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ORIGINAL

Decision S4 09 121 SEP 19 1984

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.)
_____)

) Application 82-11-07
) (Filed November 4, 1982)

) Application 83-01-22
) (Filed January 17, 1983)

) OII 83-04-02
) (Filed April 20, 1983)

And Related Matters.)
_____)

) Application 83-06-65
) (Filed June 30, 1983)

) (I&S) Case 83-11-07
) (Filed November 22, 1983)

In the Matter of the Application of)
AT&T COMMUNICATIONS OF CALIFORNIA,)
INC., for emergency relief.)
_____)

) Application 84-06-057
) (Filed June 19, 1984)

ORDER MODIFYING DECISION (D.)
84-06-111 AND DENYING REHEARING
THEREOF AND OF D.84-07-121

Applications for rehearing of D.84-06-111 have been filed by Pacific Bell (PacBell), AT&T Communications of California, Inc. (AT&T-C), ABC/CBS, and Western Burglar and Fire Alarm Association; petitions for modifications thereof have been filed

by Toward Utility Rate Normalization (TURN), Allnet Communications Services, Inc. (Allnet), and Telephone Answering Services of California, Inc. (TASC).

Applications for rehearing of D.84-07-121 have been filed by the California Association of Long Distance Telephone Companies (CALTEL), TURN, and MCI Telecommunications, Inc. (MCI); petitions for modification thereof have been filed by CALTEL, Allnet, and GTE Sprint Communications Corporation (GTE Sprint). MCI, together with CALTEL and GTE Sprint, has asked for expedited consideration and for oral argument of the petitions and the applications for rehearing.

AT&T-C has filed responses to the filings of MCI, TURN, Allnet, etc., asking that they be denied in full. MCI and CALTEL, in turn, have replied to those responses.

By D.84-09-086, signed on September 6, 1984, we responded to PacBell's requests regarding procedural and reporting requirements applicable in later hearings. By D.84-09-087, also signed on September 6, 1984, we responded to the issues raised by various parties with respect to PacBell's rates adopted in D.84-06-111. In this order we address the issues raised with respect to AT&T-C's rates adopted in D.84-06-111 and the additional issues raised as to D.84-07-121.

We have carefully considered each and every allegation of error and request for modification and are of the opinion that good cause for granting rehearing of D.84-06-111 or D.84-07-121 has not been shown. However, D.84-06-111 should be modified in certain respects to more clearly set forth our intentions with respect to AT&T-C's Central Management Organization expenses for ratemaking purposes. Also, in response to the many questions raised regarding the competitive impacts of the long-distance

rates and plans approved for AT&T-C, we explain below how we have considered competition in our pricing of AT&T-C's services. Finally, upon reconsideration, we conclude that the Optional Discount Calling Plans A and B adopted for AT&T-C should be modified as set forth below.

MCI contends that "the drastic long-haul toll rate reductions" adopted in D.84-06-111 jeopardize competition in the California long-distance market. According to MCI these reductions have occurred "precisely where they are likely to result in the greatest competitive damage." CALTEL raises somewhat similar objections to the long-haul toll rate reductions, insofar as those reductions, together with the increase in certain WATS charges, tend to narrow the rate advantage enjoyed by WATS users. CALTEL argues that WATS rates should move in tandem with long-haul toll rates.

MCI also calls for the suspension of AT&T-C's Optional Discount Calling Plans A and B, which it described as "predatory" and "blatantly anticompetitive," and particularly criticizes the Commission for "reinstating" Plan A at the originally proposed rate levels. It is apparent from MCI's discussion of the optional plans that it has confused Plans A and B, which offer discounts for off-peak calling and high-volume calling, respectively, with "Options A and B" under a discount plan for off-peak interstate calling which has been approved by the Chief of the Common Carrier Bureau of the Federal Communications Commission (FCC). MCI's criticism is limited to the Plan A off-peak calling discount plan, which resembles the FCC-approved interstate plan.

Allnet and GTE Sprint likewise object to the Commission's approval of Optional Discount Calling Plans A and B. Allnet also misunderstands both Plans A and B as being equivalent to the FCC-

approved "Block-of-Time" off-peak discount plan. Like MCI, Allnet specifically criticizes only Plan A, stating that the \$10.00 monthly charge for the first hour of off-peak calling does not even cover the \$12.30 in access charges assessed to AT&T-C for an hour of calling under PacBell's tariffs.

CALTEL, as part of its objections to the narrowing of the rate advantage enjoyed by WATS users, discussed supra, also criticizes Plan B. CALTEL states that for a subscriber to Plan B with usage exceeding \$1,000 per month, the cost of an on-peak 5-minute call between San Francisco and Los Angeles would be reduced to \$1.61, less than the \$1.66 cost of the same call for certain WATS users. CALTEL urges that the Commission has failed to address the anticompetitive impacts of the adopted rate design, which assertedly will produce "the demise of WATS."

TURN, in requesting modification of D.84-06-111, also objects to the approved version of Plan B, but for a different reason. TURN argues that the Plan B discounts benefit customers with interLATA intrastate toll bills as low as \$200 per month, although there is no evidence that customers with bills this low present a threat of bypass. TURN proposes that Plan B be revised to conform approximately to the intraLATA discount plan approved for PacBell by D.84-06-111.

AT&T-C has responded to the MCI and Allnet petitions by distinguishing between the two optional plans and defending both plans as "beneficial to all customers and offer(ing) the only opportunities for pricing options for those California toll customers whom AT&T Communications' competitors have chosen not to serve." AT&T-C notes that the Commission has recognized that certain elements of AT&T-C rate design "may not be wholly compensatory," such as the directory assistance charge set at 35¢

per call despite evidence that access and billing costs exceed 81¢ per call. AT&T-C asserts that establishment of a fixed principle that every rate for every service element must fully recover costs "would require wholesale redesign of the rates of virtually every carrier in the state...."

AT&T-C challenges CALTEL's calculation of the price advantage of Plan B over WATS service, noting that CALTEL compares the 20% Plan B discount, applicable to bills exceeding \$1,000 per month, to the WATS charges applicable for usage of only 40 hours per month. At higher WATS usage, the WATS charge for a 5-minute call falls significantly below the charge under the Plan B 20% discount. Thus, "AT&T WATS remains attractive to relatively large users...."

In its reply to AT&T-C's response, MCI asserts that there is "not a shred of record support establishing any cost justification" for the long-haul toll rates set by D.84-06-111. In this reply MCI does not further discuss the optional calling plans.

In D.84-06-111 the Commission did not discuss in detail the possible effects on competition of the authorized rate design. We were, however, acutely aware of the increasing relevance of competition for the pricing of the interLATA services of AT&T-C, and this awareness established the context for our consideration of policy directions for regulation of AT&T-C. (Id., mimeo. at 296-299). We specifically found that the authorized reductions in long-haul toll rates would enhance AT&T-C's ability to compete with other toll carriers. (Id., mimeo. at 309). While we did not expressly discuss the impacts of these and other rate changes on AT&T-C's competitors, our "policy directions" discussion made clear our intention that AT&T-C's

rates should, generally speaking, cover at least its marginal costs of service. (Id., mimeo. at 298.) A major reason for applying this standard was and is a concern that we should guard against predatory, below-cost pricing by the dominant long-distance carrier.

A countervailing consideration in some instances is our concern for rate stability. This explains why, although we established a new charge for interLATA directory assistance and higher short-haul toll rates, those charges were not set high enough to recover all AT&T-C costs.

Contrary to MCI's assertion, there is clear, uncontroverted evidence in the record of this proceeding, specifically Exhibit 726 sponsored by AT&T-C witness MacLay, providing cost justification for the toll rate changes effected by D.84-06-111. Exhibit 726 shows that AT&T-C's costs for a 6-minute on-peak call vary between \$1.47 and \$1.53, depending on the length of haul. Prior to D.84-06-111, AT&T-C's rates for short-haul calls fell substantially short of meeting this cost; its medium- and long-haul rates substantially exceeded the cost. D.84-06-111 revised both short-haul and long-haul rates to bring them closer to cost.

Although we are unpersuaded by the attacks on the optional discount calling plans approved by D.84-06-111, we are concerned by our lack of comparably specific evidence to show that these services will cover their costs. We will modify both plans slightly to provide reasonable assurance of cost coverage.

Optional Discount Calling Plan A, which has been the primary object of criticism by MCI and Allnet, appears to be priced below AT&T-C's costs of access. We note that AT&T-C's last proposal for Plan A would have charged \$12.00 for the first hour

of off-peak usage per month and \$10.00 per additional hour, but that D.84-06-111 adopted the originally proposed \$10.00 and \$8.00 charges, respectively, partly "in view of the decreased revenue requirement for AT&T-C." Considering that the final determination of revenue requirement is subject to further review, and in order to assure coverage of AT&T-C's access costs (presently \$12.30) for the first hour of usage, we will revise the authorized charges for Plan A to the levels last proposed by AT&T-C (\$12.00 and \$10.00 per hour plus applicable surcharges). Because access costs constitute nearly the entirety of AT&T-C's costs for off-peak calling (according to Exhibit 726, \$1.33 out of a total cost of \$1.38 for a 6-minute call), and subscribers must pay the full hourly rate for a marginal fraction of an hour of usage, it is unnecessary for the additional hour rate to exceed the hourly access costs.

The only specific criticisms directed to Optional Discount Calling Plan B were CALTEL's concern that its charges would undercut WATS rates and TURN's objection to discounts for usage below the level at which a serious risk of bypass exists. As AT&T-C has suggested, it would only be in a specialized case that the Plan B discount would offer rates more attractive than WATS for the high-volume customers WATS is intended to serve. Still, we can respond to the concerns of both TURN and AT&T-C's competitors by more carefully modelling Plan B to serve its goal of deterring bypass while moderating the discount provided under this plan.

On further consideration we conclude that a discount like that originally proposed by TURN, a one-step 15% discount on that portion of interLATA usage which exceeds \$500 per month, better serves the purpose of bypass deterrence than the two-step plan

approved by D.84-06-111. A 15% discount is consistent with the plan approved for PacBell, while limiting the discount to a single step better recognizes that AT&T-C's access costs do not decline with increased customer usage. We will revise Plan B to replace the present two-step 10% and 20% discounts with a one-step 15% discount applicable only to that portion of the subscriber's monthly usage charges for interLATA intrastate message toll service exceeding \$500.

The changes we are making in Optional Discount Calling Plans A and B are expected to increase AT&T-C revenues. These revenue changes will be taken into account in the course of the further hearings on AT&T-C results of operations to be held pursuant to D.84-07-121. We note that revenue from the 4.21% billing surcharge approved in that decision remains subject to refund.

We recognize that the changes we are requiring in Plans A and B will tend to disrupt AT&T-C's present efforts to market these service offerings. We also recognize that some customers will have subscribed to these plans based on the more favorable terms previously offered. AT&T-C will be allowed to defer the effectiveness of tariff changes regarding the optional discount calling plans for up to 60 days as such changes apply to persons already subscribing to the plans or subscribing within seven days of this order.

No other issues require discussion.

Findings of Fact

1. The interLATA toll rate changes adopted in D.84-06-111 were cost justified.
2. The revised monthly charges last proposed by AT&T-C for

Optional Discount Calling Plan A provide reasonable assurance of cost coverage.

3. An Optional Discount Calling Plan offering a one-step 15% discount on that portion of interLATA usage which exceeds \$500 per month serves the purpose of bypass deterrence while providing reasonable assurance of cost coverage.

4. It is reasonable to defer application of less favorable Optional Discount Calling Plan terms to persons who have subscribed to such plans based on their present, more favorable terms.

Conclusion of Law

1. Optional Discount Calling Plans A and B should be modified slightly to provide reasonable assurance of cost coverage.

INTERIM ORDER

IT IS ORDERED that D.84-06-111 is modified as follows:

1. Modify AT&T-C - Results of Operations - Finding of Fact 5 by adding the underlined text:

"5. Expense to revenue ratios are not an appropriate measure of the reasonableness of utility operating expenses. A more appropriate basis for judging such reasonableness relates the level of operating expenses to the utility's plant in service."

2. Modify AT&T-C - Results of Operations - Finding of Fact 6 by adding the underlined text:

"6. A reasonable cost of operation of

AT&T-C's Finance Department is \$324,010,000. In allocating this cost to California, it is reasonable to use a composite allocation factor made up of employees, assets, and expenses excluding access charges. A reasonable allocation of this cost to AT&T-C's Total California operations is \$25,305,000."

3. Add Finding of Fact 6a to AT&T-C - Results of Operations:

"6a. Although the former Bell System is drastically transformed because of divestiture, the problems caused by subsidiaries of a holding company dealing with each other at less than arm's length remain, and it is reasonable to apply Commission precedents in order to ensure that California ratepayers bear expenses incurred at AT&T's national level only to the extent that such expenses benefit California operations."

4. Add Conclusion of Law 2a:

"2a. Commission precedents, developed during the Commission's regulation of the integration of the former Pacific Telephone & Telegraph Company in the former Bell System, are relevant in regulating AT&T-C's relationship with the Central Management Organization (CMO) of AT&T. These precedents should be used in allocating CMO expenses to AT&T-C unless and until AT&T-C (or other interested party) demonstrates a superior basis for such allocation."

IT IS FURTHER ORDERED that,

1. Within 15 days after the effective date of this order,

AT&T shall file with this Commission, in conformity with the provisions of General Order 96-A, revisions to Section 6.3 of its Tariff Schedule Cal. P.U.C. No. A6, implementing the changes set forth above in Optional Discount Calling Plans A and B. The effective date of the revised tariff sheets shall be 15 days after the date of filing, except that AT&T-C is authorized to defer the effectiveness of such revisions for an additional 30 days with respect to persons who initially subscribed to such Optional Discount Calling Plans no later than seven days after the date of this order. AT&T shall within 90 days file a report on the revenue effects of these changes in Optional Discount Calling Plans A and B.

2. Rehearing of D.84-06-111 and D.84-07-121 is denied.
3. Except as provided herein, modification of D.84-06-111 and D.84-07-121 is denied.
4. The motion for oral argument is denied.

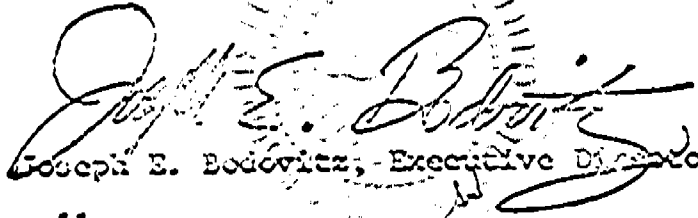
This order is effective today.

Dated SEPT 19 1984, at San Francisco, California.

VICTOR CALVO
PRISCILLA C. GREW
DONALD VIAL
Commissioners

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

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


Joseph E. Bodovitz, Executive Director

Optional Discount Calling Plan A provide reasonable assurance of cost coverage.

3. An Optional Discount Calling Plan offering a one-step 15% discount on that portion of interLATA usage which exceeds \$500 per month serves the purpose of bypass deterrence while providing reasonable assurance of cost coverage.

4. It is reasonable to defer application of less favorable Optional Discount Calling Plan terms to persons who have subscribed to such plans based on their present, more favorable terms.

Conclusions of Law

1. Optional Discount Calling Plans A and B should be modified slightly to provide reasonable assurance of cost coverage.

INTERIM ORDER

IT IS ORDERED that D.84-06-111 is modified as follows:

1. Modify AT&T-C - Results of Operations - Finding of Fact 5 by adding the underlined text:

"5. Expense to revenue ratios are not an appropriate measure of the reasonableness of utility operating expenses. A more appropriate basis for judging such reasonableness relates the level of operating expenses to the utility's plant in service."

2. Modify AT&T-C - Results of Operations - Finding of Fact 6 by adding the underlined text:

"6. A reasonable cost of operation of

A.82-11-07 et al. L/SK:ij

AT&T shall file with this Commission, in conformity with the provisions of General Order 96-A, revisions to Section 6.3 of its Tariff Schedule Cal. P.U.C. No. A6, implementing the changes set forth above in Optional Discount Calling Plans A and B. The effective date of the revised tariff sheets shall be 15 days after the date of filing, except that AT&T-C is authorized to defer the effectiveness of such revisions for an additional 30 days with respect to persons who initially subscribed to such Optional Discount Calling Plans no later than seven days after the date of this order.

2. Rehearing of D.84-06-111 and D.84-07-121 is denied.

3. Except as provided herein, modification of D.84-06-111 and D.84-07-121 is denied.

4. The motion for oral argument is denied.

This order is effective today.

Dated SEP 19 1984, at San Francisco, California.

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

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PRISCILLA C. GREW
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Commissioners