues against PacBell's method of calculating the costs of basic exchange services, contending that PacBell should have allocated portions of those costs to toll and ancillary "vertical" or enhanced" services. TURN notes that in D.83-12-024 the Commission rejected PacBell's allocation of all NTS costs to the end user as the

basis for setting access charges, finding it equitable that usage-based services contribute toward those costs. TURN contends that the same logic dictates allocation of some access line costs to "enhanced" services, reducing the revenue requirement to be garnered from basic monthly rates. TURN sees "no reason to believe that the existing $7 monthly charge is unreasonably low."

The element of PacBell's proposed $11.50 rate for flat rate service to which TURN directs most attention is the $5.75 "usage" element which represents the difference between the proposed flat and measured rates. TURN contends that local usage costs "are virtually zero on most equipment for at least 23 hours per day." TURN suggests PacBell should isolate peak usage days for premium charges to measured service (mainly business) customers. For the rest, TURN urges:

> "The Commission should recognize that most residential calls are virtually cost-free, and so should be priced accordingly."

TURN concludes that there is no justification for raising residential flat rates and that, because of the costs of measurement, monthly rates for measured service should equal or exceed those for flat rate service.

Dr. Brylawski, testifying on his own behalf, supported the unbundling of residence basic service rates into access and usage components. He favored eliminating the $3 or 60 unit usage allowance from measured rate service. If the usage allowance were to be retained, he suggested that it be renamed "minimum monthly charge for all ZUM calls," with the access line charge unbundled from it.

Brylawski restates these positions in his brief. He also echoes TURN's position in arguing that residence flat rate service is "standard," not "premium" service and that PacBell's proposed $5.75 rate for the usage component of the residence flat rate is set too

high. Because staff would preserve the $3 measured service usage allowance, he calculates the usage component of the staff-proposed flat rate as $7.85, with a $2.65 access component.

Brylawski objects to staff's proposal of equal percentage increases in monthly rates because it would impose a greater dollar burden on flat rate service. He sees staff's proposal as overpricing flat rate usage and extremely underpricing the access element, and so favors PacBell's design and rates.

DMA witness Patton supported the staff-proposed basic exchange rates but disputed staff's position that a larger percentage increase in residence than business rates would be unreasonable. Patton saw an imbalance between business and residence rates that should be corrected through increasing rates for basic residence services.

Staff witness Shantz disputed Dr. Brylawski's contention that the $3 measured service usage allowance "obscures" PacBell's rate design, "as long as the customer is properly presented with the options that are available...explained with some degree of accuracy." He explained that staff looks at the monthly basic exchange rates as a source of "guaranteed revenue," whereas usage charges provide a riskier revenue source. It was Shantz' view that "particularly in a residually priced service, you [should not] put a tremendous amount of the revenue at risk" by lowering the measured rate and cutting out the usage allowance. Shantz favored retaining the $3 usage allowance as an incentive for customers to subscribe to measured service while maintaining measured service charges as a stable revenue source.

We have traditionally set rates for basic exchange services by residual pricing, increasing these rates only after all other reasonable sources of revenue generation have been tapped. This is not an insidious process geared to increase basic rates, as TURN seems to perceive it; just the opposite. Residual pricing shields

basic services from the burden of rate increases by assigning increased revenue needs elsewhere to the greatest extent reasonable. This includes, in effect, the assignment of NTS costs of local plant to services other than basic local service. While criticizing residual pricing, TURN is really calling for more of the same by its suggestion that enhanced services should bear a portion of access line costs. As noted in our discussion of Touch-Tone Service, supra, our ability to extract revenue contribution from enhanced services is severely limited.

Because residual pricing seeks to shield basic exchange service, particularly residence service, from rate increases to the greatest extent reasonable, it is important that basic exchange service be defined to include all elements of service which deserve this special protection.

What is basic exchange service? We noted its essential elements in our recent access charge decision: dial tone, a white pages directory listing, the capacity to place calls, and the capacity to receive them. (D.83-12-024, mimeo. at 37-38.) Basic exchange service also requires that an access line be provided between the subscriber's premises and the utility's central office. For residence customers, some amount of local calling not separately charged for is included in every class of basic service, whether flat rate, measured rate or lifeline. We also note that a limited amount of local calling is included in the definition of basic lifeline service per our recent D.84-04-053, implementing the Moore Universal Telephone Service Act.

PacBell proposes to "unbundle" basic exchange service to residence customers into access line and usage components. This exercise is, at this time, more didactic than practical; PacBell does not actually propose unbundled rates but merely uses the access/usage dichotomy to explain the relationship between its proposed rates and its calculated costs.

Dr. Brylawski has perceptively noted that unbundling of access line and usage charges is inconsistent with maintaining a free calling allowance as part of measured rate service. We agree. However, we find the maintenance of a limited free calling allowance to be an essential element of any residually priced basic exchange service for residence customers. Consequently, we reject further unbundling of the access line and local usage elements of residence basic exchange service.

Based on a residual pricing approach, staff's rate design proposal to meet a net $750 million revenue requirement obtains an estimated $389.2 million from increased rates for basic exchange services. To reach this revenue level staff's proposed increases are in nearly all cases set at 50%. We find it necessary to gain approximately $160 million from basic exchange rate increases. This indicates that we must increase basic exchange rates, on average, by approximately 18% above the present tariffed levels. This equates to about an 8% increase above present charges including the 10.32% billing surcharge.

We agree with staff that PacBell has provided no adequate basis for the substantially greater increases it proposes for residence exchange rates as compared to business. Because of our commitment to residual pricing, we reject PacBell's assertion that its cost studies justify drastic increases in residence basic exchange rates. By the same token, we reject TURN's suggestion that the price differential between flat rate and measured rate residence service should reflect only the cost of measuring local calls, which would result in a service that offers limited local calling being priced above one that offers unlimited calls. We find that the relative pricing of service offerings within the residually priced class of basic exchange service should be based on considerations of fairness informed but not dominated by evidence of the relative costs of service.

TURN's basic concern over how PacBell allocates its flat rate between access and usage, however, does have validity because the amount assigned to access by PacBell is also the access service charge for measured service. If in fact, as TURN argues, the amount assigned to usage is too great in the flat rate service, then the access charge for measured service would be too low, raising questions as to whether measured service would be bearing its fair share of exchange costs, including NTS, in relation to flat rate service. TURN has called the alleged underpricing of access costs of measured service a subsidy from those on flat rates to those on measured service. Unfortunately, these issues cannot be disposed of at this time because of the shortcomings of current cost studies noted here and elsewhere. In this decision we are not accepting PacBell's unbundling of costs in arriving at the flat exchange rate or its method of costing access to measured service in relation to the fixed exchange rate. The residential flat exchange rate will be residually determined as a complete service without distinction between access and usage. In our residential measured rate we will continue an allowance for usage in the access rate for the service.

We also reject DMA witness Patton's assertion that business rates are overpriced in relation to residential rates. The Commission has sought, throughout our rate design efforts in this and prior proceedings, to distribute the burden of rate increases carefully and fairly between business and residence customers.

Consequently, we will distribute the revenue burden which must in this proceeding be placed upon basic exchange services by equal percentage increases in rates. The average increase will be about 18%, with rates rounded, in most cases, to the nearest 5¢. We approve staff's proposal, to which no objection was raised, to standardize advance billing of monthly rates for measured service.

In our recent decision implementing the Moore Universal Telephone Service Act and defining the terms of a new statewide lifeline service, we found that the present lifeline service will not be required when the Moore Act lifeline service is instituted July 1, 1984, and we stated our determination to discontinue PacBell's current lifeline service by that date. (D.83-04-053, mimeo. at 15, 20.) The steps and procedures for the full transition to Moore Act lifeline service are covered in PacBell's Advice Letter No. 14756.

The discontinuance of the present lifeline offering will result in additional revenues to PacBell from basic exchange rates, over and above the effects of increases in basic exchange rates. Conservatively assuming that all of the almost 540,000 present lifeline subscribers either qualify for Moore Act lifeline service or regrade to measured rate service, the increase in annual customer billing is estimated as 540,000 times $1.25 per month times 12 months, or $8.1 million ($7.9 million in revenue to PacBell after settlements). There is no basis to assume a corresponding loss of revenue due to conversion of subscribers to Moore Act lifeline service, because the revenue shortfall will be made up by contributions from the Moore Act Fund. It is possible that the conversion of flat rate subscribers to lifeline will diminish basic exchange service revenues by more than the corresponding increase in ZUM Zone 1 usage charges. If PacBell can demonstrate a significant revenue loss from this service, based on recorded data, it will be permitted to propose an appropriate adjustment in connection with its 1985 attrition Advice Letter filing.

D.84-04-053 provides that Moore Act lifeline service will be offered at charges based on one-half the basic flat or measured rate including mileage charges and minus a 75¢ discount. Where a measured rate applies the service is to include a call allowance of 30 to 60 calls not less than the present lifeline number of 30 ZUM Zone 1 calls of unlimited duration. (Id. at 11, 14.) For PacBell the Moore Act lifeline rates will be $3.38 for a flat rate individual line, $1.48 for a measured rate individual line, $2.05 for a flat rate two-party line, and $1.43 for a measured rate two-party line. The measured rate lifeline services will include an allowance of the first 30 local calls per month regardless of duration.

PACIFIC BELL
Rates for Basic Exchange Services

	Present Rates		Proposed Rates All Areas‖		
	Los Angeles and San Francisco - East Bay Metropolitan Extended Areas	Orange County, Sacramento, San Diego, and Non-Metropolitan Areas‖	PacBell Revised	Staff Revised	Adopted Rates All Areas‖
Business Service					
Individual Line					
Flat Rate	$ -	$14.55	$17.75††	$21.85	$17.15
Measured Rate	7.00	7.00(7.50†)	9.25	10.50(11.00†)	8.25
2-Party Line	-	10.75	14.50	16.15	12.70
4-Party Suburban	-	11.00	14.50	16.50	13.00
Farmer Line	4.15	4.15	5.60	6.25	4.90
PBX Trunk					
Flat Rate	-	21.75	26.50	32.75	25.65
Measured Rate	7.00	7.00	9.25	10.50	8.25
Semipublic Coin	13.00	13.00	22.00	20.00	20.00
Residence Service					
Individual Line					
Flat Rate	7.00	6.70	11.50	10.50	8.25
Lifeline	-		5.75††	-	3.38ø††
Measured Rate	3.75($3.00)	3.75(60)	5.75*	5.65($3.00)	4.45($3.00)
Lifeline	2.50(30)	2.50(30)	2.85(30)	2.50(30)**	1.48ø
2-Party Line					
Flat Rate	-	4.75	8.50	7.15	5.60
Lifeline	-		-	-	2.05ø††
Measured Rate	-	3.70(60)	5.00*	5.55($3.00)	4.35($3.00)
Lifeline	-	2.50(30)	-	2.50(30)**	1.43ø
4-Party Suburban	-	4.90	8.50	7.35	5.80
Farmer Line	2.20	2.20	3.65	3.30	2.60
PBX Trunk	10.50	10.05	17.25	15.75	12.40

Above rates apply in exchanges where offered.
‖ Plus extended area service increment where applicable.
† Offered in Chualar and Gonzales only.
†† Nonmeasured exchanges only.
* No monthly allowance included.
** Certification provisions apply.
ø Moore Act Lifeline Service per D.84-04-053.

The staff proposal to eliminate the 30¢ difference in the flat rate charge between ZUM and non-ZUM areas will be adopted. This is reasonable in view of our replacement of SMRT rates by either ZUM Zone 1 charges or the full ZUM rate plan. We also find it reasonable to eliminate two other geographically based rate discrepancies - the 50¢ higher business line measured rate which applies only in the Chualar and Gonzales exchanges and the 45¢ higher residence PBX trunk rate which applies in the San Francisco and Los Angeles extended areas. Such isolated geographical distinctions are arbitrary in the context of an overall basic rate structure based largely on service-area-wide average costs. We note that this finding does not apply to PacBell's differentiated charges for nonoptional EAS, Farmer Line Service, and PBX Trunk Service in exchanges outside metropolitan areas. Those charges will be subject to the same 18% increases applied to other basic exchange rates, rounded to the nearest 5¢.

Present, proposed, and adopted rates for the principal basic exchange services are shown on the following table.

We adopt the staff-proposed rates for individual line and manual PBX service in the context of Airport Intercommunicating Service. These rates represent significantly less than a 35% increase for these services and no party objected to them. For other Airport Intercommunicating Services and Centrex Services, for which staff proposed 50% increases, we authorize rate increases of approximately 18%. The proposed and adopted rates are as follows:

PACIFIC BELL

Rates for Airport Intercommunicating Service and Centrex Service

Service	Present	Adopted
Airport Intercommunicating Service		
Individual Line and Manual PBX Service		
on Airport Property	$ 15.25	$ 18.75
off Airport Property	23.25	26.75
Mechanized Station Service		
First 25 Primary Lines	17.50	21.25
Each Additional Primary Line	.70	.85
Centrex Service		
Measured Rate Service		
First 100 Primary Lines	$ 70.00	$ 85.00
Each Additional Primary Line	.70	.85
Flat Rate Service (Trunk Line Rate ≤ $32.50)		
First 100 Primary Lines	220.00	260.00
Each Additional Primary Line	2.20	2.60
Flat Rate Service (Trunk Line Rate > $32.50)		
First 100 Primary Lines	250.00	295.00
Each Additional Primary Line	2.50	2.95

We find all the rates and terms for basic exchange services adopted above to be reasonable. They will increase PacBell's annual revenues by approximately $150.9 million, in addition to the revenue

effects of the conversion of present lifeline customers to other services as noted above.

In view of the significant increases authorized in residence basic service rates and the changes in rate structure for local measured services, we find it reasonable to require a waiver of service connection charges applicable to conversion of residence subscribers to different basic exchange services for a period of 90 days after the effective date of tariffs revising basic exchange rates pursuant to this decision. Dr. Brylawski objected to staff's proposal to waive such regrade charges only for conversion by flat rate customers to other grades of service. We agree; all residence customers should be permitted a grace period to select the basic exchange service of their choice free of regrade charges for that conversion.

I. Information Access Service

In testimony presented in November 1983, staff witness Shantz noted that PacBell has a new source of revenue in its 976 Information Access Service (976 Service), a service which the Commission authorized PacBell to provide by Advice Letter No. 14603, effective September 9, 1983. The advice letter stated,

> "This service will enable a caller, for a charge, to dial a 976 prefixed number and receive a pre-recorded announcement or interactive program."

Shantz testified that in a tariff proposal preceding filing of the advice letter PacBell forecast additional 1984 customer billing from this service of $49.8 million. Staff took the position that the revenue effects of the 976 Service offering are "significant enough" to require consideration in this proceeding. Shantz noted that,

> "The addition of perhaps $49.8 million in additional customer billing in 1984 could negate the need for some of the increases in basic exchange access line rates which will be required to meet the increase in revenue requirement."

Except for one perfunctory reference to this testimony in cross-examination, no further evidence relative to 976 Service was received in the rate design phase of this proceeding. However, Exhibit 190 on the effects of advice letter filings indicates that 976 Service will have a negative $13.3 million revenue requirement effect in 1984. This effect has been taken into account, along with the lesser impacts of other advice letter filings, in determining the net increase in revenue requirement to be met through rate changes in this proceeding.

We note that 976 Service, like several other services referred to in Exhibit 190, is a new service offering uncertain revenue generating potential. We will require that in conjunction with PacBell's advice filing for attrition year 1985 the net revenues from 976 Service as well as High Capacity Transport Service and Premiere 2/6 Communications Systems Service be estimated for the year 1985 and that PacBell's 1985 attrition adjustment be adjusted by the difference in estimated revenue requirement impact for these three new services between 1984 and 1985.

J. Direct Inward Dialing Service

PacBell does not propose to revise its rates for DID Service, but TASC placed the reasonableness of these rates in issue by a complaint filed in October 1982, C.82-10-09, and consolidated as part of this proceeding by ALJ ruling August 1, 1983. TASC alleged that PacBell's DID rates were unjust, unreasonable, and discriminatory in relation to the rates PacBell charges radio common carriers (RCCs) for a similar service.

In June 1983, the Commission had issued D.83-06-091 in C.82-10-08, a complaint by TASC against General challenging General's DID rates on a theory identical to that applied in C.82-10-09 against PacBell. D.83-06-091 concluded that charges included in intercarrier agreements between General and RCCs are not for public utility

service available to public end users, and that charges assessed by General to RCCs pursuant to intercompany agreements cannot be used to show that tariffed charges for comparable service to the public are discriminatory or unreasonable. The Commission did, however, find that TASC had stated a cause of action, based primarily on TASC's allegation that General's tariffed DID rate and conditions of service were unreasonable in relation to General's cost. TASC's complaint was consolidated with General's rate application, A.83-07-02.

Consideration of TASC's complaint against PacBell was to follow the guidelines of D.83-06-091. TASC presented its case through testimony of two witnesses and the deposition of three PacBell employees. Although the depositions were taken in March 1983, they were first made available to interested parties and the ALJ in January 1984, when TASC's witnesses took the stand.

PacBell objected to the admission into evidence of portions of the depositions which concern cost, rate, and service characteristics of the provision of outpulsing numbers to RCCs pursuant to intercarrier agreement. TASC responded that the challenged deposition testimony was relevant as rebuttal to PacBell's evidence as to DID costs, because DID service is "identical" to the outpulsing number service provided to RCCs. The ALJ overruled PacBell's objection, on the basis that portions of the challenged testimony related to the costs of outpulsing number service and to the assertion of identity between that service and DID service, and so were relevant to the reasonableness of DID charges.

TASC asserts on brief that PacBell "has failed to provide any evidence to justify" its DID rates. TASC argues that telephone answering services use DID service "in much the same manner as RCCs" except that calls are directed to answering equipment instead of radio transmitters. As in the case of RCCs, call holding times are "quite short." PBX systems, on the other hand, use DID service differently, for the duration of full length conversations, therefore requiring a greater number of trunks to accommodate the same volume of numbers.

TASC objects to PacBell's present DID rate structure, which bases charges on the volume of numbers without a separate trunk charge. Because telephone answering services have short holding times, they can sustain high number to trunk ratios and so impose less trunking costs on the utility. In effect, argues TASC, they are being charged for trunks they do not use. TASC urges a disaggregation of charges for DID numbers and trunks.

Because PacBell proposes no changes in DID charges, it presented no cost studies related to this service. PacBell concedes that "it may be appropriate at some time in the future" to separate the rate elements of DID service, but "a decision to do so must be based on an accurate and fully developed record," including analysis of the impacts of proposed changes on all present subscribers to the service.

PacBell sees the present record as inadequate, because TASC offered no cost studies of its own, instead relying on portions of prior PacBell studies. According to PacBell these studies provide insufficient detail to resolve the present issue, and the relevance of PacBell's outpulsing number service for RCCs has not been demonstrated. PacBell therefore asserts that TASC has failed to meet its burden of proof as a complainant.

In summary, PacBell urges that a sufficient record has not been developed to allow separation of DID rate elements at this time. PacBell offers to address the issue in its next rate proceeding and to be prepared to develop an adequate record with notice to all parties so the issue can be resolved.

Large Users also address the DID issue in their brief, asserting that TASC's analysis is "very misleading." According to Large Users, the cost of DID service in the central office is a function of processing and outpulsing the dialed number. Once the call is connected, the central processing unit is released for other work. The cost is thus related to the number of call attempts and is not a function of the number of trunks. Large Users see the present

method of pricing on the basis of numbers as properly reflective of cost incurrence.

Large Users conclude that costs are in dispute and that TASC has offered no concrete rate proposal. Therefore, Large Users assert that no action should be taken on TASC's complaint.

TASC did not participate in the oral replies to the briefs. TASC's brief includes few citations to the record. It appears that most cost evidence to substantiate TASC's position must be drawn by implication from the deposition testimony that was made available only in the closing days of hearing. TASC has not offered sufficiently definite recommendations to permit our adoption of specific rate changes in this proceeding. Moreover, based on Large Users' unrebutted analysis, we must find that TASC has failed to show that its proposal to disaggregate DID rates for numbers and trunks more fairly reflects costs than the present rate design. We conclude that TASC has failed to meet its burden of proof as a complainant to show the unreasonableness of PacBell's DID rates.

We note that the parallel issue of the reasonableness of General's rates for DID service is at issue in General's rate proceeding. The record developed in that proceeding may permit us to take more positive action on TASC's complaint against General. Meanwhile, we will deny TASC's complaint against PacBell without prejudice to reconsideration of the reasonableness of TASC's arguments and PacBell's DID rates in the next PacBell rate proceeding. We will instruct PacBell to address the issues raised by TASC by a study of DID costs and an appropriate rate proposal to be properly noticed and submitted with its next general rate application.

K. Billing Surcharges

PacBell proposes to eliminate the existing 5.4% rate surcharge which was implemented by D.93367, and to reduce nearly to zero the 6.66% billing surcharge which was originally established by D.93728 and replaced by a 10.32% interim surcharge by D.83-12-025. PacBell witness Evans explained that the 5.4% surcharge was levied mainly against private line services and customer premises equipment

(CPE), for which improved cost studies were needed. CPE has been deregulated and appropriate rates have been set for private line services, based on improved (if still imperfect) cost studies, so the 5.4% surcharge is no longer needed.

Staff supports the elimination of the 5.4% surcharge and the substantial reduction of the remaining billing surcharge. Staff witness Shantz disputed PacBell's initial calculations of the revenue effects of these changes. Revised calculations brought the difference down to less than $5 million, with PacBell calculating a $144.2 million and staff a $139.3 million revenue reduction, the difference being due to staff proposing to maintain a 0.24% billing surcharge versus a 0.002% surcharge assumed by PacBell.

Both Evans and Shantz explained their proposals to retain small billing surcharges as means of balancing the revenue requirement with a proposed rate design. Shantz strongly opposed use of a billing surcharge greater than plus or minus 3% as a final rate set in a major rate proceeding. He stated that such surcharges "tend to distort rate relationships and to mask rate inequities," and should be avoided especially when "much higher than a few percentage points."

TURN, on the other hand, in effect urges that all the effort which has gone into establishing fair and reasonable rates in this proceeding be abandoned and that the rate changes required in this decision for both PacBell and AT&T-C be implemented through massive surcharges. We reject this suggestion as inequitable and unnecessary.

We agree with staff that billing surcharges should be set at low levels in general rate proceedings. The primary utility of a billing surcharge is to adjust for changes in revenue requirement, including attrition adjustments, which occur between general rate cases. A billing surcharge is also useful to "fine tune" the rate design to the revenue requirement in a general rate case, but it should generally be possible to set the surcharge at an absolute

value much lower than the 3% limit proposed by staff. Surcharges appearing on customer bills are a major source of customer misunderstanding, distrust, and informal complaints.

Because rates are being increased significantly for most services subject to the 5.4% surcharge, it is appropriate to eliminate that surcharge, except as it applies to rates for Centrex service. In D.83-05-45, issued April 4, 1984, we authorized a Rate Stability Plan (RSP) for most rates applicable to Centrex service. Centrex rates subject to the RSP are not being increased by the present decision, either for customers participating in the RSP or for those who do not. Consequently, the 5.4% surcharge should remain applicable to Centrex rates subject to the RSP. We note, however, that D.83-05-45 provides for the removal of this surcharge from Centrex rates coincident with the anticipated 1985 increase in the FCC-mandated Centrex customer access line charge.

In order to promote clarity in customer billing, such surcharges should be eliminated, or set as low as practical, in general rate decisions. In this proceeding we set the billing surcharge at a negative 0.41%, which, together with elimination of the 5.4% surcharge from all except Centrex rates, will decrease annual revenues by $143.3 million.

L. Settlement Effects

Many of the rate changes we are authorizing for PacBell will affect the revenues of ITCs providing local service in California. In the case of MTS rates, the changes we are authorizing affect the statewide message toll schedule and so affect the rates charged by every ITC. In the case of ORTS, OCMS, ZUM, and local coin service, the changes we are approving for PacBell will be applied to General as well, and so will significantly affect our forthcoming decision in General's rate proceeding, A.83-07-02.

In addition to the effects of changes in rates they will charge, the ITCs also will feel the effects upon intercompany settlements of changes in rates for PacBell. The settlement process was described in Exhibit 18, at 18-15:

> "In principle, whenever telephone traffic flows from one company's facilities to another, some process of settlement must be devised. The objectives of all settlement agreements are to produce smooth and continuous provision of service and an equitable sharing of the revenues derived from the service."

Settlement effects of the amended rate spread proposals of PacBell and staff were set forth in Exhibit 721. Settlement effects of the adopted rate design will differ from those shown in Exhibit 721, and are estimated as follows:

PACIFIC BELL

Estimated Settlement Revenue Effects
of Adopted Rate Design
for Estimated Year 1984
(000)

Independent Tel. Co.	Message Toll*	Private Line Toll	EAS	ZUM*	Total
General	$38,424	$12,623	$11,591	$11,625	$74,263
Continental	3,478	510	156	-	4,144
Citizens	915	114	432	-	1,461
Roseville	557	-	1,062	-	1,619
All Other	1,028	50	151	-	1,239
Total	44,402	13,297	13,392	11,625	82,726

* Includes effect of revised ORTS and OCMS rates.

As indicated, the rates authorized for PacBell will produce increased settlement revenues for all ITCs. In some instances these effects could produce excessive earnings; in others they will help forestall the need for rate increases. In the case of several ITCs we have conditioned recent rate decisions on adjustments to reflect the settlement effects of the PacBell rate changes we are now authorizing. We direct staff to implement appropriate action, in coordination with the utilities involved, to expeditiously effect rate reductions for the ITCs as required to reflect changes in their settlement revenues.

General and Continental now have rate applications pending before us. In these proceedings, A.83-07-02 and A.83-12-57, we will determine the effects of increased settlements on the operations of General and Continental, respectively, and will make appropriate revenue requirement adjustments to reflect settlement changes.

M. Continuous Property

PacBell proposes to revise the definition of "continuous property" in Rule No. 1 of its Tariff 36-T. The definition would be modified by addition of the following sentence:

"One or more premises of the same or different customers located within the same building are considered on continous property."

Staff supports the proposed change. No party opposes it. We find the proposed change reasonable.

N. Further Study

As noted in the discussion of various specific rates above, we are ordering Pacific to undertake several studies related to costing, some of which must be completed for the purposes of Pacific's next general rate case showing. These studies include analysis of (1) time of day and day of week variations in the cost of providing ZUM and MTS services, (2) costs of transmitting individual messages within metropolitan regions disaggregated by service arrangement (e.g. local vs. toll), (3) costs and benefits of unlimited flat rate metropolitan calling plans, (4) effects of changes in exchange area and local calling area boundaries and of ZUM expansion, (4) costs of detailed billing on ZUM messages, and (5) costs of DID service.

Apart from these specific areas where refinements in embedded cost and related studies are called for, we note that TURN has generally attacked all of Pacific's "tops-down" cost studies. TURN asserts that "the tops-down approach allows the company to manipulate cost data to reach preordained results supporting its proposals."

TURN asserts that "bottoms-up" cost studies are preferable because they separate direct costs from loadings of overheads and other common costs, and would make explicit the effects of line fill factors on cost calculations. TURN recommends that PacBell be required to develop, through independent consultants, reliable bottoms-up studies for all services for its next general rate application.

TURN exaggerates both the utility of and the need for bottoms-up cost studies. Bottoms-up studies are no panacea for the hard problems of cost allocation. Time and motion studies, panels of estimators, and statistical samples are no more foolproof than PacBell's tops-down category cost studies. Indeed, in a recent proceeding concerning PacBell's proposed Centrex Rate Stability Plan, a respected economist, testifying on behalf of the protestants in that case, objected to bottoms-up cost studies on the grounds that they tend to produce inconsistent results among services and fail to add up to the overall revenue requirement. She considered bottoms-up cost studies "essentially inauditable." (A.83-05-45, Exhibit 29, at 17; Tr. at 741.)

Bottoms-up studies do not do away with the need to allocate overheads and common costs among services. The tops-down approach also makes such allocations, which can be discerned through analysis of the methods PacBell applies in developing category and subcategory costs. The proper place to criticize the magnitude of common costs is in the revenue requirement portion of a rate application.

The embedded cost studies submitted by PacBell in this proceeding, both tops-down and bottoms-up, were far from perfect and have been properly dissected and criticized in many respects. Still, those studies have provided essential benchmarks against which to test the reasonableness of proposed rates. We do not wish for PacBell to abandon its category analysis approach to the study of service costs.

There are, however, several generic deficiencies in PacBell's embedded cost studies which cry out for attention. We are disturbed by the degree to which PacBell's bottoms-up studies of recurring private line costs failed to reconcile with the corresponding tops-down category results. As is stated in our discussion of private line services, we expect PacBell to conduct these studies anew and to explain more adequately any failure to reconcile tops-down with bottoms-up results.

Moreover, in the next rate application, for any other major service category for which PacBell proposes rate increases substantially greater than the proposed percent increase in totalrevenues, PacBell should conduct and submit detailed bottoms-up as well as tops-down service cost studies. Although not directly applicable, the D.83-04-012 Cost Manual should be taken as an example of how such studies should be formulated for services other than private line.

Several intervenors have expressed alarm about what they consider to be the inaccuracy of Pacific's costing studies and the difficulty associated with their evaluating such studies due to the inaccessibility of study development materials. TURN, in oral argument, calls for the Commission to order that independent consultants perform the costing studies. Large Users call for an independent audit of Pacific's private line costs.

We instruct staff and invite all interested parties to join in a Task Force for the purpose of reviewing the development of the costing studies ordered by us for Pacific's next general rate case (listed in ordering paragraph 16 below). Pacific shall work with the Task Force on the development of these studies and file with the Commission a study plan for each within 90 days of the date of this decision. Task Force members are invited to file comments on these study plans at the same time. Based on these comments and these plans we will consider further orders at that time regarding costing studies, if such appear warranted, including whether some of the studies should be performed by an independent consultant.

It may be that embedded cost studies, however refined, will not prove to be an adequate basis for the Commission's rate design decisions in a period such as the current one which is marked by increasing local telephone costs and increasingly competitive telecommunications markets. We are also interested in exploring whether a greater reliance on other bases for pricing such as marginal costs and marginal value can provide more satisfactory

guideposts. In an era of increasing local telephone costs, more efficient use of the telephone system, which lowers total system costs for all users, becomes more important. As we have noted in numerous electric and gas rate decisions during the last decade, lower utility system costs are likely to be promoted by marginal cost based pricing of utility services. Further, as marginal costs, properly defined, represent the cost of competitive entry into the relevent utility service market, a knowledge of marginal cost on our part is necessary for us to ascertain the effects of our pricing decisions on entry and competition, both economic and uneconomic, in the telecommunications markets that we regulate.

We recognize that the development of a marginal cost approach to rate design is more difficult in telecommunications than it is in electricity and gas. There are more interdependencies in the costs required to produce a given product such as voice transmission, and there is more ambiguity in the definition of the product being provided (e.g., voice versus data transmission, high versus low quality transmission).

We call on Pacific and other parties to address in Pacific's next rate case whether marginal cost analysis might be used as a basis for rate design decisions. Due to the capital intensive nature of telephone operations, we expect short run marginal costs on the telephone system to be generally difficult to pinpoint and, more specifically, to vary substantially over time and space. Therefore, it is likely that long-run marginal or incremental cost methodologies may be more relevant here.

In light of the claims and counterclaims about which services are "responsible" for what proportion of fixed local network costs, which are being "subsidized", and which are bearing costs in excess of the costs they cause, we will also order Pacific to specifically study the relationship between incremental capital costs and incremental service demand on a recent historical and

prospective basis. We shall require a detailed analysis of its construction budgets for local network and switching for the past ten years and, prospectively, for the next five years, to assess what types of service demand those construction budgets were or are intended to meet. PacBell will be expected to explain its choice of particular types of facilities and service capacities based on the categories and volumes of service for which they were or are designed. PacBell should propose allocations of the capital costs implicit in each year's construction budget among the various PacBell service offerings, past, present, and future, including exchange access services. Those cost allocations should be consistent with PacBell's explanation of the facilities design process.

Beyond more precise costing analysis on both marginal and embedded cost bases, we are concerned about the lack of information regarding the income distribution effects of various rate design alternatives. Movement toward accurate cost-based prices is not a sufficient goal if this also leads to deleterious income distribution effects and reduced participation in the telephone system by low and middle income consumers. In the record now before us we find little data upon which we can judge the income distribution and telephone service penetration effects of various rate design alternatives. We do not wish to repeat this experience. We shall order PacBell to undertake a statistically reliable study of the usage of its various services by residence subscribers of various income levels, employment types, ages, and family sizes. We are particularly interested in analysis of basic exchange service choice, local usage, and toll usage disaggregated by subscriber income level. The study plan for this analysis should be developed with the participation of the Task Force which we have established to review further embedded cost studies.

Finally, we note the importance of casting our rate design decisions in light of broader regulatory strategy toward intrastate telecommunications markets. We will direct staff to prepare a public report on the Commission's broader policy options regarding intraLATA pricing (e.g., traditional embedded cost, marginal cost, elasticity-based value of service, etc.). Which alternatives are more likely to promote efficient usage and prevent uneconomic entry? How does each alternative affect the achievement of universal service goals? Which alternatives employ the most rational cost classification scheme, representative of present and emerging services? Are different alternatives more or less appropriate depending on market or service type? What is the administrative and technical feasibility of each?

The report shall be filed with the Commission within six months from the date of this decision. We will invite comments of other parties on the report at that time and then consider possible rule-making.

The results of the studies which we include in Ordering Paragraph 16 of this decision should be submitted in the course of PacBell's next general rate application. We appreciate the conflict between the need for timely submission of these study results and the need for thorough analysis of these complex issues. We cannot state too strongly our desire to have useful results of these studies submitted early enough in the next rate proceeding to permit their thorough review on the evidentiary record. Submission of the study results later than is consistent with our Rate Case Plan will be permitted, but could delay the proceeding and the date of decision on PacBell's application. Failure to submit useful study results may be the basis for concluding that PacBell has failed to meet its burden of proof to justify increased rates.

O. Monitoring Bypass

The threat of uneconomic bypass* has been discussed at great length in this proceeding, as well as in the access charge proceeding (A.83-06-65) and this Commission's generic investigation into telecommunications competition issues (OII 83-06-01). We have acknowledged the long-term nature of this threat and have stated our intent to limit future incentives for uneconomic bypass (D.83-12-024, mimeo p. 148). We have taken an initial step in this decision by adopting a discount plan for large toll users for both Pacific and AT&T-C designed to make bypass less attractive for such large users and thereby maintain their full participation in an integrated telephone system. Since we are in a period of transition, we are well aware that as regulators we may be required to take additional steps to minimize the impact of bypass on the local exchange.

In order to ensure that we have sufficient information to take appropriate future action, we hereby instruct our Executive Director to establish a Bypass Task Force composed of staff members from Communications, Policy and Planning, and Legal Divisions. The principal duty of this Task Force will be to monitor the threat of uneconomic bypass with a view to developments in bypass technologies and specific instances of documented bypass, and bypass potential, and to periodically report its findings by memorandum to the Commission.

At a minimum we expect this Task Force to provide us with its estimate of the magnitude of future uneconomic bypass, its assessment of the rate impact of this bypass on local service, and its analysis of the regulatory options available to us to meet this threat. The Task Force should also provide us with any other information it deems relevant.

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* In general, economic bypass occurs when a customer has access to comparable or superior services at lower incremental costs than those of the regulated utility. In contrast, uneconomic bypass occurs when the bypassing customer seeks comparable or superior services which cost more than the utility's incremental costs.

While we would expect the Task Force to report to us on its own initiative whenever events merit immediate Commission attention, we will require that the Task Force submit a written report by memorandum of its findings on a semi-annual basis. The first such report shall be made three months after PacBell's next bypass report submitted in compliance with D.83-12-024. This should enable the Task Force to analyze and use relevant information provided by PacBell in its report.

VIII. AT&T COMMUNICATIONS RATE DESIGN

In order to have rates effective at the commencement of business on January 1, 1984, AT&T-C filed initial tariffs on October 17, 1983 by its Advice Letter 1. However, by Order of November 22, 1983, in (I&S) C.83-11-06, the Commission suspended those tariffs and required AT&T-C to adopt PacBell's existing interLATA rates and tariffs, pending hearings and decision on AT&T-C rate design. Pursuant to that Order, AT&T-C filed Advice Letter 2, adopting PacBell's rates and tariffs on an interim basis commencing January 1, 1984. Hearings on proposed revisions of this interim AT&T-C rate design were held in early March 1984, with briefs filed March 27.

AT&T-C offers two sets of rate design proposals, one a group of general exhortations that more flexible regulatory and pricing policies be applied to AT&T-C and the other a package of specific proposals for changes in rates and rate structures. Only staff responded to AT&T-C's statements on regulatory policy, but several parties took positions regarding particular rate proposals or offered alternative proposals.

The major issues raised by staff concern the levels of short-haul toll rates, the Directory Assistance (DA) charge, and private line rates; the appropriate approach to discount plans for large users of toll service; and the treatment of 800 Service and interLATA foreign exchange (FEX) service. PacBell concentrates its attention on the 800 Service issue and AT&T-C's comments on the level of PacBell's access charges. TURN concerns itself with the large toll user discount plan proposals and the issue of DA charges. Dr. Brylawski also presents a position on DA charges. DCARA proposes a toll rate discount plan for TDD users. Large Users raise an issue about the passing through in private line rates of a $25 monthly access charge per closed end of a private line circuit. A number of AT&T-C proposals provoked no discussion; many of these track PacBell rate design proposals or implement established Commission policies.

A. Policy Directions for Regulating AT&T-C

AT&T-C has taken the opportunity offered by this proceeding to present arguments for greater flexibility in the setting of its rates and in regulatory oversight of its operations. These arguments resemble those which AT&T-C has offered in OII 83-06-01, our investigation to determine whether competition should be allowed in the provision of telecommunications, and which are discussed in D.84-06-113, issued today in that matter.

AT&T-C describes California's interLATA services market as "vigorously competitive." AT&T-C notes that our D.84-01-037, issued in January 1984 in OII 83-06-01, has opened this market for entry by "any and all" service providers, and dozens of companies have taken advantage of a streamlined tariffing process to establish services in direct competition with AT&T-C, at generally lower rates. According to AT&T-C,

> "The explosive growth of competition mandates that rate design proposals be evaluated with a realistic concern for marketplace effects. It can no longer be assumed, for example, that a revenue shortfall in one area of the interLATA telecommunications business can be made up through higher rates in heavily competitive services such as long-haul toll."

AT&T-C contends that flexibility in rate-setting is crucial to its ability to respond to marketplace conditions in a competitive environment. AT&T-C witness Kenneth Parker testified that the overall ability to change prices easily to meet contingencies is highly desirable in a "simultaneously regulated and competitive" environment. AT&T-C urges that it be permitted "for instance [to] set and change prices within a predetermined reasonable range without extensive time-consuming regulatory procedures." Parker suggested the allowable range "could be from incremental cost up to an [] regulatory limitation on overall rate of return," or within a range of plus or minus 15%. He saw competition as providing a "market test" of the reasonableness of such rates.

AT&T-C also seeks regulatory flexibility to facilitate prompt rate revisions to reflect changes in underlying costs. This is particularly relevant to access costs, which comprise at least 80% of AT&T-C's total costs for switched network operations in California and which are likely to change with revisions in access charges. Parker testified, however, that he would not want to see an "automatic" reduction in AT&T-C rates in the event of a downward revision in access charges.

Parker also saw "regulatory flexibility" as encompassing freedom to bring new services to market with minimal regulatory delay and Commission "evenhandedness" in applying the regulatory process to all carriers. Beyond this request that all competitors "be treated the same way," Parker had no specific recommendations for changes in present procedures.

Staff witness Popenoe agreed that generally speaking, in the long run, "AT&T should have the flexibility to meet the competition by adjusting their rates to whatever the floor is." He noted that Commission approval is not required for rate reductions in the absence of protest. He suggested that, if AT&T-C's rates are not below its marginal costs nor below competitors' rates, "you'd have sort of a prima facie case that the rates would be reasonable in those circumstances."

Popenoe saw the present advice letter procedures as adequate to provide AT&T-C the necessary flexibility, considering that it is still the dominant carrier. He recommended, however, that in order to minimize frivolous or harassing protests, the Commission not entertain protests to AT&T-C rates where the rates exceed both AT&T-C's marginal costs and rates charged by the protestant.

Popenoe testified that AT&T-C rates must, within some reasonable range, reflect the cost of providing service. Because of its dominant market position, AT&T-C's earnings on any particular service should be limited, and below-cost pricing should generally not be permitted, in order to avoid anticompetitive or predatory

conduct. Popenoe recommended exceptions to this "full cost" standard where excessive rate increases would result or where below-cost rates are necessary to meet basic communications needs.

This is not the proper proceeding for detailed consideration of reforms in the regulation of long distance telephone companies. We take this opportunity, however, to make clear our understanding that this Commission holds plenary jurisdiction over the operations of AT&T-C as a provider of telecommunications services between points within the State of California.

Flexible regulation is something of a "motherhood and apple pie" issue; a preference for rigid regulation is neither intellectually nor politically acceptable. We will be as flexible and as expeditious in regulating AT&T-C as is consistent with our duty to assure the reasonableness of rates and the adequacy of service by the dominant provider of long distance telephone utility services under our jurisdiction.

As we have stated in D.84-06-113 in OII 83-06-01, the time for authorizing a zone of reasonableness approach to rate regulation of AT&T-C has not yet arrived. We agree with staff witness Popenoe, however, that AT&T-C is free to propose rate reductions and that we should discourage frivolous protests against such proposals. As Popenoe suggested, if AT&T-C can show that proposed rate reductions are not below either its marginal costs or its competitors' rates, we will be reluctant to suspend such proposed reductions in response to a competitor's protest. We note, however, that the maintenance of a reasonable relationship among rates for various services is also a relevant factor. We also recognize that determination of the marginal costs of telecommunications services is a challenging and, to this date, novel task in the regulatory context.

We are concerned by AT&T-C witness Parker's opposition to "automatic" adjustments in AT&T-C rates to match potential changes in access charges. This Commission has customarily required such

automatic adjustments in cases of substantial reductions in utility operating expenses resulting from government actions, such as the reduction in property tax obligations due to enactment of Proposition 13, the Jarvis-Gann Initiative, and the flowthrough of refunds from interstate gas pipelines ordered by the Federal Energy Regulatory Commission. The relationship between AT&T-C and local exchange telephone companies is directly analogous to that between natural gas distributing utilities and their interstate suppliers. We conclude that in the event of substantial reductions in intrastate access charges imposed on AT&T-C, this Commission has both the authority and the responsibility to require that the resultant access cost savings be flowed through to AT&T-C's intrastate customers as directly and promptly as possible.

B. AT&T-C Rate and Tariff Proposals

AT&T-C offered an extensive list of proposed changes in its rates and tariffs. AT&T-C witness Parker listed the following proposed changes to the Message Toll Service (MTS) rate structure:

1. An initial minute rate structure including a fixed 25¢ for call set-up and billing to recover access costs, plus a one-minute charge for usage.
2. Off-peak discounts reduced from 30 and 60% to 25 and 50%, to partially account for the lack of such discounts in access charges.
3. Reduced mileage bands from 18 to 7 to better reflect interLATA message distribution.
4. Adoption of Rate Period Specific Billing (RPSB), for consistency with other rate structures.
5. Replacement of the coin paid toll schedule with a 25¢ or 50¢ surcharge to dial direct rates, for consistency with other rate structures.
6. Increased service charges for Calling Card calls (from 40¢ to 50¢) and for Person messages (from $2.50 to $3.00), which are discretionary services "for which there is a demonstrated willingness to pay."

7. Introduction of a surcharge for operator handled conference calls, to reflect the method of providing the service.

8. Introduction of day and evening discounts for TDD users, as discussed in regard to PacBell, supra.

9. Elimination of the prohibition on resale.

Parker calculated three different sets of revised MTS rates, geared to generate a negative $143.9 million, a negative $1.0 million, and a positive $30.3 million in revenue change, respectively, to suit progressively increasing assumed revenue requirements. In each case the initial minute rates for calls up to 70 miles and additional minute rates up to 40 miles would be substantially increased, but additional minute rates for calls over 40 miles would decrease.

AT&T-C proposes no change in WATS/800 Service usage rates but proposes to increase the WATS set-up charge from 5¢ to 15¢ per call to reflect access costs of 13¢ per call. Resale and sharing of WATS would be permitted and the minimum period of access line interruption for which credit is allowed would be increased from 2 to 24 hours. AT&T-C would flow through PacBell's nonrecurring access charges for installation of interLATA WATS lines. AT&T-C proposes "full state" (including intraLATA) 800 Service.

AT&T-C proposes to discontinue interLATA ORTS and OCMS. Witness Parker proposed a new optional calling plan offering flat or discounted rates for off-peak calling. In response to a staff proposal, he later proposed a second optional calling plan offering a discount to large volume MTS users regardless of time of day.

AT&T-C also proposes to introduce a new charge of 90¢ per call for interLATA DA Service, except for calls from coin phones or by handicapped persons, based on a calculated access cost of 81¢ per call. Charges for verification of a busy line and interruption of a

conversation in progress are proposed to be increased from 25¢ to $1.30 and $1.70, respectively, again reflecting costs near those levels, and an exemption from such charges for calls from coin phones would be removed.

In the area of private line services (sometimes referred to as "Special Services"), AT&T-C states that it proposes no change in its overall revenues, but seeks a new, simplified rate structure consisting of three basic rate elements: the "Local Channel" between customer and local switching office; the "LATA Access Channel" between local office and AT&T-C serving office; and the "Interoffice Channel" between AT&T-C offices. The Local Channel and LATA Access Channel charges reflect access costs only; the Interoffice Channel is provided over AT&T-C-owned or leased facilities. AT&T-C also proposes to withdraw all Series 6000 audio offerings, for which there are no interLATA customers. AT&T-C concurs in staff's proposal to discontinue interLATA Telpak Service, a discounted private line offering.

AT&T-C proposes to provide interLATA FEX Service by a private line connected to switched access. FEX charges would consist of private line charges based on the three-element rate structure described above, plus a flowing through of PacBell's access charges for the switched access element. This pricing arrangement would be cost-based but would make installation of interLATA FEX Service very costly due to high nonrecurring charges for the private line elements.

By late-filed amended testimony of witness Parker, submitted by letter of counsel for AT&T-C which was received by the ALJ on March 22, 1984, AT&T-C proposed further rate increases in its 800 Service set-up charge and its WATS usage charges. The ALJ issued a ruling identifying this testimony as Exhibit 740 but stating that it would be received into evidence only if no substantial objection was made by April 13 and remained unresolved at that date. In its brief filed March 27, supplemented by letter of counsel of April 11,

PacBell "strongly objects" to receipt into evidence of Exhibit 740, an objection which remains unresolved. In the face of this outstanding objection, late-filed Exhibit 740 was not and will not be received into evidence.

C. Uncontested and Previously Resolved Issues

As noted above, many of the AT&T-C proposals are noncontroversial, tracking PacBell recommendations or established Commission policy. For MTS rates, these include the adoption of RPSB, establishment of simplified surcharges for coin paid toll calls and operator handled conference calls, and increased service charges for Calling Card calls and Person messages. For the reasons stated elsewhere in this decision with respect to PacBell, these changes are found reasonable and will be approved. Elimination of the prohibition on resale or sharing of interLATA MTS or WATS was approved in D.84-01-037 in OII 83-06-01, so the corresponding tariff changes for AT&T-C are reasonable and will be approved. The level of MTS discount for TDD users, including a night and weekend discount not proposed by AT&T-C, has been determined in the discussion of PacBell's rates, supra.

The proposal to increase the minimum credit period for access line interruption under the WATS tariff is of negligible significance to subscribers. Its approval is reasonable to avoid excessive administrative cost. The proposal to flow through exchange carrier access charges in WATS installation charges is uncontested and cost-justified. Staff witness Popenoe supports the proposed increase in the WATS set-up charge, which reasonably reflects access costs. These proposals also will be approved.

Staff agrees with the proposal to discontinue interLATA ORTS and OCMS. It sees ORTS as designed to be a metropolitan calling service and OCMS as a discounted toll plan which generates too little revenue to cover access costs. In either case the offering of these primarily intraLATA discount plans on an interLATA basis is

inappropriate. Other optional calling plans have been proposed which are better suited to the interLATA market, so it is reasonable to withdraw interLATA ORTS and OCMS.

Staff itself proposes to discontinue interLATA Telpak Service, and AT&T-C concurs. Telpak is a large volume discount plan for private line users. It was discontinued in interstate service several years ago and is a closed tariff in California. Therefore, it is not available to new subscribers in California. We find that large volume private line users have alternatives available, such as high capacity Transport Service, which offer a real cost saving to the carrier as well as the customer. This makes it reasonable to withdraw interLATA Telpak Service. It is also reasonable to withdraw the offering of Series 6000 audio services in view of the absence of customers.

No party objects to the proposed increase in the 25¢ verification/interrupt charge to $1.30 and $1.70 for the two service elements. However, in view of the fact that we are recognizing a decrease in revenue requirement for AT&T-C, these proposed increases are excessive. We will set verification and interrupt charges for AT&T-C at the same levels we are approving for PacBell, 50¢ and $1.00, respectively. The revenue effect of these rate changes is negligible.

D. Message Toll Service

Staff witness Popenoe favored allowing AT&T-C the flexibility to design a rate schedule reflecting market conditions in the toll market, "in which there is extensive competition." Staff therefore accepts the general direction of AT&T-C's proposed changes in rate structure for MTS, including a lesser number of mileage bands, higher initial minute rates, and a reduction in shoulder-peak and off-peak discounts.

Popenoe objected, however, to the drastic rate increases proposed for short-haul toll. He considered these increases

excessive, and noted that they would create a large disparity with PacBell's rates for short-haul toll calls. Staff notes that this would have,

> "...an undesirable effect on telephone subscribers living along LATA boundaries...who depend on short-haul toll calls to meet their day-to-day communications needs for basic services."

To remedy this problem, staff proposes to retain a larger number of mileage bands (10 instead of 7) to permit increases for all existing mileage bands to be held to less than 100%. Witness Popenoe proposed an alternative toll rate schedule with increases in short-haul rates much less than AT&T-C proposes, which could be balanced by slight increases in initial minute rates for longer distances.

There was some confusion on the record about the revenue impact of Popenoe's revisions to AT&T-C's MTS rate proposal. His cross-examination and comparison of the various exhibits indicate that his lower proposed short-haul rates would generate $14 million less than the $1.0 million decrease in annual revenue that would result from the schedule shown in Exhibit 732, sponsored by AT&T-C witness Parker.

Facing, as we do, the need to provide for a decreased, rather than increased revenue requirement, we must examine the entire range of MTS rate proposals which are in the record, except the final AT&T-C proposal of a $30.3 million MTS revenue increase, which is clearly excessive. These proposals are set forth in the following table:

AT&T COMMUNICATIONS
Message Toll Rate Schedule Proposals

Rate Mileage	Present Rates* Initial Minute	Present Rates* Add'l. Minute	AT&T-C Exhibit 730 Initial Minute	AT&T-C Exhibit 730 Add'l. Minute	AT&T-C Exhibit 732 Initial Minute	AT&T-C Exhibit 732 Add'l. Minute	Staff Exhibit 735 Initial Minute	Staff Exhibit 735 Add'l. Minute
0- 8	$ .15	$ .07	$ .40	$ .15	$ .40	$ .15	$ .25	$ .12
9- 12	.15	.07						
13- 16	.17	.09					.30	.14
17- 20	.21	.13					.35	.16
21- 25	.24	.15	.45	.20	.45	.20	.40	.18
26- 30	.27	.18					.45	.20
31- 40	.30	.21						
41- 50	.34	.25	.47	.22	.50	.25	.50	.25
51- 70	.38	.29						
71- 90	.42	.33	.51	.26	.54	.29	.54	.29
91-110	.44	.34						
111-130	.47	.36	.53	.28	.58	.33	.58	.33
131-150	.50	.38						
151-170	.53	.40						
171-195	.56	.42	.57	.32	.61	.36	.61	.36
196-220	.58	.43						
221-245	.60	.44						
Over 245	.62	.45	.60	.35	.64	.39	.64	.39
Change in Net Annual Revenues			($143.9 million)		($1.0 million)		($15.0 million)	

*Excluding present 10.32% billing surcharge.

Comparison of these three proposals for toll rate schedules geared to generate revenue decreases reveals that all three contemplate virtually across-the-board increases in initial minute rates, substantial increases in short-haul additional minute rates, and decreases in long-haul additional minute rates. This is consistent with AT&T-C's concern that its toll rate schedule be designed to cover its access costs, which comprise roughly 80% of its entire costs and which are concentrated in the first minute of calling and do not vary with the calling distance over the facilities of an interexchange carrier (IEC).

AT&T-C witness John MacLay testified that the intrastate access charges per AT&T-C call amount to 25.9¢ for setting up and billing each call plus 20.5¢ per minute of call duration. This suggests that initial minute rates should exceed additional minute rates by up to 25¢. The difference between these rates, by mileage band, currently ranges from 8 to 17¢. Based on the structure of access charges, an increased differential between initial minute and additional minute interLATA MTS rates is justified.

There is no reason why a provider of access services, such as PacBell, should care how long a distance an IEC, such as AT&T-C, has transmitted or will transmit a message for which the IEC requires access to or from the local carrier's network. PacBell has no way of knowing, at least presently, the distance of such calls. Accordingly, PacBell's access service rates are not mileage sensitive in relation to the total length of haul, but only in relation to the amount of its own local facilities required to provide access. There is no reason to expect this situation to change in the foreseeable future. Consequently, the structure of access charges justifies making the MTS rate schedule of AT&T-C less distance sensitive, so that short-haul calls will come closer to covering their cost and so require less contribution from long-haul calling revenues.

This concern that particular service elements cover their costs must be balanced against the concerns raised by staff - that rate increases not be excessively sudden or great and that too large

a discrepancy between PacBell and AT&T-C short-haul rates would be unfair to subscribers living along LATA boundaries. We find that such subscribers depend on short-haul interLATA toll calls to meet their day-to-day communication needs for basic services. It is therefore necessary to limit increases in short-haul MTS rates, even to the point of requiring contribution from long-haul revenues to cover a portion of the costs of short-haul service. An exercise of judgment is required to determine the appropriate level of such contribution. In the context of an overall reduction in revenues, for AT&T-C, we find it reasonable to limit increases in any MTS rate to less than 50% and to limit increases in any except the shortest mileage bands to no more than one-third.

The final element of MTS rate structure we must consider is the level of off-peak discounts. Because access charges do not vary by time of day, AT&T-C proposes to reduce its time-of-day discounts from 30 to 25% for the evening period and from 60 to 50% for the night period. No party objects to this change, and we find it a reasonable compromise between the interest in strictly covering access costs and the value of offering off-peak discounts.

The issue of whether to provide for off-peak discounts in access service tariffs is set for hearing in Phase II of our consideration of PacBell's access charges in this proceeding, beginning in July. If PacBell's access service tariffs are revised to provide for off-peak discounts, we expect an advice filing by AT&T-C proposing appropriate upward and downward adjustments in its MTS rate schedule.

Based on these considerations, the revenue effects of our treatment of other AT&T-C services as discussed elsewhere in this decision, and the requirement of a $73.5 million reduction in total AT&T-C revenues for the test year, we will authorize the MTS rate schedule shown below. These rates represent an increase in initial minute rates for distances up to 150 miles and a decrease in additional minute rate for distances over 50 miles. For a 5-minute call the adopted rates will result in a lower charge above 50 miles

and a higher charge up to that distance. The adopted rates are generally lower than the corresponding rates proposed by staff and AT&T-C. (We note that the present rates shown do not include the 10.32% billing surcharge, which will be removed with this decision. In relation to the present surcharged rates, no rate will be increased by more than one-third and initial minute rates will increase only for distances up to 90 miles. Effects of the 4% Moore Universal Telephone Service Act tax also are omitted.)

AT&T COMMUNICATIONS

Adopted Message Toll Rate Schedule

Rate Mileage	Present Rates* Initial Minute	Present Rates* Add'l. Minute	Adopted Rates Initial Minute	Adopted Rates Add'l. Minute	Percent Change* Initial Minute	Percent Change* Add'l. Minute
0- 8	$ .15	$ .07	$ .22	$ .10	47%	43%
9- 12	.15	.07	"	"	47	43
13- 16	.17	.09	.25	.12	47	33
17- 20	.21	.13	.28	.15	33	15
21- 25	.24	.15	.32	.18	33	20
26- 30	.27	.18	.36	.21	33	16
31- 40	.30	.21	.40	.23	33	(10)
41- 50	.34	.25	.44	.25	29	0
51- 70	.38	.29	.50	.25	32	(14)
71- 90	.42	.33	.47	.27	12	(18)
91-110	.44	.34	"	"	7	(20)
111-130	.47	.36	.50	.29	6	(19)
131-150	.50	.38	"	"	0	(24)
151-170	.53	.40	"	"	(6)	(28)
171-195	.56	.42	.54	.31	(4)	(26)
196-220	.58	.43	"	"	(7)	(28)
221-245	.60	.44	"	"	(10)	(30)
Over 245	.62	.45	.57	.34	(8)	(24)

*Excluding present 10.32% billing surcharge.

One result of the adopted MTS rates is an increase in the differential between initial and additional minute rates to a range of 12 to 23¢, which better reflects access costs. Mileage bands will be reduced from 18 to 11. Another result will be a substantially diminished requirement that long-haul revenues contribute toward the

recovery of short-haul costs. We find that this change will enhance AT&T-C's ability to compete with other LECs which are not bound to offer short-haul toll services to the general public. Our revisions in AT&T-C's MTS rates will reduce annual revenues by about $105.6 million, including a $0.3 million reduction due to the discounts to be authorized for TDD users.

E. Optional Discount Calling Plans

In his original proposed testimony, Exhibit 729, AT&T-C witness Parker proposed an "optional volume discount calling service" offering (1) one hour of night-period calling per month plus a 10% discount on all evening calling for a $10 monthly charge per billing number and (2) additional night-period hours at $8 each. There would also be a $10 nonrecurring service order charge. In his supplemental testimony proposing a rate spread to reflect a $98 million revenue increase, Exhibit 733, Parker referred to this proposed optional calling plan as Plan A, and revised it by increasing the monthly rates to $12 for the first hour and $10 for additional hours. Parker estimated that his original proposal would generate $4.8 million in additional test year revenue, and that his revised proposal would produce $6.0 million.

Staff witness Popenoe supported this optional discount plan, noting that it should assist in generating greater off-peak use of the network. There was no opposition to the proposal. We find that the proposed Optional Discount Calling Plan A offers an appropriate service alternative which will help to generate greater off-peak use of the network. We also find that, in view of the decreased revenue requirement for AT&T-C and the reduction in additional minute MTS rates, the charges for this optional service should be set at the lower levels originally proposed.

Staff witness Popenoe proposed another discount plan, directed to benefit high volume toll users. Its purpose is to discourage large users from constructing local exchange bypass systems. Staff's recommendation, analogous to its proposal of such a

plan for PacBell, is for a block discount of 20% on all long distance billing over $1,000 per month per AT&T-C customer bill.

AT&T-C witness Parker agreed that,

> "...a signal needs to be sent to the marketplace that large businesses can look forward to some relief from the present heavy NTS burden on toll rates."

He testified, however, that rather than the automatic block discount plan proposed by staff, optional plans are in the best interest of all customers, because they offer a choice for customers, provide a new source of demand and revenue, and should increase network efficiency.

Parker proposed a second optional calling plan, Plan B, which "partially addresses the bypass issue" to which staff's recommended block-discount plan was directed. He proposed "provisional rates," subject to future adjustment and possible withdrawal of the plan up to 15 months after implementation. For a $10 nonrecurring service order charge and a $20 monthly subscription fee per billing number, the customer would receive a 10% discount on calling in all rate periods, including on-peak calling. AT&T-C prefers this plan because it would generate $6.0 million in added revenue while staff's proposal would result in at least a $16.9 million revenue reduction.

Staff witness Popenoe was skeptical whether a 10% discount would be enough to discourage bypass by high volume toll users. He did agree that it would at least provide "a signal to the marketplace." TURN, on the other hand, suggested that an appropriate discount would be 15% on interLATA usage over $1,000 per month.

Earlier in this decision, we faced a similar set of facts in establishing a discount plan for large users of PacBell's toll service. In accord with our determination for PacBell, we find that a discount plan for high volume users of AT&T-C's toll service is an appropriate means of deterring uneconomic bypass of the local network, and that it need not be interim or temporary in nature. In view of our approval of a two-step 10 and 15% optional discount plan

for PacBell and in recognition that AT&T-C faces access costs which do not decline as a customer's usage increases, we find that a two-step 10 and 20% optional discount plan is reasonable for AT&T-C.

We will authorize Optional Discount Calling Plan B as proposed by AT&T-C, except that: (1) the plan will provide a 20% discount on all long distance charges over $1,000 per month per AT&T-C customer bill, and (2) the plan will not be "provisional" or "subject to change" other than through normal tariff revision procedures. Hence, for a $10 nonrecurring and a $20 monthly subscription fee, customers will receive a 10% discount on charges less than or equal to $1,000 per month and a 20% discount on charges over $1,000 per month.

Although witness Parker testified that AT&T-C's Plan B would generate $6.0 million in test year revenues, we revise that estimate to $5.0 million because fewer customers may subscribe to the discount plan in view of the MTS rate reductions we are adopting. In addition, we estimate that our modification to Plan B which provides subscribers with an additional 10% discount on billing over $1,000 per month will result in a revenue reduction of about $8.5 million (one half of the $16.9 million estimate made for staff's 20% discount plan). Therefore, we estimate the net revenue reduction from our adopted discount plan to be about $3.5 million ($8.5 million minus $5.0 million).

F. Directory Assistance Service

AT&T-C provides DA service by connecting its customers to a DA operator of the appropriate local exchange carrier. AT&T-C must pay an access charge for this service, which for PacBell is set at 81¢ per call. AT&T-C calculates its total cost at 88¢ per DA call.

AT&T-C proposes a 90¢ charge for every DA call except those placed from coin phones or from physically handicapped customers. AT&T-C seeks to recover its full DA costs, including the high access costs, directly from users of the service, avoiding "a forced subsidy of this noncompetitive service with revenue from the highly competitive long distance service." An important motive for full

cost recovery is the fact that competing IECs do not offer DA service to their subscribers; rather, their customers use AT&T-C's DA service to obtain a number and then place the call over the competitor's facilities. The competitor derives revenue; AT&T-C bears the DA cost.

AT&T-C notes that the local carrier's cost of providing DA service for AT&T-C should not differ much from the cost for intraLATA customers. PacBell cost studies show the cost of its intraLATA DA service as about 34¢. AT&T-C suggests that the level of the DA

access charge should be addressed promptly, but AT&T-C should not have to put off recovering its present cost of providing DA service.

Staff acknowledges that the DA access charge may be too high and that this should be investigated in the Phase II Access Charge hearings set to begin in July. Staff also agrees that DA service will be used by subscribers to competitive long distance companies, so that AT&T-C should be permitted to charge for the service. However, staff sees 90¢ as "an excessive amount for the initial charge." Staff recommends that the charge be set at 50¢ with authorization to increase the charge to a level sufficient to recover PacBell access charges when the final access charge order is issued.

Staff witness Popenoe foresaw "a very adverse reaction from the public" to a 90¢ charge. Popenoe noted that in its February 17, 1984 order rejecting certain proposed tariffs for interstate access service (in CC Docket 83-1145) the FCC has prescribed a 25¢ cap on the DA element of interstate access charges. If this cap were applied to PacBell's intrastate access tariffs, which Popenoe recommended, the total access charge for a DA call billed to AT&T-C would be reduced from about 81¢ to "something like 43¢." Popenoe did not expect to see this change in access charges prior to a decision in the Access Charge Phase II portion of this proceeding.

Popenoe agreed that his 50¢ proposed charge would generate at least $20 million less revenue than a 90¢ charge. He saw AT&T-C recovering the difference through its long-haul MTS rates. He saw need in the long run to set those rates at a competitive level, but emphasized the "transitional condition to get over the first year or so of divestiture without too big a bump on customers in this state."

Dr. Brylawski opposes any service specific charge for interLATA DA calling. He advocates "maintaining the current practice of not charging end users for interLATA DA service." Instead, he would allocate DA costs among interLATA carriers, "who could then equitably pass on these costs to their customers."

Brylawski asserts that,

> "The right of reasonable access, at no additional charge, to all current listed phone numbers is a basic right that is integral to access to long distance phone service."

Because DA service is not a "premium or luxury service," Brylawski does not consider it proper to charge the user. He sees the present practice of not doing so as working well and sees it possible to continue this approach by allowing AT&T-C to recover from its interLATA competitors "a fair and equitable proportion of its interLATA DA costs." Brylawski initially proposed that this be done by allocating DA costs among interLATA carriers on a per customer basis. He acknowledges problems with this approach, particularly because the competitors of AT&T-C are likely to have much higher usage per customer than AT&T-C. He calls for study to come up with a workable means of allocating DA costs among interLATA carriers. In the meantime, the Commission should not authorize usage charges for interLATA DA service.

Brylawski argues that another disadvantage of the proposed charge is that it will necessarily force customers of AT&T-C's competitors to deal additionally with AT&T-C. He fails to note that the competitors are free to offer their customers access to local carriers' DA services just as AT&T-C does today. More fundamentally, Brylawski appears not to understand that AT&T-C provides DA service only by connecting callers to the DA facilities of local carriers. There is no reason why MCI and GTE-Sprint cannot do the same, even offering a discounted rate if they wish to do so.

TURN likewise considers it unfair to charge residential customers for DA calls "when they have no other source of information." TURN is willing to have business customers pay for DA service because they are "likely to use directory assistance for business purposes which would enhance their profits." The costs of DA service for residence customers, however, should be distributed

among IECs on a minutes-of-use basis and should not be passed through to customers through DA charges. TURN concludes by observing that free long-distance DA "is properly a part of basic residential service." TURN does not suggest how the IECs should be permitted to recover the DA costs distributed among them, but since TURN considers DA part of basic service TURN witness Gabel's testimony suggests that a flat monthly charge for every residence subscriber would be appropriate.

AT&T-C objects to staff's proposed 50¢ charge and possible access charge reduction as "a makeshift solution which will continue to deepen the already severe chasm between [AT&T-C] rates and costs." AT&T-C sees staff's willingness to place "all the burden" on AT&T-C customers even though competitors' customers will use DA service as "blatantly discriminatory." AT&T-C is concerned that "adoption of staff's proposal will further compound the mistakes which have already occurred in the setting of access charges." On the other hand, AT&T-C witness Parker stated that he could "guarantee that AT&T would reduce its directory assistance charge proposal" if PacBell's DA access charge were reduced.

AT&T-C considers Brylawski's proposal inappropriate, impractical, and lacking in any analysis of costs or the allocation of costs. On a policy basis, AT&T-C argues, the proposal "fundamentally misses the mark," because it would burden the occasional user to the benefit of frequent users of DA service.

In our discussion of DA charges for PacBell, supra, we rejected Brylawski's premise that a right of access to all current number listings should be considered part of basic service at no extra charge. We found it reasonable that the caller bear the costs which arise from the called party being hard to reach. These considerations apply to interLATA calling as well.

In the context of a competitive market for interLATA services it is not fair to permit AT&T-C's competitors a free ride on

the DA service provided through AT&T-C. The same would have been true even absent the Bell System divestiture. Customers of competing long-distance services should pay for the interLATA DA service they require, either directly or through the competitor's rates for long-distance service. No practical means of allocating AT&T-C's DA costs among all long distance carriers has been proposed. The only alternative is a charge to the DA user. We find that, in the context of a competitive market for interLATA services, interLATA DA cannot be considered part of basic exchange service. We find imposition of a user charge for interLATA DA service fair and reasonable, if set at a level not unduly disruptive of normal calling patterns and customer expectations.

We are concerned by the disproportion between PacBell's DA costs and the access charges it imposes on AT&T-C for DA calling. We lack an adequate record at this time to adjust PacBell's access charges, but we signal our intention to do so in the Access Charge Phase II portion of this proceeding. We note, however, that AT&T-C was an active party in Access Charge Phase I last fall and failed to express any concern whatsoever about PacBell's proposed tariffs for DA access service. Consequently, AT&T-C's strident alarms about "compounding mistakes in the setting of access charges" do not arouse our sympathy.

The prospect is good for an early reduction in DA access costs. In the context of a reduction in AT&T-C's overall revenue requirement it is not immediately essential that the entire costs of DA service be recovered through the DA charge. Gradual progress toward fully cost-based rates is reasonable even in the context of a competitive market. Based on these considerations, we agree with staff that a 90¢ charge for interLATA DA service would be excessive, at least at this time.

We have set a 25¢ DA charge for PacBell, based in part on evidence indicating a cost of 34¢ per call. We will set a DA charge

for AT&T-C based on the cost which appears likely to prevail in the near future, about 50¢ (43¢ for access plus 7¢ AT&T-C operating cost). Based on a comparable proportion of charge to cost, and on the relative value of the DA services provided, we find a 35¢ per call DA charge reasonable for AT&T-C.

We find it unreasonable to exempt calls from coin phones or handicapped callers from this 35¢ charge. Very few callers, in any physical location or state of health, will have alternative sources of directory information available to them. An exemption for coin phone callers or the handicapped would be arbitrary discrimination.

From evidence that a 50¢ DA charge would generate at least $20 million less than PacBell's estimate of $45 million from a 90¢ charge, we conservatively estimate that a 35¢ charge will generate $15 million in net test year revenue.

G. Private Line Services

AT&T-C witness Parker testified, and AT&T-C asserts on brief, that he has proposed rate revisions for private line services to comport with access charges but without changing AT&T-C's overall revenues. As described above, the proposed rate structure is simplified to contain three basic rate elements: the Local Channel, the LATA Access Channel, and the Interoffice Channel. The major effect of this restructuring is to unbundle private line access costs into the Local Channel and LATA Access Channel elements, permitting AT&T-C to flow those costs through directly to the customer responsible.

The only objection to the proposed restructuring of interLATA private line services comes from Large Users, who object that AT&T-C has not provided for exceptions to the application of a $25 access surcharge per closed end of a private line circuit. PacBell and other exchange carriers provided for such exceptions in their access service tariffs, and Large Users request that AT&T-C be required to include corresponding exceptions in its private line tariffs. This request is consistent with AT&T-C's intent to flow through access costs associated with interLATA service, and we find it reasonable.

We will approve the tariff structure AT&T-C proposes for private line services, conditioned upon AT&T-C mirroring the "Exceptions to the Surcharge Application" and the "Self Reporting" provisions of PacBell's access service tariffs, Schedule Cal. P.U.C. 175-T, paragraphs 7.4.2(B) and (C).

While the private line tariff structure proposed by AT&T-C is not controversial, the proposed rate levels and their revenue effects are more of a problem. Although AT&T-C asserts that the proposed rates will not change its overall revenues, staff witness Singh offered evidence (Exhibit 736, App. C) that they would produce an $8.54 million increase in annual revenues, comprised of a $2.05 million, 3.4% increase from recurring charges and a $6.49 million,

548.5% increase from nonrecurring charges. Singh's own rate proposals differed only with respect to nonrecurring charges, producing an $8.07 million overall increase, $6.02 million of which results from a 509.3% increase in nonrecurring revenues.

AT&T-C provided cost studies using the same approach employed by PacBell for its private line services except that AT&T-C applied lower labor rates. Staff made adjustments to AT&T-C's cost estimates based generally on the same reasons relied on in its study of PacBell's private line costs, except that in the case of AT&T-C staff allowed no commercial and marketing expenses and applied different growth factors to adjust 1983 estimates for test year 1984. PacBell endorses the private line rates proposed by AT&T-C.

In the area of recurring rates staff witness Singh testified that the proposed Local Channel and LATA Access Channel rates equal the direct cost to AT&T-C of PacBell access charges. The Interoffice Channel rates result from "market based pricing" and are priced well above service costs. Singh compared the proposed rates to similar and competing services, found the proposed rates significantly lower, and concluded that they were reasonable. In the absence of controversy and based on staff's analysis, we find the proposed private line recurring rates reasonable.

For the nonrecurring charges proposed by AT&T-C, Singh proposed a downward adjustment of 17.51% to all charges except those directly passing through access costs. This adjustment was related to assumed adjustments in revenue requirements, and Singh proposed that whatever revenue requirement adjustments the Commission ultimately adopts should be applied in calculating a revised adjustment ratio for private line nonrecurring charges.

Staff's suggestion that its rate adjustment ratio be recalculated based on adopted revenue requirement adjustments is impractical at this stage of the proceeding. There has been no objection to AT&T-C's proposed rates other than the staff's proposed

adjustment. We must observe, however, that the cost studies on which AT&T-C based its proposed nonrecurring charges were very similar to those PacBell studies which we have found inadequate to determine with precision the cost basis for private line nonrecurring charges. In this context we cannot accept staff's assertion that its proposed charges would produce revenues equal to AT&T-C's cost of service.

In view of the imprecision of the cost studies on which the nonrecurring charges proposed by both AT&T-C and staff are based, and considering that we are recognizing a decrease in overall revenue requirement, we find it reasonable to authorize increases in AT&T-C's current private line nonrecurring charges amounting to only one-half the increases proposed by staff, with the charge to be rounded upward to the nearest $5.00. For example, charges for private line service installations, based on the proposed and authorized nonrecurring charges, are set forth in the following table. The authorized amounts are subject to slight change based on rounding of the component nonrecurring charge elements.

It may be that some of the authorized nonrecurring charges will not fully cover AT&T-C's access costs. If that proves to pose a continuing problem AT&T-C may seek appropriate rate adjustments. For administrative convenience AT&T-C will be allowed six months to implement the approved changes in its private line tariffs, but we shall assume prompt implementation for purposes of estimating test year revenue effects.

AT&T COMMUNICATIONS

Private Line Service Installation Charges

(Per Station)

	Present	AT&T-C Proposed*	Staff Proposed*	Authorized
2000 Series	$ 47.43	$1,005.00	$ 935.00	$ 495.00
3000 Series	47.43	1,005.00	935.00	495.00
Analog Bridging, per Station	0	46.00	46.00	25.00
8000	47.43	1,005.00	935.00	495.00
8000 Wideband	432.14	**	**	**
DDS - 2.4 kbps	890.00	1,023.50	972.50	935.00
DDS - 4.8 kbps	890.00	1,108.50	1,057.50	975.00
DDS - 9.6 kbps	890.00	1,281.50	1,230.50	1,065.00
DDS - 56 kbps	890.00	1,816.50	1,765.50	1,330.00
Digital Bridging, per Station	0	42.00	42.00	25.00
High Capacity Transport Service	2,750.00	3,617.50	3,344.50	3,050.00
Hybrid Arrangement, per Channel or Terminal	***	433.00	***	220.00

*Except for Bridging, amounts include nonrecurring charges for 1 Local Channel, ½ Interoffice Channel, and ½ Service Order.

**Determined on individual case basis.

***Not in evidence.

Based on staff's revenue estimates, we project a $2.1 million increase in revenues from recurring charges and a $3.0 million increase from nonrecurring charges, for a total increase in test year private line revenues of $5.1 million.

E. 800 Service

No changes are proposed in AT&T-C rates for 800 Service, but a controversy has arisen over how both interLATA and intraLATA

800 Service will be provided, and by what carrier. To permit the Bell Operating Companies (BOCs) to continue to provide intraLATA 800 Service after divestiture, the United States District Court for the District of Columbia (Federal Court) in December 1983 granted a temporary waiver until April 1984 permitting the determination of usage and billing for intraLATA 800 Service on the basis of a statewide sampling of 800 Service calls.

In the event the present waiver expires without being renewed, AT&T-C requests authority to provide statewide 800 Service, both inter- and intraLATA. PacBell opposes this proposal, as does staff. PacBell asserts that to authorize AT&T-C to provide intraLATA 800 Service would deprive PacBell of revenues and violate an alleged Commission policy against competition within the LATAs.

AT&T-C states that it does not seek to exclude PacBell from providing intraLATA 800 Service. To the contrary, before the Federal Court AT&T-C has supported two alternative methods whereby intrastate 800 Service can be separated into an interLATA service provided by AT&T-C and an intraLATA service offered by the BOCs. The first of these is a continuation of statistical sampling during the interim period until the BOCs have developed the capability to identify, sort, screen, and measure intraLATA 800 calls - probably not before the end of 1986. The second alternative, the so-called "Comptroller's Solution," would have AT&T-C supply the BOCs data showing 800 numbers for AT&T-C's intrastate customers along with the traditional telephone numbers to which the 800 numbers translate. Using a yet-to-be developed software capability, the BOCs could then match calling numbers with called numbers and thereby determine and bill for actual interLATA and intraLATA usage.

PacBell has urged the Federal Court that the present statistical sampling arrangement does not run afoul of the MFJ, but nonetheless PacBell has requested extension of the temporary waiver. PacBell is preparing to implement the "Comptroller's Solution," which

it anticipates having in place by September 1984, although AT&T-C asserts it will not be operable before the end of the year.

On May 4, 1984, the Federal Court ruled that PacBell may implement the "Comptroller's Solution" and, until that has been done, continue to provide 800 Service under the present statistical sampling arrangement. This ruling eliminates the risk that intraLATA 800 Service will have to be suspended. It is therefore unnecessary and inappropriate to authorize AT&T-C to offer intraLATA 800 Service at this time.

I. Foreign Exchange Service

As in the case of private line services, AT&T-C has proposed to restructure its rates for FEX Service to unbundle and flow through access costs to the responsible customer. Staff witness Popenoe supported these changes. Although the reflection of access costs results in substantial increases in interLATA FEX rates, the proposed tariff structure and rate levels are uncontested and cost-justified, and will be approved. Here, as for private line services, we will allow six months for AT&T-C to implement the approved tariff changes.

As an alternative means of providing FEX Service between contiguous exchanges, where it sometimes serves community of interest needs, PacBell and this Commission filed a joint motion with the Federal Court in December 1983, seeking a waiver of the MFJ to permit PacBell to continue to provide FEX Service linking contiguous exchanges across a LATA boundary. AT&T-C supported the waiver request, but only for service to present FEX subscribers, arguing that the request for a waiver for new business was overbroad. The Federal Court has yet to rule on this waiver request.

J. Revenue Summary

Based on our findings regarding the various AT&T-C services as discussed above, we will approve changes in rates, rate structures, and other tariff provisions to produce a $73.5 million reduction in test year revenues. The following table shows the estimated revenue effects of the adopted rate and tariff changes in comparison to the effects of the interim and final AT&T-C proposals.

AT&T COMMUNICATIONS
Revenue Effects of Proposed and Adopted
Tariff Changes
($ million)

Service Category	January AT&T-C Proposal	Final AT&T-C Proposal	Adopted
Message Toll Service	$(1.0)	$30.3	$(105.6)
WATS	10.7	10.7	10.7
Optional Calling Plan for High Volume Users	-	6.0	(3.5)
Optional Calling Plan for Off-Peak Users	4.8	6.0	4.8
Directory Assistance	45.0	45.0	15.0
Verification/Interrupt	*	*	*
Private Line Services	*	*	5.1
Total	$59.5	$98.0	$ (73.5)

*Net effect estimated to be less than $100,000.

K. Note re Access Charges

AT&T-C witness Parker criticized elements of PacBell's access charges as resulting in rates which he considered unreasonable and unfair to customers of AT&T-C. These included access charges for DA service, the absence of time-of-day sensitivity in access charges, charges for billing services, and access charges for nonrecurring private line services. Parker proposed that these matters be addressed in the further hearings on access charges set by D.83-12-024 in this proceeding.

PacBell responds to these AT&T-C suggestions by noting the list of issues already set for hearing in Access Charges Phase II, including some but not all of the issues mentioned by Parker. PacBell sees no reason why the issues AT&T-C raises should be added to that list.

We are concerned by the apparent lack of consistency between PacBell's access charges and intraLATA costs and rates for comparable services. We expect that the reasons for this situation will be explored in Access Charges Phase II in the course of considering access charge levels for digital data services, PacBell's detailed costing studies, PacBell's proposal for time-of-day sensitive access rates, and other matters set for consideration by D.83-12-024. In addition, we intend to consider in Access Charges Phase II the reasonableness of the present level of access charges for DA service and for nonrecurring private line services.

We place AT&T-C and other interested parties on notice that we will consider requiring a dollar-for-dollar flowthrough to interLATA end users of the positive or negative revenue effects for AT&T-C of changes in PacBell's access charges. Such a requirement may be included in decisions forthcoming from the Access Charges Phase II portion of this proceeding.

Finally, we observe that the 10.32% billing surcharge now applicable to all charges for AT&T-C services, imposed by D.83-12-025, as well as the interim incremental premium access charge imposed on AT&T-C by D.83-12-024, will be discontinued effective simultaneously with the effective date of all tariffs filed pursuant to this decision.

IX. ORDERS OF SUSPENSION AND INVESTIGATION

On November 22, 1983, the Commission issued Orders of Suspension and Investigation with respect to advice letters filed by AT&T-C and PacBell to effect the filing or revision of tariffs reflecting the assumption by AT&T-C of PacBell's intrastate interLATA toll operations and the corporate divestiture of PacBell from AT&T.

In our order (I&S) C.83-11-06 suspending AT&T-C's Advice Letter 1, we noted a number of significant changes in the tariffs AT&T-C proposed to file as compared to the present tariffs of PacBell

for the services being taken over by AT&T-C. We concluded that thorough review of Advice Letter 1 was necessary to avoid undue disruption of services. The proposed tariffs were set for hearing during the rate design phase of this proceeding. AT&T-C was directed to file a Notice of Adoption of PacBell's rates and tariffs applicable to the services it would be taking over January 1, 1984, with these adopted tariffs to remain in effect until the Commission has acted upon Advice Letter 1.

Similarly, in our order (I&S) C.83-11-07 suspending PacBell's Advice Letter 14641, we noted that PacBell's advice letter reflected a revised tariff format "designed to centralize repetitive information," and we expressed concern that "a restructured tariff, although containing present rates and charges, may result in revised interpretation." We concluded that thorough review and close coordination with AT&T-C's Advice Letter 1 were required. The proposed tariff revisions were set for hearing in this proceeding. PacBell was directed to amend the preliminary statement in its tariffs to indicate the limitations upon its service offerings due to the Modified Final Judgment.

By a ruling dated January 9, 1984, ALJ Mattes formally consolidated C.83-11-06 and C.83-11-07 into this proceeding. After consultation with counsel for the interested parties, it was determined to incorporate issues related to C.83-11-06 within the existing schedule for AT&T-C rate design matters. Consideration of issues related to C.83-11-07 was deferred until after submission of Phase II of this proceeding. We ratify these procedures.

Most of the substantive issues raised by AT&T-C's Advice Letter 1 were aired in the course of hearings on AT&T-C rate design and are being resolved by this decision. Other issues, relating to tariff format and other technical matters, have been the subject of ongoing discussions between AT&T-C and staff. Staff counsel has informed the record, by letter of May 15, 1984, that AT&T-C and staff

have resolved their differences as to these matters, which will permit AT&T-C to make future tariff filings in acceptable form. Likewise staff and PacBell are engaged in continuing discussions concerning the tariff restructuring proposed by Advice Letter 14641. Both AT&T-C Advice Letter 1 and PacBell Advice Letter 14641 are rendered obsolete by the rate changes and other tariff revisions we are authorizing today. We therefore will reject both these Advice Letters, without prejudice to resubmission of tariffs in comparable format to the extent considered appropriate by our staff. In view of the resolution of technical differences between staff and AT&T-C, it is reasonable for us to terminate C.83-11-06. We will hold C.83-11-07 open to provide a convenient forum for resolution of any tariff issues relating to PacBell which may require our attention.

Findings of Fact - PacBell
Results of Operations

1. PacBell's shared multifunctional facilities are an integral part of PacBell's public utility operations and are dedicated to public use. They should be included "above the line."

2. No allowance for CPE preoperational costs was ever included in PT&T's or PacBell's rates. There should be no imputation of revenues for reimbursement of CPE costs.

3. PacBell's claim for $6.7 million more marketing expenses in Ac. 640, General Commercial Administration, than was recommended by the staff is not reasonable; however, an additional $3.8 million is reasonable and should be adopted.

4. PacBell's claim for $5.6 million more business usage advertising expense in Ac. 642, Advertising, than recommended by the staff is reasonable and should be adopted.

5. The "clearinghouse" function is not of benefit to California ratepayers and the costs thereof are not reasonable.

6. PacBell's reasonable share of PT&T's penalty for underutilized plant is, at half of the D.83-12-025 adopted reasonable rate of return of 12.70%, $45,439,000. This penalty, when, modified for the effects of D.84-04-104, is reasonable.

7. A reasonable determination of PacBell's 1983 Results of Operations, adjusted for the effects of divestiture is, before accommodating D.84-04-104:

PACIFIC BELL

Phase II Adopted 1983 Results of Operations
Adjusted for Divestiture
Recast

	Total California	California Intrastate
	(S000)	
Revenues		
Local Service Revenues	$2,071,193	$2,071,193
Toll Service Revenues	1,401,511	1,401,511
Miscellaneous Revenues	3,706,332	1,677,334
Uncollectibles	(59,624)	(51,943)
Total Revenues	$7,119,412	$5,098,095
Expenses and Taxes		
Current Maintenance	$1,609,048	$1,152,078
Depreciation & Amortization	948,558	671,484
Traffic Expenses	238,493	212,593
Commercial Expenses	674,088	582,614
Gen. Office Salaries & Expenses	495,204	368,182
Operating Rents	222,273	208,403
Balance Other Operating Expenses	831,306	629,096
Total Expenses	$5,018,970	$3,824,450
Taxes - Federal Income	484,562	239,184
Cal. Corp. Franch.	100,234	47,567
Social Security	155,909	118,304
Other	141,048	103,910
Total Expenses & Taxes	$5,900,723	$4,333,415
Balance Net Revenues	$1,218,689	$ 764,680
Rate Base		
Telephone Plant In Service	$16,005,900	$11,956,407
Property Held For Future Tel. Use	55,100	40,967
Working Cash	260,320	201,592
Materials & Supplies	377,948	259,911
Less: Depreciation Reserve	2,902,244	2,201,642
Less: Deferred Tax Reserve	1,782,742	1,382,873
Total Rate Base	$11,714,282	$ 8,674,362
Rate of Return	10.40%	8.82%

( ) Denotes negative amount.

8. The staff methods of projecting wage and salary costs for the 1984 attrition allowance are reasonable.

9. Under the attrition mechanism adopted in this order, the incremental growth in rate base is assumed to be financed in part by debt. It is reasonable to recognize interest expenses associated with this debt in determining income tax deductions and expense for 1984.

10. No growth in PHFU and a growth rate for M&S equal to that for Plant in Service are reasonable for use in the 1984 attrition allowance.

11. The technical update of depreciation reserve and remaining life in the context of establishment of an attrition allowance is reasonable and essential.

12. "Prospective rates" should not be used in the technical depreciation update.

13. The ELG method should not be used to determine depreciation rates.

14. The reasonable effect of the technical depreciation update on 1984 depreciation expense is $105,921,000, and on 1984 revenue requirement $76,400,000.

15. Trending of recorded Materials, Rents, and Services expenditures and Plant in Service to obtain attrition-year budgets is not reasonable.

16. Recognition in attrition adjustments of growth in expense levels due to inflationary and system growth impacts is reasonable.

17. A 10% increase in Plant in Service in 1984 compared to the 1983 authorized Plant in Service is reasonable.

17a. A growth rate of 4.5% for Other Taxes is reasonable for purposes of determining an attrition allowance for 1984.

18. A reasonable determination of PacBell's 1984 intrastate results of operations, and required incremental gross revenue increase, before accommodating D.84-04-104, is:

PACIFIC BELL

Phase II Adopted 1984 Results of Operations
And Incremental Revenue Increase
California Intrastate Operations

Recast 3

RESULTS OF OPERATIONS	($000)
Revenues	$7,076,494
Expenses and Taxes	
Depreciation	734,756
Relief and Pensions	523,072
All Other Expenses	2,827,420
Taxes - FIT	517,070
CCFT	104,955
Soc. Sec.	122,614
Other	111,684
Total	$4,941,571
Balance Net Revenues	1,134,923
RATE BASE	
Plant In Service	$13,148,735
Plant Held For Future Use	40,967
Working Cash	209,601
Materials & Supplies	65,884
Less: Depreciation Reserve	2,419,895
Less: Deferred Tax Reserve	1,743,149
Total Intrastate Rate Base	$ 9,332,143
REVENUE REQUIREMENT CALCULATION	
Intrastate Rate Base	$ 9,332,143
Times: Adopted Rate of Return	.1270
Equals: Net Revenue Reqt.	1,185,182
Minus: Balance Net Revenues	1,134,923
Equals: Increase in Net Rev. Reqt.	50,259
Times: Div. Net-to-Gross Multiplier	2.0734
Equals: Increase in Gross Rev. Reqt.	104,227
Underutilized Plant Adjustment	(45,439)
Technical Update of Depr. Rates	76,409
Required Incremental Gross Revenue Increase	$ 135,177

( ) Denotes negative amount.

19. The PacBell annual revenues produced by the surcharges authorized by D.83-12-025 should be first increased by $135,177,000, and then further increased by $786,000 as indicated by D.84-04-104 for a total increase of $135,963,000.

20. PacBell revenues should be increased pursuant to the net effects of D.84-04-083 and D.84-04-104 (as corrected by D.84-05-003) with such revenue increase terminating on December 31, 1984.

Findings of Fact

AT&T-C Results of Operations

1. The effects of the Moore Universal Telephone Service Act need not be considered in this decision.

2. Issues presented in these proceedings by AT&T-C as "Recast 4" fall outside the scope of the proceedings as established by the Commission's Rate Case Plan as set forth in D.82-12-072, as modified for these proceedings by D.83-04-021, and should not be considered in these proceedings.

3. AT&T-C's shared multifunctional facilities are an integral part of AT&T-C's public utility operations and are dedicated to public use. They should be included "above the line."

4. The sum of $5 for each of California's 13,500,000 access lines, or $67,500,000, is a reasonable allowance for AT&T-C's Total California combined Marketing and Advertising Expenses.

5. Expense to revenue ratios are not an appropriate measure of the reasonableness of utility operating expenses.

6. A reasonable cost of operation of AT&T-C's Finance Department is $324,010,000. A reasonable allocation of this cost to AT&T-C's Total California operations is $25,305,000.

7. A reasonable allocated cost of AT&T Corporate Headquarters to AT&T-C's Total California operations is $9,310,000.

8. The reasonable allocated cost to Total California operations of Bell Telephone Laboratories is $4,910,000 and of system engineering, $10,250,000.

9. AT&T-C's request for $675,000 for Total California public relations activities is not reasonable.

10. The rate of return of 12.70% found reasonable for PT&T by D.83-12-025 is also a reasonable rate of return to apply to AT&T-C's Recast 3 Total California rate base. The ongoing revenue requirement established on a Recast 3 basis must be reduced to reflect the effects of the reduction in rate of return required by D.84-04-104.

11. A portion of the former PT&T plant now held by AT&T-C is underutilized.

12. The underutilization of the aforementioned plant results in part from imprudent management by its former owner.

13. The rate of return to be applied to the underutilized plant should be reduced by one-half to 6.35% and the amount thus determined should be adjusted to accommodate D.84-04-104.

14. The $483,500,000 of underutilized plant should be allocated $461,700,000 to PacBell and $21,800,000 to AT&T-C. The associated penalties, at 6.35%, are:

PacBell	$45,439,000
AT&T-C	2,149,000

15. The penalties for underutilized plant, set forth in the previous finding, are in harmony with the Commission's findings in D.83-12-025 and, when modified per D.84-04-104, are reasonable.

16. The presently effective rates of AT&T-C will for the future produce an excessive and unreasonably high rate of return. The extent of such excessive rate of return translated into annual gross 1984 estimated test year intrastate revenues is, before the effects of D.84-04-104, $73,128,000, and, after adjusting for D.84-04-104, $73,503,000.

17. AT&T-C's intrastate rates, effective July 1, 1984, should be reduced by $73,503,000 annually based on 1984 estimated test year operations.

Findings of Fact -
Attendant Results of Operations Issues

1. The use of an attrition mechanism to determine the reasonableness of 1985 rate levels for PacBell is reasonable.

2. The 1985 attrition mechanisms presented in this proceeding are not reasonable.

3. PacBell should, after meeting with authorized representatives of recognized minority groups, specifically including those groups represented by PA in these proceedings, draft and submit to the Commission for its approval, as part of its next general rate case filing, a tracking procedure that comprises:

   a. Stated year 1986 female and minority goals for the ethnic classifications used by the State of California as set forth in Exhibit 197.

   b. Reporting categories of purchase of or contracts for similar goods or services aggregating five million dollars or more.

   c. A report covering F/MBE activity in 1984 shall be submitted by March 1, 1985. Thereafter, PacBell shall file semiannual reports on March 1 and October 1 of each year. The March report shall cover F/MBE activity from July 1 through December 31 of the prior year and the October 1 report shall cover F/MBE activity during the January 1 through June 30 period.

4. AT&T-C should not, in this proceeding, be required to establish a F/MBE tracking procedure.

Findings of Fact - PacBell-Rate Design

1. The 1984 test year revenue objective for PacBell rate design is an increase of $565.2 million.

1a. PacBell's proposed restructuring and disaggregation of private line rate elements promotes equitable pricing of private line services and is reasonable.

2. PacBell's general approach to the study of private line costs is acceptable and consistent with the D.83-04-012 Cost Manual.

3. Tops-down category and subcategory analysis is an appropriate means of disaggregating overall revenue requirements among classes of service and between recurring and nonrecurring costs.

4. PacBell's bottoms-up cost studies assist in apportioning category costs to specific service offerings.

5. PacBell has not adequately explained the lack of reconciliation between its service-specific cost estimates and test year estimated results of operations.

6. The results of PacBell's disaggregated local loop study are of limited value, due to PacBell's failure to assure adequate statistical reliability.

7. PacBell's failure to reconcile its tops-down and bottoms-up cost studies or adequately to explain the lack of reconciliation does not discredit the tops-down studies, but justifies caution in setting rates based on them.

8. PacBell's cost studies are adequate to justify substantial increases in private line recurring rates.

9. Staff's proposed private line recurring rates, based on PacBell's cost studies subject to appropriate adjustments, provide a reasonable starting point for determining appropriate rate levels.

10. Reflecting the impression of the underlying cost studies, it is reasonable to approve increases in private line recurring rates of 80% of the increases proposed by staff.

11. PacBell's private line nonrecurring cost study fails to comply with the D.83-04-012 Cost Manual on several important points.

12. It is important to facilitate prompt recovery of all reasonable expenses associated with installation of service.

13. Addition of a new loop to an existing private line circuit should be treated as a change service order rather than a new installation.

14. It is impossible at this time to determine with precision the cost basis for private line nonrecurring charges, but it is clear that such charges now are drastically below cost and should be increased substantially.

15. It is reasonable to authorize increases in private line nonrecurring charges up to cost or by 150% of present charges, whichever is less, and to authorize further increases in these charges in 1985 of 50% above the 1984 level or up to cost, whichever is less, with the relevant cost calculation for each rate element being 90% of the cost level estimated by staff.

16. PacBell's studies of recurring and nonrecurring private line costs provide a sufficient and compelling basis for the increases the Commission will authorize in private line rates and charges.

17. It is reasonable that the caller bear the costs which arise from the called party being hard to reach.

18. PacBell should seek to keep the directory listings readily accessible to subscribers as up-to-date as possible.

19. Cost of service considerations justify decreasing the free directory assistance calling allowances for residence and business customers to five and two calls per month, respectively, except that the allowance per Centrex line should be one call per month.

20. Cost of service considerations justify increasing the charge for directory assistance calls beyond the applicable free calling allowance to 25¢ per call, and to eliminate exemptions and modify details of the directory assistance charging plan as proposed.

21. PacBell's cost studies provide a sufficient evidentiary basis for service connection charge increases in the range proposed by PacBell and staff.

22. PacBell's dual element plan for service connection charges will simplify rates, better inform subscribers, better match costs incurred with service received, and permit differential charges for basic and optional services.

23. It is reasonable to establish separate installation charges for optional service features in order to assist in holding installation charges for basic exchange service to an affordable level.

24. A $3 Touch-Tone service installation charges is cost-justified.

25. Staff's proposed service connection charges are cost-justified.

26. A uniform charge for any regrade among residence basic exchange services is reasonable, so long as a grace period is allowed for free regrades when substantial basic exchange rate increases are authorized.

27. PacBell's proposed $1 minimum late payment charge would be inequitable and burdensome to needy residential ratepayers.

28. A late payment charge of 1.5% on delinquent balances due is reasonable as a penalty to encourage timely payment of amounts due and owing.

29 PacBell has experienced a rapid increase in receipt of bad checks, which burdens the utility with added costs, warranting a significant increase in the bad check charge to discourage the practice.

30. The proposed increases in directory listing and nonpublished service charges are reasonable in the context of a substantial rate increase.

31. It is appropriate to impose a modest charge for nonpublished number reports to recover at least part of the cost of the service.

32. PacBell's original proposal for changes in its verification/interrupt tariff is reasonable in view of the nature of the service.

33. Simplification of Custom Calling rates is appropriate, but some portion of the existing differential in Custom Calling rates for business and residence subscribers should be retained so that all will bear a portion of the increased revenue requirement.

34. The proposed rate increase for Remote Call Forwarding is reasonable in the context of a substantial rate increase.

35. Federal government decisions have placed the pricing of most enhanced services beyond our control.

36. A change in Touch-Tone Service charges is not reasonable at this time.

37. Vacation Rate Service provides a discount which is no longer appropriate, and should be eliminated.

38. It is appropriate to mitigate the extent to which high-volume toll users are required to bear NTS costs of local exchange plant.

39. A discount plan for high-volume toll users is an appropriate means of deterring uneconomic bypass of the local exchange network and of retaining toll revenue contribution toward exchange costs.

40. It is reasonable to rely on PacBell's judgment in narrowing the parameters of a discount plan for high-volume toll users.

41. The discount plan for high-volume toll users proposed by PacBell is reasonable, subject to resellers being ineligible to participate and a modest nonrecurring service order charge being added.

42. Modest increases in short-haul message toll rates are reasonable in the context of a substantial rate increase.

43. Other changes in Message Toll Service rate design proposed by PacBell are reasonable.

44. It is reasonable to relieve the hearing impaired of a portion of the Message Toll Service charges they incur due to the relative slowness of TDD communications.

45. A significant discount in message toll rates is reasonable for calls made from households including certified hearing-impaired TDD users, but not for incoming calls to such households because the discount cannot be restricted to calls employing a TDD.

46. The Message Toll Service TDD discounts proposed by PacBell and AT&T-C are reasonable, except that a 75% night and weekend period discount is justified by revenue and cost considerations.

47. It is necessary to diminish the rate preference which has been allowed to ORTS and OCMS subscribers.

48. The changes in ORTS rate structure and charges proposed by staff are reasonable, except that the applicable discount from message toll rates should be 30%.

49. In order to broaden availability of a common MTS discount plan, it is reasonable to offer ORTS Option 1 on all routes for which OCMS is now available.

50. It is inappropriate to discontinue OCMS at this time, but the severe underpricing of this service justifies a 100% rate increase.

51. Detailed billing of ORTS and OCMS calls is not justified at this time.

52. PacBell and General should be required to expand ORTS to include 192 PacBell and 16 General return direction routes.

53. Because FEX Service is optional for most subscribers, it is reasonable to increase FEX rates to better cover its costs and, if possible, generate contribution to support basic service.

54. It is reasonable to set monthly business and residence FEX rates closer to cost.

55. There is ample cost-justification for a 100% increase in typical FEX service connection charges.

56. PacBell's proposed revisions in its Foreign Prefix Service tariff are reasonable.

57. Grandfathering residence FEX service would unjustly discriminate between existing and new subscribers.

58. Except as necessary to assure the maintenance of universal service, proportioning charges in relation to the use of local telephone service more equitably divides the burden of maintaining that service than under a flat rate approach (cf. D.15830 (1926), 27 CRC 409, 412).

59. The availability of optional measured service to residence subscribers does not unfairly burden flat rate subscribers but rather enhances the quality of all residence service by permitting each subscriber greater choice.

60. There are significant differences between ZUM service provided in a metropolitan area and short-haul toll service provided elsewhere in PacBell's service area.

61. It is reasonable to maintain ZUM rates substantially below MTS rates for the same calling distances, based on differences in typical costs and community of interest considerations.

62. It is reasonable to set ZUM rates at levels which may generate contribution toward recovery of local NTS costs, moderated by the community of interest nature of ZUM calling.

63. Cost evidence justifies increasing initial minute rates but not additional minute rates for ZUM calling at this time; it is reasonable to apply RPSB to the calculation of ZUM charges.

64. PacBell accurately described its proposals to change local calling areas and expand ZUM in four separate bill insert notices distributed to subscribers in 1983.

65. Phased implementation of exchange boundary and charge plan changes is necessary to avoid sudden increases in charges on a substantial number of routes of the magnitude shown to result from PacBell's proposals.

66. PacBell's and General's proposed revisions in exchange boundaries are a reasonable means of achieving greater equity in the service offered to subscribers in similar metropolitan areas and in comparison to the service offered to rural subscribers.

67. The ZUM rate structure is based on local calling areas defined with community of interest considerations in mind.

68. ZUM provides a more flexible, equitable, and appropriate local calling charge plan than does SMRT; the benefits of substituting ZUM for SMRT in the metropolitan areas proposed by PacBell exceed the costs of its implementation.

69. The proposed exchange boundary and charge plan changes will increase charges for a 5-minute call by more than 300% on 59 presently local calling routes; these changes should be phased to occur in two steps at least one year apart.

70. For calling routes subject to phased ZUM implementation, it is reasonable, for the interim, to set rates lower than indicated by the ZUM and MTS tariffs.

71. It is reasonable to permit PacBell to recover their 1985-86 costs of ZUM expansion through billing surcharge changes and to permit Roseville and Citizens to recover such costs through the EAS Settlement Agreement.

72. The revenue impact for PacBell of exchange boundary changes and ZUM expansion will be de minimis in test year 1984, and will not be so great in 1985 as to require separate identification in the attrition adjustment process; such impacts for Citizens and Roseville can be dealt with through the EAS Settlement Agreement.

73. The advantages of the ZUM charge plan over SMRT justify converting all SMRT local calling areas to ZUM Zone 1 rates and to implement ZUM Zone 1 rates in future expansion of measured service according to the revised schedule proposed by PacBell.

74. Staff's proposed procedure for implementing Rate Banding will lessen administrative burdens and benefit suburban customers.

75. Local coin revenues are making an inadequate contribution toward the fixed costs of coin station service.

76. A 20¢ local coin rate is reasonable for PacBell.

77. The interest in statewide uniformity justifies a 20¢ local coin rate for all telephone companies providing exchange service in California, to be authorized only for exchanges in which DTP capability exists.

78. Revenues generated by the 20¢ local coin rate will be increased by the frequent use of quarters without refund of the extra nickel.

79. The customer convenience and cost of Semipublic Coin Service justify an increased rate premium over the measured business service rate.

80. Residual pricing shields basic exchange services from the burden of rate increases by assigning increased revenue needs elsewhere to the greatest extent possible.

81. Maintenance of a limited free calling allowance is an essential element of any residually priced basic exchange service for residence customers; therefore, further unbundling of access line and local usage elements of residence basic exchange service is inappropriate.

82. It is reasonable to set all basic exchange service offerings at approximately the same percentage above their present levels.

83. Fairness requires standardized advance billing of monthly basic exchange rates.

84. The procedures and steps for conversion to Moore Act lifeline service are covered by PacBell's Advice Letter No. 14756.

85. Conversion to more highly priced services of present lifeline subscribers ineligible for or not desiring Moore Act lifeline service will result in additional revenues to PacBell.

86. Replacement of SMRT by ZUM and an overall basic rate structure based on service-area-wide average costs make it reasonable to eliminate certain geographically based rate discrepancies.

87. In view of the significant increases authorized in residence basic service rates and the changes in rate structure for local measured services, it is reasonable to require waiver of service connection charges applicable to regrades among basic exchange services for residence customers for 90 days after the effective date of tariffs revising such basic service rates.

88. TASC has failed to show that its proposal to disaggregate DID rates for numbers and trunks more fairly reflects costs than the present rate design.

89. To implement the rate change required in this proceeding solely by a massive billing surcharge would be inequitable and unnecessary.

90. To promote clarity in customer billing, billing surcharges should be eliminated, or set as low as possible, in general rate decisions.

91. The adopted rate and tariff changes for PacBell are estimated to produce a $565.2 million increase in test year revenues above the level of revenues which would have resulted from rates and tariffs in effect prior to issuance of D.83-12-025.

Findings of Fact - AT&T
Communications Rate Design

1. Adoption of RPSB, simplified surcharges for coin paid toll calls and operator handled conference calls, and increased service charges for Calling Card calls and Person messages are reasonable for AT&T-C for the reasons stated with respect to PacBell.

2. An increase in the minimum credit period for WATS access line interruption is reasonable to avoid excessive administrative cost.

3. Increased WATS installation and set-up charges are cost-justified.

4. ORTS and OCMS are primarily intraLATA discount plans, inappropriate for offering on an interLATA basis.

5. Because alternatives are available to large volume private line users which offer cost savings to the carrier as well as the customer, it is reasonable to withdraw Telpak Service.

6. In view of the absence of customers, it is reasonable to withdraw the offering of Series 6000 audio services.

7. Increases proposed in verification/interrupt charges are excessive in view of the decreased revenue requirement, but lesser increases are cost-justified.

8. The structure of access charges justifies an increased differential between initial minute and additional minute interLATA MTS rates and a less distance-sensitive interLATA MTS rate schedule.

9. Too large a discrepancy between PacBell and AT&T-C short-haul MTS rates would be unfair to subscribers living along LATA boundaries, who depend on short-haul interLATA toll calls to meet day-to-day communications needs for basic services.

10. In the context of an overall revenue reduction, it is reasonable to limit increases in any MTS rate to less than 50% and generally to no more than one-third.

11. The proposed reduction in time-of-day MTS discounts is a reasonable compromise between strict coverage of access costs and the value of offering off-peak discounts.

12. The adopted changes in MTS rates will substantially diminish the contribution of long-haul revenues toward recovery of short-haul costs, enhancing AT&T-C's ability to compete with other IECs not bound to offer short-haul toll services to the general public.

13. The proposed Optional Discount Calling Plan A offers an appropriate service alternative which will help generate greater off-peak usage.

14. In view of the decreased revenue requirement and the reduced additional minute MTS rates, the originally proposed charges for Optional Discount Calling Plan A are reasonable.

15. A discount plan for high volume users of AT&T-C's toll service is an appropriate means of deterring uneconomic bypass of the local network, and need not be interim or temporary in nature.

16. In the context of the optional discount calling plan approved for PacBell and in recognition that AT&T-C faces access costs which do not vary with usage, a two-step 10% and 20% optional discount plan and the proposed charges are reasonable for AT&T-C.

17. In a competitive interLATA services market it is not fair to permit AT&T-C's competitors a free ride on the DA service provided through AT&T-C and interLATA DA service cannot be considered part of basic exchange service.

18. A user charge for interLATA DA service is fair and reasonable if set at a level not unduly disruptive of normal calling patterns and customer expectations.

19. In the context of a reduced AT&T-C revenue requirement, gradual progress toward fully cost-based rates is reasonable and a 90¢ DA charge would be excessive; a 35¢ charge is reasonable in relation to the 25¢ charge approved for PacBell.

20. To exempt calls from coin phones or handicapped callers from the 35¢ DA charge would be arbitrary discrimination.

21. Consistent with flowing through access costs associated with interLATA service, it is reasonable to require AT&T-C to provide for exceptions to application of the $25 private line access surcharge.

22. In the absence of controversy and based on staff's analysis, we find the proposed private line recurring rates reasonable.

23. In view of the imprecision of the cost studies on which proposed charges are based and in the context of a reduced revenue requirement, it is reasonable to authorize one-half the amount of increases proposed by staff in AT&T-C's private line nonrecurring charges.

24. The risk that provision of intraLATA 800 Service by PacBell will have to be suspended has been eliminated.

25. The proposed tariff structure and rate levels for interLATA FEX Service are uncontested and cost-justified.

26. The adopted rate and tariff changes for AT&T-C are estimated to produce a $73.5 million reduction in test year revenues.

Findings of Fact - I&S Cases

1. Issues relating to tariff format and other technical matters raised by AT&T-C Advice Letter 1 have been the subject of discussions between AT&T-C and staff, which have resolved differences as to these matters.

2. Both AT&T-C Advice Letter 1 and PacBell Advice Letter 14641 are rendered obsolete by the rate and tariff changes authorized by this decision.

INTERIM ORDER

IT IS ORDERED that:

1. Eight days after the effective date of this order, PacBell shall file with this Commission, in conformity with the provisions of General Order 96-A, revised tariff schedules with rates, charges, and conditions of service modified as set forth in Appendix B. The effective date of the revised tariff sheets shall be five days after the date of filing. The revised tariff schedules shall apply to service rendered on and after the effective date of the revised schedules, provided that the 10.32% billing surcharge now set forth in Rule 33 of Tariff Schedule Cal. P.U.C. No. 36-T shall only apply to rates and charges for all services rendered by PacBell prior to the effective date of the revised schedules.

2. Eight days after the effective date of this order, AT&T-C shall file with this Commission, in conformity with the provisions of General Order 96-A, revised tariff schedules with rates, charges, and conditions of service modified as set forth in Appendix C. The effective date of the revised tariff sheets shall be five days after the date of filing, except that AT&T-C is authorized to defer for up to six months the effective date for revised tariff sheets applying specifically to private line services and foreign exchange services. The revised tariff schedules shall apply to service rendered on and after the effective date of the revised schedules, provided that the 10.32% billing surcharge now applicable to rates and charges for all service rendered by AT&T-C shall apply to rates and charges for all such services rendered prior to the effective date of the revised schedules.

3. The obligation of AT&T-C, pursuant to Ordering Paragraph 7 of D.83-12-024, to pay an interim incremental premium access charge by lump sum monthly payments to PacBell shall be terminated on the effective date of the revised tariff schedules provided for in the Ordering Paragraph 1, supra, except that AT&T-C shall render a true final payment to PacBell in the amount of revenues from the 10.32% surcharge referred to in Ordering Paragraph 2, supra, accrued by

Conclusions of Law

1. Based on the foregoing findings of fact, the rates, charges, and conditions of service set forth in Appendix B are just and reasonable for PacBell.

2. Based on the foregoing findings of fact, the rates, charges, and conditions of service set forth in Appendix C are just and reasonable for AT&T-C.

3. PacBell provided notice of its proposal to revise local calling area boundaries and to implement ZUM in the San Diego, Orange County, and Sacramento areas which met the requirements of D.93367 and the Public Utilities Code.

4. PacBell and General should be authorized to revise exchange area boundaries and implement ZUM in the San Diego, Orange County, Sacramento and Los Angeles areas, as provided in this decision.

5. Roseville and Citizens should be permitted to recover costs and revenue losses due to ZUM expansion through the EAS Settlement Agreement.

6. All telephone companies providing exchange service in California should be authorized to implement a 20¢ local coin service rate, as provided in this decision.

7. TASC failed to meet its burden of proving that PacBell's DID rates are unreasonable.

8. TASC's complaint against PacBell regarding DID rates should be denied without prejudice to reconsideration in the next PacBell rate proceeding.

9. This Commission holds plenary jurisdiction over the operations of AT&T-C as a provider of telecommunications services between points within the State of California.

10. In the event of substantial reductions in total intrastate access charges imposed on AT&T-C, this Commission has both the authority and the responsibility to require that the resultant access cost savings be flowed through to AT&T-C's intrastate customers as directly and promptly as possible.

AT&T-C subsequent to the last previous lump sum monthly payment to PacBell.

4. In conjunction with its attrition adjustment tariff filing provided for in this Order, PacBell shall file revised tariff schedules providing for increases in private line nonrecurring charges as specified in the foregoing Opinion, in the amount of 50% of the charges authorized to take effect in 1984 or up to cost, whichever is less. These revised tariff schedules shall be effective concurrently with the tariff schedules implementing PacBell's attrition adjustment and shall reduce by $14.4 million the attrition year revenue change required to be generated through other tariff changes. The effects of this provision on any attrition adjustment to be authorized for General will be reflected in our forthcoming decision in A.83-07-02.

5. In conjunction with its attrition adjustment tariff filing provided for in this Order, PacBell shall file estimates of its net revenues for the year 1985 from 976 Information Access Service, High Capacity Transport Service, and Premiere 2/6 Communications Systems Service. PacBell's 1985 attrition adjustment shall be adjusted by the difference in estimated revenue requirement impact for these services between 1984 and 1985.

6. PacBell shall routinely inform all residence customers at the time they receive installation of service that Rule 9 of Tariff Cal. P.U.C. 36-T allows all residence customers up to three months to pay new installation charges free of interest or late payment charges.

7. PacBell and General shall promptly implement the expansion of ORTS service to include the 192 PacBell and 16 General return direction routes discussed in the foregoing Opinion. PacBell and General shall implement return direction ORTS within 6 months of the effective date of this decision on all such routes where facilities will be available to implement return direction ORTS. The implementation of return direction ORTS on all of the remaining 192

PacBell and 16 General routes shall be completed within 24 months after the effective date of this decision.

8. PacBell and General shall implement the changes they have proposed in exchange area boundaries in the Orange County, San Diego, and Los Angeles areas, and shall extend the ZUM Calling Plan as they have proposed in the Orange County, San Diego, Sacramento, and Los Angeles areas, except that the consequent increases in charges for calling on 59 routes should be implemented in a two-step process as described in the foregoing Opinion.

9. Roseville and Citizens shall be permitted to recover costs and revenue losses due to extension of the ZUM Calling Plan through the EAS Settlement Agreement.

10. PacBell shall carry out future expansion of local measured service by implementing ZUM Zone 1 rates according to the revised schedule proposed by PacBell in Exhibit 569.

11. All telephone companies providing exchange service in California are authorized to implement a 20¢ local coin service rate subject to the terms stated in the foregoing Opinion and the tariff provisions set forth in Appendix B of this decision, with appropriate offsetting adjustments in other rates for companies otherwise subject to rate changes in 1984. Each company filing for an increase in the local coin service rate must clearly state the annual revenue impact on the utility of such an increase. The annual revenue effect should be developed in a manner consistent with the discussion in the foregoing Opinion.

12. By at least two clearly marked mailings separated by at least 30 days PacBell shall notify its residence service subscribers of the changes in offerings and rates effected by this Order and by D.84-04-053.

13. The Commission staff shall implement appropriate action, in coordination with those telephone companies experiencing significant changes in settlement revenues as a result of this Order, to adjust such companies' rates as required to reflect those revenue changes.

14. PacBell and General each shall conduct and file with this Commission's Communications Division staff three copies of the following studies, with one copy of each to be forwarded to the formal file in this proceeding, and shall provide copies of such studies to any party to this proceeding requesting copies thereof:

a. Studies, to be filed by November 30, 1984, on the feasibility and merits of offering a service similar to Direct Inward Dialing or a subscriber line multiplex service to their respective alarm system subscribers.

b. Studies, to be filed within one year of the effective date of this Order, of subscriber usage of ORTS and OCMS, in order to determine to what degree each of these services diverts MTS usage and to what degree each service generates additional usage which otherwise would not occur, and also to determine the effects of each service on intercompany settlements and separation of revenues.

15. PacBell shall conduct and file with this Commission's Communications Division staff three copies of the following studies, with one copy of each to be forwarded to the formal file in this proceeding, and shall provide copies of such studies to any party to this proceeding requesting copies thereof:

a. A report, to be filed within one year of the effective date of this Order, describing PacBell's current plans for future "white pages" directory services or their replacement and for changes in the facilities or procedures used to provide directory assistance services. If PacBell considers publication of this report threatening to its competitive position, it may file a motion with the Commission requesting that the report be filed under seal and that distribution to interested parties not be required.

b. A study, to be filed within six months of the effective date of this Order, of the costs of transmitting individual messages on calling routes within the San Francisco-East Bay Extended Area and the Los Angeles Extended Area, with calling routes to be disaggregated by rate mileage and type of serving arrangement rather than current pricing treatment (ZUM vs. MTS). Calling routes to be studied should be selected by sampling techniques adequate to meet customary standards of statistical reliabilty.

c. A study, to be filed within six months of the effective date of this Order, of the savings in

operating expense and capital investment which might be achieved through offering detailed billing of ZUM messages only as an optional service priced to recover the incremental cost of that billing (not including the associated cost of metering).

16. PacBell shall conduct and file with the Commission as part of its next general rate application the following studies:

a. An analysis of the effects of the changes in exchange area and local calling area boundaries and of ZUM expansion, as authorized in this Order, upon its revenues and cost for the 1986 test year.

b. A study of the costs and benefits of establishing residence flat rate metropolitan calling plans offering unlimited calling without charge throughout the San Francisco-East Bay Extended Area or the Los Angeles Extended Area or throughout substantial portions of those areas. The issues related to this study listed in the foregoing Opinion should be addressed in detail.

c. A study of Direct Inward Dialing costs and, if appropriate, a rate proposal addressing the issues raised by the TASC complaint in this proceeding.

d. Detailed bottoms-up as well as tops-down service cost studies for any major service category for which PacBell proposes rate increases substantially greater in percentage terms than the proposed increase in total revenues.

e. A detailed study of time-of-day and day-of-week variations in the usage characteristics by class of user, traffic volumes, and cost of providing local measured and unmeasured service and message toll service, to form the basis for possible adjustments in the hours defined as peak, shoulder-peak, and off-peak, and in the percentage discounts provided for ZUM and MTS calling, respectively. Based on this study PacBell should formulate rate structures for local and MTS usage providing overall levels of contribution comparable to those presently achieved from these services but better reflecting differences in cost by time of day.

f. A statistically reliable study of the usage of its various services by residence subscribers of various income levels, employment types, ages, and family sizes, with particular focus on the analysis of basic exchange service choice, local usage, and toll usage disaggregated by subscriber income level.

g. A detailed analysis of the relationship between incremental capital costs in the local network and incremental service demand for various services, on a recent historical and prospective basis. This analysis should include an assessment of construction budgets for local network and switching facilities for the past ten years, and, prospectively, for the next five years, with an assessment of what types of service demand those construction budgets were or are intended to meet. PacBell should explain its choice of particular types of facilities and service capacities based on the categories and volumes of service for which they were or are designed. Consistent with these explanations, PacBell should propose allocations of the capital costs implicit in the construction budget, for each of the 15 years studied, among the various service categories which PacBell has offered in the past or will offer in the future including exchange access services.

Submission of the studies required by paragraphs c., f., and g., later than is consistent with this Commission's Rate Case Plan will be permitted, but could delay the proceeding and the date of decision on PacBell's application.

We instruct staff to form with all interested parties a Task Force to participate with PacBell in formulating study plans for the studies listed in this ordering paragraph. We expect PacBell to cooperate in good faith with the Task Force. PacBell shall file a study plan for each study within 90 days of the date of this decision. Task Force members are invited to file comments on these study plans at the same time.

16a. Staff shall report to the Commission within the next six months on broad policy options available to the Commission in relation to pricing intraLATA services. These pricing alternatives should be analyzed in the context of broader, longer term strategy toward intra-state telecommunications regulation.

17. C.82-10-09 is denied.

18. AT&T-C Advice Letter 1 and PacBell Advice Letter 14641 are rejected.

19. (I&S) C.83-11-05 is terminated.

20. PacBell is authorized to file by July 17, 1984 prepared testimony and exhibits regarding the 1984 and 1985 attrition mechanisms and addressing the issues identified in this opinion. Hearings should commence within 30 days following PacBell's filing.

21. PacBell shall, after meeting with authorized representatives of recognized minority groups, specifically including those groups represented by PA in

these proceedings, draft and submit to the Commission for its approval, as part of its next general rate case filing, a tracking procedure that comprises:

a. Stated - year 1986 female and minority goals for the ethnic classifications used by the State of California as set forth in Exhibit 197.

b. Reporting categories of purchase of or contracts for similar goods or services aggregating five million dollars or more.

c. A report covering F/MBE activity in 1984 shall be submitted on March 1, 1985. Thereafter, PacBell shall file semiannual reports on March 1 and October 1 of each year. The March 1 report shall cover F/MBE activity from July 1 through December 31 of the prior year and the October 1 report shall cover M/FBE activity during the January 1 through June 30 period.

22. The $20.1 million annual revenue increase authorized by D.84-04-043 which terminates at the end of 1984, and the $11.0 million annual revenue decrease ordered by D.84-04-104 which terminates at the end of 1984, when netted, shall result in PacBell's rates being reduced by $9.1 million, through an adjustment to the surcharge/surcredit, effective January 1, 1985. If the surcharge is adjusted effective January 1, 1985 in connection with PacBell's 1985 attrition allowance the $9.1 million reduction can be netted with that rate change, otherwise the $9.1 million reduction shall be made separately effective January 1, 1985 through an advice letter filing.

23. Following is the disposition of each of these consolidated proceedings:

a. PacBell's A.82-11-07, A.83-01-22, and A.83-06-65 remain open, as does OII 83-04-02, because they are the subject of further consolidated hearings related to access charges for interLATA carriers. Further hearings will also be held in A.83-01-22 regarding 1984 and 1985 attrition mechanisms.

b. The relief requested by TASC in C.82-10-09 is denied and that proceeding is closed.

c. I&S C.83-11-06, involving AT&T-C is terminated; the issues raised in that proceeding are resolved by today's order.

d. I&C's C.83-11-07, involving PacBell's Advice Letter 14641, remains open to consider potential tariff issues which may arise in connection with today's order.

25. The Commission's Executive Director shall establish a staff Bypass Task Force to monitor the threat of uneconomic bypass. The Task Force shall submit written reports of its findings by memorandum to the Commission on a semi-annual basis, the first such report to be made three months after PacBell's next bypass report submitted in compliance with D.83-12-024.

26. D.84-04-104 is modified as follows:

a. On page 3, the second paragraph will end after "plant". Delete "however, upon further consideration, we do not feel it appropriate that Pacific should file for relief from this penalty between general rate cases. We will modify our discussion and finding accordingly".

b. On page 5, Ordering Paragraph 1 is deleted.

c. On page 6, Finding of Fact 32 is deleted.

This order becomes effective five days from today.

Dated June 13, 1984, at San Francisco, California.

LEONARD M. GRIMES, JR.
President
VICTOR CALVO
DONALD VIAL
WILLIAM T. BAGLEY
Commissioners

I dissent in part.
/s/ VICTOR CALVO
Commissioner

I dissent in part.
/s/ WILLIAM T. BAGLEY
Commissioner

Commissioner Priscilla C. Grew, being necessarily absent, did not participate.

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

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Joseph E. Bodovitz, Executive Director

APPENDIX A

List of Additional Appearances

Applicant: Ronald R. McClain, Attorney at Law, for Pacific Bell.

Interested Parties: Ruth R. MacNaughton, Attorney at Law, for AT&T Communications; Mark Barmore, for Public Advocates, et al.; McCutchen, Doyle, Brown & Enersen, by Beth Parker and Robert Ebe, Attorneys at Law, for GTE Sprint; Morrison & Foerster, by Gary M. Rinck, Attorney at Law, for MCI Communications; Joseph P. Smith, for MCI Telecommunications; Laura P. Worsinger, Attorney at Law, for J. C. Penney Company, Inc.; Graham & James, by Thomas J. MacBride, Attorney at Law, for California Association of Long Distance Telephone Companies; Tricia Breckenridge, for Lexicom; George Steffes, Inc., by Terri Townsend, for American Express; Rogers, Joseph, O'Donnell & Quinn, by Mary P. Nichols and Richard Wyde, Attorney at Law, for Richard Wyde, Esq.; Judith Bell and Kenneth McEldowney, for Consumer Action; Michael A. Morris, Attorney at Law, for California Cable Television Association; Gerald J. LaFave, Attorney at Law (Michigan), for California Farm Bureau Federation; Wendell Nichols, for Xerox Computer Services; Nancy Weston, Attorney at Law, for Minority Coalition; and Dinkelspiel, Donovan & Reder, by David M. Wilson, for Direct Marketing Association.

Respondents: Hathaway Watson, III, Attorney at Law, for AT&T Communications; and John L. Clark, Attorney at Law, for CP National Corporation and Tuolumne Telephone Company.

Commission Staff: Emily T. Marks.

(END OF APPENDIX A)

SCHEDULES CAL. P.U.C. NOS. 4-T, 9-T, 13-T, 117-T AND 121-T. BASIC EXCHANGE ACCESS LINE SERVICE

The following rates and revisions are authorized:

Service	Monthly Rate All Areas#
Business	
Individual Line	
Flat Rate	$17.15
Measured Rate	8.25
2-Party Line	12.70
4-Party Suburban	13.00
Farmer Line	4.90
PBX Trunk	
Flat Rate	25.65
Measured Rate	8.25
Semipublic Coin	20.00
Residence	
Individual Line*	
Flat Rate	8.25
Universal Lifeline	3.38ø+
Measured Rate	4.45**
Universal Lifeline	1.48ø
2-Party Line	
Flat Rate	5.60
Universal Lifeline	2.05ø+
Measured Rate	4.35**
Universal Lifeline	1.43ø
4-Party Suburban	
Flat Rate	5.80
Universal Lifeline	2.15ø
Farmer Line	2.60
PBX Trunk	12.40

Plus extended area service and mileage increments where applicable.
ø Universal Lifeline Service per D.84-04-053. Rates shown include the 75¢ telephone set allowance credit. Measured Rate Universal Lifeline serivce includes a usage allowance of 30 untimed local calls.
* Individual Line 30 Unit allowance Measured Rate Residence Service is withdrawn on October 1, 1984 pursuant to the provisions of D.84-04-053.
**Includes a usage allowance of $3.00.
+ Offered in nonmeasured exchanges only.

Basic Exchange Access Line Service - continued

Airport Intercommunicating Service

	Monthly Rate
Individual Line and Manual PBX Service:	
Business individual line service:	
Primary station line -	
On Airport Property	$18.75
Off Airport Property	26.75
Commercial Manual PBX service:	
Trunk line -	
On Airport Property	18.75
Off Airport Property	26.75
Mechanized Station Service:	
Trunking:	
First 25 mechanized primary station lines	21.25
Each additional mechanized primary station line	.85

Centrex Service

Exchange Access Trunking Charge

	Monthly Rate*
Measured Rate Service	
ESS, #5XB First 100 Primary Lines or less	$85.00
Each additional Primary Line	.85
#101ESS, 701 - First 100 Primary Lines or less	85.00
Each additional Primary Line	.85
Flat Rate Service	
ESS, #5XB	
First 100 lines or less where trunk line rate is $28.65 or less	260.00
First 100 lines or less where trunk line rate is greater than $28.65	295.00
Each additional Primary Line where the trunk line rate is $28.65 or less	2.60
Each additional Primary Line where the trunk line rate is greater than $28.65	2.95
#101ESS, 701	
First 100 lines or less where trunk line rate is $28.65 or less	260.00
First 100 lines or less where trunk line rate is greater than $28.65	295.00
Each additional Primary Line where the trunk line rate is $28.65 or less	2.60
Each additional Primary Line where the trunk line rate is greater than $28.65	2.95

* Plus appropriate Extended Area Service Increments where applicable.

Basic Exchange Access Line Service - continued

Service Connection Charges
Service connection charges shall not apply to residence customer requested changes in type or grade of service for a period of 90 days after the effective date of the tariffs filed under authority granted in this decision to revise residence basic exchange access line rates.

SCHEDULE CAL. P.U.C. NO. 4-T, NON-PUBLISHED NUMBER REPORT CHARGE
Proposed revisions as set forth in Exhibit No. 619 Appendix E except as modified below are authorized:

	Charge Per Request
Non-Published Number Report Charge	$2.50

SCHEDULE CAL. P.U.C. NO. 4-T, VERIFICATION/INTERRUPT
The following revisions are authorized:

Where facilities and operating conditions permit, the Utility's Toll Operators may verify a busy line condition and/or interrupt a conversation in progress at the calling party's request. The charges for such service are:

1. Verify $0.50
2. Interrupt 1.00

No Charge will aply to the following:

a. When the Operator finds the called telephone to be out of-order.
b. To place a call to or from any public agency whose responsibility it is to provide or render emergency aid.

SCHEDULES CAL. P.U.C. NO. 4-T AND 11-T, LOCAL COIN SERVICE
The following revisions are authorized:

PUBLIC TELEPHONE SERVICE	RATE*#
Applicable to service from the Company's nonlisted public telephone stations	
All Exchanges:	
Each direct dialed exchanged message	20¢
SEMIPUBLIC MESSAGES	
Each semipublic individual line service exchange message	20¢

* The 20¢ rate shall apply to local calls paid for in coin at the coin box for such calls which originate from Semipublic and Public Coin Stations equipped with Dial Tone First capability. The present 10¢ rate shall continue to apply for such calls originated from Semipublic and Public Coin Stations which are not equipped with Dial Tone First capability. Within 12 months after the effective date of the increase to a 20¢ rate for a local coin call, all Semipublic and Public Coin Stations shall be converted to Dial Tone First capability. During the period in which both the 10¢ and 20¢ local coin call rates are effective, Pacific's tariffs shall clearly identify each Semipublic and Public Coin Station to which the 10¢ local coin call rate applies.

A customer, at his or her option, may deposit 25¢ as payment for a local coin message. Such customers shall not be entitled to a refund of the extra 5¢.

SCHEDULES CAL. P.U.C. NOS. 4-T, 13-T AND 34-T, CONVERSION OF SMRT ROUTES TO ZUM ZONE 1 LOCAL ROUTES

The following revisions are authorized:

The number following a rate for individual line or party line service designates the unit allowance of local service area message usage under the measured rate quoted. The rates for each unit over the allowance are 1.2¢ 1/ for calls from Foreign Exchange services and 1¢ for calls from all other services and apply as follows:

	Initial period 2/	Each Addl. 2/
a. @ Measured Rate Service (excluding Lifeline)	1 Min.*	Min.*
Measured rate business service (1MB) and residence service (1MR and 2MR):	4 Units	1 Unit
# Untimed measured rate business service (1MB)		
All days/hours	5 Units	-

* or portion thereof

No expansion of extended area routes shall be made under these provisions. Only the present local calling routes to which the SMRT usage rate structure applies shall be converted to ZUM 1 routes.

Corollary tariff changes may be required in Schedules 2-T, 6-T, 28-T, 36-T, 112-T, 117-T and 121-T.

1/ All residence and business message rate and measured rate foreign exchange services outside of the LA EA and SF-EB EA shall be converted to this authorized rate and rate structure.
2/ The time of day discounts set forth in Schedule Cal. P.U.C. No. 6-T shall apply for calls originated from measured rate services.

See Special Conditions: #1.k.; @1.i. and 1.m. of Schedule Cal. P.U.C. No. 4-T.

SCHEDULE CAL. P.U.C. NO. 6-T, ZONE USAGE MEASUREMENT SERVICE

The following revisions are authorized:

ZONE	INITIAL PERIOD 1-MINUTE #
1 (Local)	4 Units
2 (9 - 12 miles)	8 Units
3 (13 - 16 miles)	10 Units

Zone Calling:

Rate Discounts

Discounts for all messages apply to the total day rate dial charges. For messages which overlap one or more rate period boundaries, the rate in effect in each rate period applies to the portion of the message occurring in that rate period.

or portion thereof

SCHEDULE CAL. P.U.C. NO. 17-T, DIRECTORY LISTINGS

Proposed revisions as set forth in Exhibit No. 619 Appendix H are authorized.

SCHEDULE CAL. P.U.C. NO. 28-T, DUAL ELEMENT CHARGES

Proposed revisions as set forth in Exhibit No. 619 Appendix D except as modified below are authorized:

1. CHARGES FOR ACCESS LINES, LABOR AND SERVICE ENHANCEMENTS
GENERAL

1.1.5 REGULATIONS

H. Dual Element charges apply to all requests by residence customers for changes in class type or grade of service except as specifically exempted by tariff provisions.

1.2 ACCESS LINES (PRIMARY AND EXTENDED SERVICES)

1.2.2 TRUNK LINE SERVICE	Service Charge
A. New and additional local and extended area service charges, each trunk	
- Concentrator/Identifier trunk - C.O	$179.00
- Concentrator/Identifier trunk - C.U.	179.00

1.2.3 TIE LINE SERVICE

A. Each leg of each tie line within the same exchange or same district area	
- Between PBX and Centrex systems	166.00
- Between Centrex systems	166.00
- Between All Other	166.00

1.2.7 FOREIGN EXCHANGE SERVICES - BUSINESS AND RESIDENCE SERVICES

A. Foreign Exchange (FXS) or Foreign District Area Service (FDA of the same exchange only).
(1) Contiguous, each line or trunk

Business	
- Individual acces lines	190.00
- Answering line	190.00
- Trunk line service	190.00
- Trunk line service, TAS	190.00
- Centrex primary access line	170.00
- Toll terminal	190.00
- Tie line (FDA of same exchange only)	190.00
Residence	
- Individual and party-line	130.00
- Trunk line service	190.00

DUAL ELEMENT CHARGES - Continued

1.2.7 FOREIGN EXCHANGE SERVICE - business and residence services - Continued

	Service Charges
A. Foreign Exchange (FXS) or Foreign District Area Service (FDA of the same exchange only) - Continued	
(2) Noncontiguous, each line or trunk	
Business	
- Individual access line	$290.00
- Answering line	290.00
- Trunk line service, residence or business	290.00
- Trunk line service, TAS	290.00
- Tie Line (FDA of the same exchange only)	290.00
- Centrex primary access line	270.00
Residence	
- Individual and party-line service	230.00
- Trunk line service	290.00
B. Foreign Prefix Service (FPS)	
(1) Contiguous, each residence or business line or trunk	190.00
(2) Noncontiguous, each residence or business line or trunk	290.00

1.2.8 EXTENSION LINE SERVICE

	Labor or Service Charge
A. On premises, or off premises in the same building, simple residence or business service	Labor
B. Off premises, all services, continuous or noncontinuous property, same exchange or district area	
(1) Simple service	66.00
(2) Complex except Centrex	66.00
(3) Centrex (same or different customer location)	66.00
C. Off premises, all services, different exchange or district area, contiguous	
(1) Simple service	66.00
(2) Complex except Centrex	66.00
(3) Centrex	66.00
D. Off premises, all services, different exchange or district area, noncontiguous	
(1) Simple services	66.00
(2) Complex except Centrex	66.00
(3) Centrex	66.00

DUAL ELEMENT CHARGES - Continued

1.2.9 SECRETARIAL LINE SERVICE (Residence and Business)

	Service Charges
A. Same exchange or district area	
- without concentrator termination	$ 61.00
- with concentrator C.O. termination	61.00
- with concentrator C.U. termination	61.00
B. Different exchange or district area, contiguous	
- without concentrator termination	61.00
- with concentrator C.O. termination	61.00
- with concentrator C.U. termination	61.00
C. Different exchange or district area, contiguous	
- without concentrator termination	61.00
- with concentrator C.O. termination	61.00
- with concentrator C.U. termination	61.00

1.6 MOVE, CHANGE, REARRANGEMENT OR MODIFICATION OF ACCESS LINE AND OTHER MISCELLANEOUS CHANGES ALL SERVICES, EACH LINE OR TRUNK

b. Change class, type or grade of service	
- Residence, simple service	15.00

SCHEDULE CAL. P.U.C. NOS. 28-T and 36-T, LATE PAYMENT CHARGE

Proposed revisions as set forth in Exhibit N. 619 Appendix B except as modified below are authorized:

- Each Account	1.5 percent on an unpaid live balance of $10.00 or more.

Rule No. 5, Special Information Required on Forms

Bills

Each bill for telephone service will contain the following notations:

WHEN TO PAY YOUR BILL

If your bill becomes delinquent in an amount of $10.00 or more, a late payment penalty of 1.5% is applicable to the total unpaid live balance carried forward from one month's bill to the next and is included in the total amount due on the current bill. Neither the billing nor payment of late charges relieves you of the obligation to pay all charges prior to the due date of the bill.

SCHEDULE CAL. P.U.C. NO. 31-T, VACATION RATE SERVICE

Proposed revisions as set forth in Exhibit No. 619 Appendix G are authorized.

SCHEDULE CAL. P.U.C. NO. 34-T, FOREIGN EXCHANGE SERVICE

The following revisions are authorized:

	Monthly Rate *
Residence Service	
Individual Line	
Flat	$15.00
Measured	8.50 ($3.60)
2 Party Flat	8.50
4 Party Suburban	8.50
Business Service	
Individual Line Measured Rate	19.50
PBX Trunk, First, Measured Rate	19.50
PBX Trunk, Each Additional, Measured Rate	19.50

Application of Charges for Foreign Prefix Service (FPS)

Customers who are assigned numbers in prefixes served from other than their normal serving central offices at the initiation of the Utility may retain these numbers, at the discretion of the Utility, without application of the Foreign Prefix Service charge for these services as long as the location of the primary station remains within the same building. If the primary station location is moved to another building within the same central office serving area, the customer has a choice of obtaining a new telephone number or retaining the present telephone number at the additional Foreign Prefix Service charge per line as shown in General Rates 1.F. (Schedule Cal.P.U.C. No. 34-T). Where the Utility has waived application of Foreign Prefix Service charges under the conditions described above, the Foreign Prefix Service charge will be applied to additional lines, served from other than their normal serving central office, as may be ordered by the customer.

*Plus applicable EAS Increments

SCHEDULE CAL. P.U.C. NO. 36-T, RULE NO. 9 RENDERING AND PAYMENT OF BILLS

The revisions set forth in Exhibit No. 668, Appendix T Sheet 4 of 5 are authorized.

SCHEDULE CAL. P.U.C. NO. 36-T, RETURNED CHECK CHARGE

Proposed revisions as set forth in Exhibit No. 619, Appendix C except as modified below are authorized.

	Charge Per Check
Returned Check Charge	$7.00

SCHEDULE CAL. P.U.C. NO. 36-T, RULE NO. 33, BILLING SURCHARGES

The following revisions are authorized:

RATES	Monthly Percentage
Adjustment Factor	(0.41)
	(Negative)

SPECIAL CONDITIONS

1. The Monthly Percentage applies to all monthly recurring rates for service or equipment provided under all of the Utility's tariff schedules except the following:

   4-T, Individual and Party Line Service - (PARTIAL) RATES 1.a., 1.b., 1.c.
   6-T, Zone Usage Measurement Service - ALL
   11-T, Public Telephone Service - ALL
   13-T, Trunk Line Service - (PARTIAL) RATES (3)
   17-T, Directory Listing - ALL
   34-T, Foreign Exchange Service - (PARTIAL) GENERAL RATES C and D
   53-T, Message Toll Service - ALL
   117-T, Airport Intercommunicating Service - (PARTIAL) USOC's as shown in Charges and Rates and corresponding Schedule Cal. P.U.C. No. 121-T, Section V.B.
   121-T, Centrex Service - (PARTIAL) USCO's as shown in Section V.C. and corresponding Section III.
   128-T, Wide Area Telephone Service - ALL
   131-T, Optional Residence Telephone Service - ALL
   149-T, Optional Calling Measured Service - ALL
   157-T, Products and Service for Handicapped Customers - (PARTIAL) RATES C.1.
   170-T, High Capacity Transport Service - ALL
   171-T, Premiere 2/6 Communications System Service - ALL
   0/172-T, Special Olympic Telecommunications - ALL
   173-T, Exchange Telephone Service - 976 Infrmation Access Service - ALL
   174-T, Sale of Multi-Line and Associated Equipment - ALL
   175-T, Access Service - ALL
   176-T, Democratic National Convention - 1984 - ALL

2. The billing adjustment amount on each bill shall be designated "Billing Surcharge".

3. The Monthly Percentage factor applies to each customer's bill for the total recurring rates except those items excluded under Special Condition 1., above, exclusive of federal and local excise taxes.

SCHEDULE CAL. P.U.C. No. 53-T MESSAGE TOLL TELEPHONE SERVICE

The following revisions are authorized:

BASIC SCHEDULE

RATE MILEAGE	Initial 1 Minute	Each Additional Minute
0- 8	$.17	$.08
9- 12	.17	.08
13- 16	.20	.11
17- 20	.23	.14
21- 25	.26	.17
26- 30	.29	.20
31- 40	.32	.23
41- 50	.35	.26
51- 70	.38	.29
71- 90	.41	.32
91-110	.44	.34
111-130	.47	.36
131-150	.50	.38
151-170	.53	.40
171-195	.56	.42
196-220	.58	.43
221-245	.60	.44
Over-245	.62	.45

SERVICE CHARGES

In addition to the Basic Schedule charges, the following service charges are applicable, per message.

Station	Miles	
Coin Sent-Paid	0-25	$ .25
	Over-25	.50
Calling Card	All	.40
Other Station	All	1.00
Person	All	3.00

Rates Discounts - Discounts as set forth in present tariffs apply to total day rate Basic Schedule charges. For messages which overlap one or more rates period boundaries, the rate in effect in each rate period applies to the portion of the message occuring in that rate period.

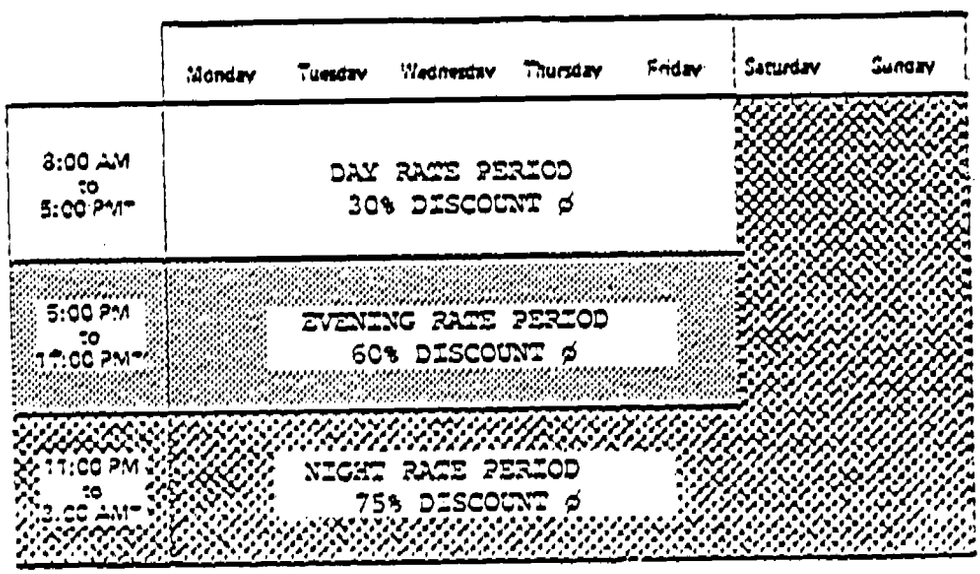
- Fractional cents are dropped.
- Discounts do not apply to the operator, person or coin service charges, shown above.

Message Toll Telephone Service-Continued

Conference Service

The sum of DDD rates for conversation Time for each leg of the conference message, plus a $3.75 Operator Service charge for each conference leg.

Message toll rate periods and rate discounts for households of certified handicapped TDD users, as defined in Schedule Cal. P.U.C. No. 157-T, are as follows:



*To, but not including
øRates Discounts - Discounts as set forth above apply to total day rate Basic Schedule charges. For messages which overlap one or more rate period boundaries, the rate in effect in each rate period applies to the portion of the message occurring in that rate period.

- Fractional cents are dropped.
- Discounts do not apply to the operator, person or coin service charge shown above.

Message Toll Telephone Service - Continued

Optional Block Discount Plan

1. Business and Residence customers may for the indicated nonrecurring and monthly charges receive a discount on all intraLATA message toll charges. The discount rate is dependent on the total amount of monthly message toll usage as billed.

Business Service

Billed Usage	Nonrecurring Charge	Monthly Rate	Discount Rate
$350-$1350 per account	$10.00	$15.00	10%
Over-$1350 per account	10.00	15.00	15%

Residence Service

Billed Usage	Nonrecurring Charge	Monthly Rate	Discount Rate
$350-$1350 per account	$10.00	$15.00	10%
over-$1350 per account	10.00	15.00	15%

2. The discounted rates are provided to the Utility's customer only and shall not be used for any purpose for which a payment or other compensation shall be received by the customer from any other person, firm or corporation for such use. Therefore, this plan is not available for, inter alia, resale or joint use.

3. Person, collect, conference, toll station, calling card or any other calls requiring operator handling, are not included and will be billed at the regular message toll rates applicable.

Pacific Bell
RATES AND CHARGES

SCHEDULE CAL. P.U.C. NOS. 131-T AND 149-T, OPTIONAL RESIDENCE TELEPHONE SERVICE (ORTS) AND OPTIONAL CALLING MEASURED SERVICE (OCMS)

The following revisions are authorized:

ORTS

Option 1- Community Calling Plan

Service Area Rate Group	Service Offerings Rate Mileage	Charge per Community: Each Exchange or District Area	Allowance per Community	Message Rate: First Minute Day	Message Rate: Additional Minute Day
1	9-12	$3.60	$ 7.20	$.1190*	$.0560**
2	13-16	4.35	8.70	.1400***	.0770***
3	17-20	5.50	11.00	.1610	.0980
4	21-25	6.30	12.60	.1820	.1190
5	26-30	7.45	14.90	.2030	.1400
6	31-40	8.55	17.10	.2240	.1610

Service Area Rate Group	Charges for Additional Allowance per Community: Double	Charges for Additional Allowance per Community: Triple	Additional Allowances: Double	Additional Allowances: Triple
1	$ 7.20	$10.80	$14.40	$21.60
2	8.70	13.05	17.40	26.10
3	11.00	16.50	22.00	33.00
4	12.60	18.90	25.20	37.80
5	14.90	22.35	29.80	44.70
6	17.10	25.65	34.20	51.30

Option 2 - Circle Calling Plan

Monthly Charge	Usage Allowance
$4.75	$0.00

Service Area Rate Group	Message Rate: First Minute Day	Message Rate: Additional Minute Day
1	$.1190*	$.0560**
2	.1400***	.0770****
3	.1610	.0980
4	.1820	.1190
5	.2030	.1400
6	.2240	.1610

*$.08 on ZUM routes
**$.03 on ZUM routes
***$.10 on ZUM routes
****$.05 on ZUM routes

OCMS

Service Area Rate Group	Service Offerings Rate Mileages	Rate Per Service: Each Exchange or District Area Selected — Monthly Time Allowance * One Hour	Two Hours	Three Hours	Overtime Rate per Minute Over Allowance *
I	9-12	$4.50	$ 9.00	$13.50	$ .08
II	13-16	5.10	10.20	15.30	.11
III	17-20	6.30	12.60	18.90	.14
IV	21-25	7.20	14.40	21.60	.17
V	26-30	8.10	16.20	24.30	.20
VI	31-40	9.00	18.00	27.00	.23

*Applies between 8:00 a.m. and 8:00 p.m. Monday through Friday only. Calling between 8:00 p.m. and 8:00 a.m. daily and all day Saturday and Sunday is unlimited.

ORTS and OCMS

The Optional Residence Telephone Service (ORTS) Option I Community Calling Plan rates, charges and conditions as set forth in Schedule Cal. P.U.C. No. 131-T as authorized in this decision shall be applicable to present OCMS routes. ORTS Option 2, Circle Calling plan, is not applicable to present OCMS routes.

Service connection charges shall not be applicable to customer requested changes in OCMS and ORTS allowance options or for customer requested changes between ORTS and OCMS for a period of 90 days after the effective date of the tariff revisions filed under authority granted by this decision.

SCHEDULE CAL. P.U.C. No. 148-T, CUSTOM CALLING SERVICE

The following revisions are authorized:

	Monthly Rates	
	Business	Residence
(a) Individual Features, each line*		
1. Call Forwarding	$4.20	$3.50
2. Call Waiting	4.20	3.50
3. Three-way Calling	4.20	3.50
4. Customer Changeable Speed Calling		
a. Eight code capacity	4.20	3.50
b. Thirty code capacity	6.00	5.00
(b) Two Feature Packages, each line*		
1. Call Forwarding and Call Waiting	7.20	6.00
2. Call Forwarding and Three-way Calling	7.20	6.00
3. Call Waiting and Three-way Calling	7.20	6.00
4. Call Forwarding and Customer Changeable Speed Calling- Eight code capacity	7.20	6.00
5. Call Waiting and Customer Changeable Speed Calling- Eight code capacity	7.20	6.00
6. Three-way Calling and Customer Changeable Speed Calling- Eight code capacity	7.20	6.00
(c) Three Feature Packages, each line		
1. Call Forwarding, Call Waiting and		
a. Three-way Calling	9.60	8.00
b. Customer Changeable Speed Calling-8 Code	9.60	8.00
2. Call Waiting, Three-way calling and Customer Changeable Speed Calling- Eight Code Capacity	9.60	8.00
3. Three-way Calling, Call Forwarding and Customer Changeable Speed Calling Eight Code Capacity	9.60	8.00
(d) Four Feature Packages, each line*		
1. Call Forwarding, Call Waiting, Three-way Calling- Customer Changeable Speed Calling-8 Code	12.00	10.00

The rates applicable for multi-feature packages are the lowest combination of the rates shown for the features provided to the customer.

*Includes all stations.

SCHEDULE CAL. P.U.C. NO. 154-T, REMOTE CALL FORWARDING SERVICE

Proposed revisions as set forth in Exhibit No. 619, Appendix J are authorized.

SCHEDULE CAL. P.U.C. NO. 159-T, DIRECTORY ASSISTANCE SERVICE

Proposed revisions as set forth in Exhibit No. 619, Appendix A except as modified below are authorized:

Type of Service	Call Allowance
Residence Service:	
(a) Individual access line, two-party line and suburban service, each service	5
(b) PBX service, each trunk line service	5
Business Service:	
(a) Individual access line, two-party line and suburan service, each service	2
(b) PBX service, each trunk line service	2
(c) Centrex service	
Dormitory service, each station line	2
All other Centrex service, each station line	1
Other services, such as Toll Stations, Marine Telephone Service, etc.	2

Charges	Charge Per Call
Each direct dialed call to Directory Assistance exceeding the allowance shown above	25¢

PRIVATE LINE SERVICES AND PRIVATE LINE LIKE SERVICES RECURRING RATES

The revisions in the rate structures for private line and exchange mileage services as set forth in Exhibit No. 624 are authorized.

Recurring Rates

Eighty percent of the incremental recurring rate increases as set forth in Exhibit No. 624 except where specifically modified herein below are authorized. However, in no event shall the recurring rates be set lower than the present rates including the present 5.4% billing surcharge. All rates shall be rounded to the nearest 1¢. The following expression shall be used to establish the authorized recurring rates for each item not specifically listed below:

$$C = A + (1 - 0.2)(B-A)$$

If $C < 1.054A$, Use $C = 1.054\ A$

Where:

A = Present recurring rate excluding the 5.4% billing surcharge.
B = The proposed recurring rate set forth in Exhibit No. 624.
C = Authorized recurring rate.

The following recurring rates are authorized:

RATE ELEMENT - LOCAL CHANNEL

*SERIES TYPE	FACILIY (DRY)		ASSOCIATED CHANNEL EQUIPMENT	MULTIPOINT/ BRIDGING (PER LEG)	COMPLETE LOCAL LOOP	
	FDX	HDX			FDX	HDX
	$	$	$	$	$	$
1001	14.92	9.95	0.70		15.62	10.65
1002,1005,1006	15.07	9.95	3.55		18.62	13.50
1009A & B		9.95	0.38			10.33
1009C		9.95	2.20			12.15
2001	16.07	9.95	6.25	0.80	22.32	16.20
2002	15.77	9.95	3.55		19.32	13.50
3001,3001DC 3002	15.07	9.95	3.55	0.80	18.62	13.50
3009,3009DC		9.95	3.55			13.50
6,1LLBP, 1LLAP		9.00	0.45			9.45
6A/68/27B 1LJBJ		4.95	0.45			5.40
6A/6B/27B 1LJBP		7.65	0.45			8.10
7/29,1LJJY		4.95	0.45			5.40
ZZAAJ		9.00	0.45			9.45
4,4A,4B 1LTAP,1LTBP		9.00	0.45			9.45
2/Port ABC 1LVBP, 1LVAP		9.00	0.45			9.45
2A		9.95	4.09			14.04

*For description of Series Type See Exhibit No. 624 Appendix C.

Private Line Services and Private Line-Like Services - Continued

Nonrecurring Charges

The following nonrecurring charges applicable to private line services and private line-like services are authorized:

	Installation Charges		Move/Change Charges	
Service *	1984	1985	1984	1985
1001/1009A/B/C	$119.00	$179.00	$ 40.00	$ 60.00
1002/1005/1006	119.00	179.00	40.00	60.00
2001/2002	119.00	179.00	40.00	60.00
3001/3002A/B/C	119.00	179.00	40.00	60.00
6000-60 to - 72	26.00	39.00	26.00	39.00
2/2A/6	66.00	99.00	28-T Labor	28-T Labor
4/4A/4B	166.00	249.00	166.00	249.00
6A/6B/2/B	61.00	92.00	28-T Labor	28-T Labor
7/29	119.00	179.00	28-T Labor	28-T Labor
3009	119.00	179.00	40.00	60.00
Bridging	14.00	14.00	-	-

Channel Conditioning *	1984	1985
C-1:P2W	$ 66.00	$ 99.00
P2X/P3G	104.00	104.00
P3E	71.00	104.00
C-2:P3H	119.00	125.00
P3J/P3W/PH9	125.00	125.00
P3B	72.00	108.00
C-4:P4G	132.00	132.00
P4H	119.00	132.00
C-5:UHD	148.00	148.00
D-1:QHA	650.00	650.00

*For a description of these services see Exhibit No.624.

RATES AND CHARGES

RATE BANDING

Pacific is authorized to withdraw the offering of business and residence Suburban services, eliminate Special Rate Areas, and to implement the Rate Banding provisions set forth under RATES (2) of Schedule Cal.P.U.C. No. 26-T coincident with the completed implementation of both residence and business Measured Exchange access line services as the offering of such measured services are expanded to additional exchanges. It is further recommended that Rate Banding not be implemented unless both business and residence Measured services are offered and Suburban services are eliminated.

SCHEDULES CALIFORNIA PUBLIC UTILITIES COMMISSION NO.'S 12-T, 13-T, 22-T, 24-T, 26-T, 28-T, 32-T, 34-T, 45-T, 46-T, 47-T, 48-T, 49-T, 50-T, 51-T, 83-T, 100-T, 102-T, 104-T, 107-T, 111-T, 112-T, 115-T, 118-T, 122-T, 126-T, 133-T, 134-T, 135-T, 139-T, 142-T, 144-T, 145-T, 150-T, 155-T, 156-T, 158-T and 166-T.

The 5.4% billing surcharge applicable to recurring and nonrecurring rates and charges is eliminated.

(END OF APPENDIX B)

APPENDIX C
Sheet 1 of 6

AT&T Communications of California

The following changes in rates, charges, rules, conditions and tariffs are authorized.

Tariff Format

AT&T Communications is authorized to file tariffs utilizing tariff format and schedule numbering as developed in consultation with the Commission staff.

New Tariff Schedule - Directory Assistance Service

SERVICE DESCRIPTION

1. Directory Assistance Service provides the calling party with the following type of information from Pacific Bell or other local exchange carrier Directory Assistance records:

   a. The requested telephone number.

   b. Information that the requested telephone number cannot be found.

2. The Directory Assistance operator will furnish up to a maximum of three items of the type of information in 1. above per call and limited to a single numbering plan area.

3. No charges are applicable in connection with "800" service number requests.

CHARGES

Each Directory Assistance call	$0.35

SCHEDULE CAL. P.U.C. NO. 34-T - FOREIGN EXCHANGE SERVICE

Revisions in the rates and service offerings for foreign exchange service set forth in Exhibit No. 731 are authorized except to the extent that a waiver of the MFJ is granted by the federal court for inter-LATA contiguous exchanges.

SCHEDULE CAL. P.U.C. NO. 36-T - RULES

Rules are authorized to be revised to the extent necessary to eliminate prohibitions against resale and sharing of MTS and WATS services.

APPENDIX C
Sheet 2 of 6

AT&T Communications of California - continued

SCHEDULE CAL P.U.C. NO. 53-T - MESSAGE TOLL TELEPHONE SERVICE

The following revisions are authorized:

I. Two-Point Service

BASIC SCHEDULE

RATE MILEAGE	Initial Minute	Each Additional Minute
0 - 12	$0.22	$0.10
13 - 16	.25	.12
17 - 20	.28	.15
21 - 25	.32	.18
26 - 30	.36	.21
31 - 40	.40	.23
41 - 70	.44	.25
71 -110	.47	.27
111 -170	.50	.29
171 -245	.54	.31
Over 245	.57	.34

SERVICE CHARGES

In addition to the Basic Schedule charges, the following service charges are applicable, per message.

Station	Miles	Charges
Coin Sent-Paid	0-20	$ .25
	Over 20	.50
Calling Card	All	.50
Other Station	All	1.00
Person	All	3.00

APPENDIX C
Sheet 3 of 6

AT&T Communications of California - continued

SCHEDULE CAL. P.U.C. NO. 53-T - MESSAGE TOLL TELEPHONE SERVICE (continued)

Message Toll Rate Periods and Rate Discounts are as follows:

	Monday through Friday	Sat/Sun
DAY 8:00 A.M. to 5:00 P.M.* FULL RATE		
EVENING 5:00 P.M. to 11:00 P.M.* 25% DISCOUNT		
NIGHT 11:00 P.M. to 8:00 A.M.*, All day Sat. and Sun. 50% DISCOUNT		

* To, but not including

Night rates apply on Holidays.

Rate Discounts
Discounts for all messages apply to the total day rate dial charges. For messages which overlap one or more rate period boundaries, the rate in effect in each rate period applies to the portion of the message occurring in that rate period.

- Fractional cents are dropped.
- Discounts do not apply to the operator, person or coin service charges.

For certified handicapped customers who communicate by teletypewriter, the Evening discount applies during the Day rate period and the Night discount applies during the Evening rate period. A discount of 75% applies during the Night rate period.

APPENDIX C
Sheet 4 of 6

AT&T Communications of California - continued

SCHEDULE CAL. P.U.C. NO. 53-T - MESSAGE TOLL TELEPHONE SERVICE (continued)

Optional Volume Discount Calling Service

AUTHORIZED RATES AND CHARGES

Plan A

Charge	Amount	Application
Non-recurring	$10.00	Order to initiate service
Monthly Rate per account	$10.00	First hour of night/ weekend use plus 10% discount on evening usage
Hourly Rate	$8.00	Night/weekend usage after first hour

Plan B

Charge	Amount	Application
Non-recurring	$10.00	Order to initiate service
Monthly Rate	$20.00	Monthly Message Toll billings less than or equal to $1,000:
		Discount of 10% in addition to applicable rate period discounts for all messages at all rate periods
		Monthly Message Toll billings greater than $1,000:
		Discount of 20% in addition to applicable rate period discounts for all messages at all rate periods

II. Conference Service

Charge

Sum of the Basic Schedule charges for each leg of the conference message plus a $3.75 Service Charge per leg for the operator-conference bridging function.

APPENDIX C
Sheet 5 of 6

AT&T Communications of California - continued

SCHEDULE CAL. P.U.C. NO. 53-T - MESSAGE TOLL TELEPHONE SERVICE (continued)

New Tariff Section - Verification/Interrupt Service

Verification/Interrupt

Where facilities and operating conditions permit, the Utility's Toll Operators may verify a busy line condition and/or interrupt a conversation in progress at the calling party's request. The charge for such service is as follows:

Verification	$0.50
Interrupt	1.00

No charge will apply to the following:

a. When the Operator finds the called telephone line to be out of order.

b. To place a call to or from any public agency whose responsibility it is to provide or render emergency aid.

APPENDIX C
Sheet 6 of 6

AT&T Communications of California - continued

SCHEDULE CAL. P.U.C. 122-T - TELPAK CHANNELS AND SERVICES

This schedule is discontinued and service is withdrawn

SCHEDULE CAL. P.U.C. NO. 128-T - WIDE AREA TELEPHONE SERVICE

OUTWARD WATS

Set-up charge $0.15 per message

ALLOWANCE FOR INTERRUPTIONS

When an outward WATS or 800 service line is interrupted for a period of less than 24 hours, no credit applies.

SCHEDULE CAL. P.U.C. NO. 131-T - OPTIONAL RESIDENCE TELEPHONE SERVICE

This schedule is discontinued and service is withdrawn.

SCHEDULE CAL. P.U.C. NO. 149-T - OPTIONAL CALLING MEASURED SERVICE

This schedule is discontinued and service is withdrawn.

PRIVATE LINE SERVICE - ALL APPLICABLE SCHEDULES

Recurring Rates

The recurring rates and rate structure as set forth in Exhibit No. 730, Part E, are authorized.

Nonrecurring Charges

Increases in nonrecurring charges equal to one-half of the amount of increase set forth in Exhibit No. 736, rounded upward to the nearest $5.00, are authorized.

(END OF APPENDIX C)

A. 82-11-07 et al.
D. 84-06-111

VICTOR CALVO, Commissioner, Dissenting in part:

In Decision 83-12-025, PacBell was assessed a rate of return penalty for certain plant which we determined was underutilized. We allowed PacBell to file for removal of the penalty when the plant in question was being utilized according to specified standards. In Decision 84-04-104, we addressed various petitions for rehearing and, among other actions, decided that PacBell should not be permitted to contest the underutilization penalty until its next general rate case. PacBell filed a petition for rehearing of that action.

In today's order, the majority would reverse that portion of Decision 84-04-104 related to the underutilization penalty. They do so without awaiting our Legal Division's analysis of the PacBell petition for rehearing. They also do so in the absence of the Commissioner to whom this proceeding was previously assigned and who has strong opinions on this particular issue. For these reasons, I must respectfully dissent from that part of this decision which would permit PacBell to contest the underutilization penalty prior to its next general rate case.

/s/ VICTOR CALVO

VICTOR CALVO, Commissioner

June 13, 1984
San Francisco, California

A. 82-11-07 et al.
D. 84-06-111

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Victor Calvo

VICTOR CALVO, Commissioner

June 13, 1984
San Francisco, California