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Decision 88 12 084 DEC 19 1988

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of AT&T COMMUNICATIONS OF CALIFORNIA, INC., a corporation, for authority to increase rates and charges applicable to telecommunications services furnished within the State of California (U 5002 C).	Application 85-11-029 (Filed November 18, 1985)

DEC 2 0 1988

Randolph Deutsch, Richard Bromley, and Michael L. Hurst, Attorneys at Law, for AT&T Communications of California, applicant.

Armour, St. John, Wilcox, Goodin & Schlotz, by Thomas J. Mac Bride, Jr., Attorney at Law, for California Association of Long Distance Telephone Companies; Alan M. Weiss and James L. Lewis, Attorneys at Law, for MCI Telecommunications Corporation; and Phyllis A. Whitten and Craig C. Dingwall, Attorneys at Law, for US Sprint Communications Company, petitioners.

Mark Barmore, Attorney at Law, for Toward Utility Rate Normalization (TURN); Davis, Young & Mendelsohn, by Jeffrey F. Beck, Attorney at Law, for 13 Independent Local Exchange Carriers; John Engel, Attorney at Law, for Citizens Utilities Company of California; A. J. Smithson, for Citizens Utilities of California; Graham & James, by Martin A. Mattes and Rachelle B. Chong, Attorneys at Law, for Extelcom, Inc.; Pelavin, Pelavin, Norberg, by Alvin H. Pelavin, Attorney at Law; and Cooper, White & Cooper, by E. Garth Black and Mark P. Schreiber, Attorneys at Law, for Calaveras Telephone Company, California-Oregon Telephone Company, Ducor Telephone Company, Foresthill Telephone Co., and The Ponderosa Telephone Company, interested parties.

Cindi Rosse, Attorney at Law, and Tom Doub, for the Division of Ratepayer Advocates.

PHASE ONE
OPINION AFTER REHEARING AND
MODIFICATION OF DECISION 88-06-036

By Decision (D.) 88-09-033 we granted a further hearing in this matter limited to six issues (identified at page 7 of that decision). A prehearing conference was held on September 28, 1988 at which time Administrative Law Judge (ALJ) Colgan announced that because of the amount of time which the complete resolution of these complex issues might require, the rehearing would be bifurcated with a first phase hearing solely addressing the question of revisions to rate reductions for the ongoing rates of AT&T Communications of California, Inc. (AT&T-C), (i.e. whether the uniform reduction adopted in D.88-06-036 for all switched services is appropriate or whether a change to a proportional reduction based on the cost reduction for each of these services ought to be adopted instead). This bifurcated treatment assured that this decision on the rate reduction question could be issued in time to be reflected in the decision on AT&T-C's rate flexibility proposal which is also issued today. In the Phase II hearings we will address matters which need not be decided in time for inclusion in the rate flexibility decision, namely, whether the Commission should adopt a method other than a prospective surcredit for returning to AT&T-C's ratepayers AT&T-C expense savings accrued before January 1, 1988, and whether, if a surcredit is adopted it should be uniform for all switched services or proportional to AT&T-C's reduction in costs for each service.

The rate reductions being addressed in Phase I, the ongoing rate reduction phase, include the $163.6 million in annual revenue requirement reductions reflecting prior Commission

decisions which reduced the access charges AT&T-C pays[1] and the revenue savings to AT&T-C from implementation of the Tax Reform Act of 1986, which this Commission had ordered AT&T-C not to flow through immediately, as well as a $4.4 million annual revenue reduction adopted in the second phase of this Commission's review of AT&T-C's 1986 test year results of operations.

The Phase I rehearing of the present matter was held on October 19, 1988. AT&T-C, US Sprint Communications Company (Sprint), MCI Telecommunications Corporation (MCI), and the Commission's Division of Ratepayer Advocates (DRA), each presented the testimony of one witness. Eighteen exhibits were identified and all but three of those were received during the hearing. With the concurrence of the ALJ those three exhibits, Exhibit RH 12, RH 17, and RH 18 were late filed. Copies were served on all parties and these exhibits were received on October 24, 1988. This phase was submitted upon the filing of post-hearing briefs on October 28, 1988. Five parties filed briefs, the four parties named above and Toward Utility Rate Normalization (TURN), a consumer organization representing the interests of residential ratepayers.

MCI's brief was not timely received by our Docket Office. However, MCI filed a motion requesting that the Commission accept its late-filed brief which explains that all other parties and the ALJ were timely served, but that MCI's messenger reached the Docket Office late due to office absences and traffic delays. Since no party will be prejudiced by the acceptance of this late-filed brief, we will order it to be accepted.

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1 The greatest part of this reduction is due to the annual incremental change from the subscriber plant factor (SPF) method of apportioning non-traffic sensitive costs between toll and local services, to a subscriber line usage (SLU) method.

A. Positions of the Parties

1. AT&T-C

AT&T-C's witness, Robert B. Stechert, claims that this Commission's decisions regarding AT&T-C's passing through the savings due to the SPF to SLU phase-down of the local exchange carriers have maintained existing rate relationships among WATS, 800, and MTS rates since 1985. He adds that the discount level for WATS service compared to MTS has ranged between 23.9% and 29.6% since AT&T-C began providing WATS in California in 1984; and that the discount level for 800 service has ranged between 12.3% and 22.8% since AT&T-C began providing that service in California that same year. AT&T-C describes these as "long-established rate relationships" upon which its customers have come to rely and claims that a proportional flow-through would deprive these customers of "an AT&T-C 'alternative'" and would force them to "turn elsewhere to satisfy their communications requirements". AT&T-C sees this as an unfair opportunity for its competitors to gain a market advantage.

Stechert asserts that such an advantage will result because like AT&T-C its competitors have received SPF to SLU access charge decreases, but unlike AT&T-C they have "unfettered freedom" in determining how these decreases will affect their rate design. He argues that maintaining the rate relationship between these three services which exists at present (WATS at 23.9% less than MTS and 800 service at 12.3% less) will protect AT&T-C from unfair competition due to the discrepancy in available rate design options among interexchange carriers.

Based on this discrepancy and on an "increasingly rivalrous" competition as manifested in a 32.5% decrease in AT&T-C's WATS service usage and revenues and the fact that competitors are now "substantially under-pricing AT&T-C's 800 service rates," Stechert urges this Commission to go beyond the consideration of cost in determining how AT&T-C should reflect

these cost decreases. Stechert added, however, that the rate flexibility AT&T-C seeks in I.85-11-013 "would go a long way towards addressing the kind of problem that we see if these access charges are [not] directed on a uniform basis." (Tr. 7457.)

At the same time Stechert argues for maintaining these present rate relationships, he asserts that AT&T-C's rates must fully cover the costs of providing the services. Thus, he testified that "if uniform flow-through of access charge reductions would cause any service to be driven below its costs we would not implement a uniform flow-through of those access charges." (Tr. 7461.)

Stechert calculates that application of a proportional decrease to MTS, WATS, and 800 service to reflect the 1988 SPF to SLU phase-down would result in WATS rates 20% below MTS and 800 service rates 7.5% below MTS. He further calculates that these percentages would diminish during each year of the phase-down through 1992 when they would be 13.6% and 0.1% respectively.

On cross examination by counsel for Sprint, Stechert explained that his determination of the discount levels for AT&T-C's WATS and 800 services was calculated by comparing the average revenue per minute generated by AT&T-C's MTS service at present rates, and at demand levels expected in 1988 to the average revenue per minute generated by AT&T-C's WATS or 800 service at current rates at anticipated 1988 demand levels. Stechert testified that when estimating the discount levels for the comparable service offerings of Sprint and MCI, AT&T-C applied the AT&T-C service demand projections to the current rates of those carriers.

2. DRA

DRA's witness, James J. Simmons urges the Commission to require AT&T-C to apply the access charge reductions on a service-by-service basis in proportion to the savings experienced. He asserts that this methodology would result in lower MTS rates than

AT&T-C's proposal and that it would and should eliminate anticompetitive concerns raised by the Applicants for rehearing. He agrees with AT&T-C that it is this Commission's desire to bring rates closer to economic costs, but dismisses AT&T-C's position that this methodology will not have such an effect, stating that "[s]uch a conclusion could only be reached through a Supplemental Rate Design" proceeding or through further hearings in a reopened AT&T-C general rate case. Simmons goes on to state that if the Commission were to grant a petition to reopen AT&T-C's general rate case, DRA would recommend a supplemental rate design proceeding prior to implementation of a regulatory flexibility plan for AT&T-C, similar to what this Commission ordered for Pacific Bell in I.87-11-033, the proceeding addressing New Regulatory Frameworks (NRF) for local exchange companies.

3. MCI

MCI's witness, Mary E. Wand, takes the position that it is in the public interest and consistent with prior Commission precedent to require AT&T-C to spread cost savings in a manner that identifies cost changes for particular services to the extent possible and then to adjust those rates to reflect such cost changes. She adds that for cost reductions which cannot be associated with a particular service, an across the board rate change is appropriate.

Wand puts reductions in the Carrier Common Line Charge (CCLC) which are due to the SPF to SLU transition into the first category and the remaining cost reductions, namely rate case reductions, changes in the federal tax rules and any other reductions that cannot be associated with a particular service into the second category. She argues that the Commission should set rates as close to cost as the available information and its policy guidelines allow and points out that a majority of the cost savings at issue here can be directly associated with the CCLC.

Wand states that the reduction in the CCLC due to the most recent SPF to SLU phase-down affects per minute costs and therefore affects MTS costs much more than it does WATS or 800 service. She asserts that this is because switched services such as MTS generally are assessed a CCLC for both the originating and the terminating ends of a call while WATS and 800 service, which are directly assigned, only have a CCLC on the open line end. All the parties agree that this is the case. As a consequence, she says, AT&T-C's MTS rates should receive twice the per minute cost reduction that its WATS and 800 services receive. She goes on to claim that such treatment furthers the purpose of striking the reasonable balance between an appropriate contribution to NTS (non-traffic sensitive) costs from access services and the maintenance of fair exchange rates which we sought when we established the SPF to SLU phase-down in D.85-06-115, and adds that a uniform percentage reduction as ordered by D.88-06-036 is inconsistent with that SPF to SLU goal. In its post-hearing brief, MCI reminds us that because of direct assignment of closed end costs for WATS/800 in 1987, and the fact that SPF to SLU reductions affect only the CCLC component of access charges, each annual SPF to SLU phase-down after 1987 reduces AT&T-C's access costs for MTS service (which generally has a CCLC component on each end), more than its access costs for WATS/800 service. Consequently, a uniform pass-through requirement will result in lower rate reductions for MTS than would be warranted by a proportionate pass-through based on service cost.

Wand disputes Finding of Fact 89 in D.88-06-036, claiming that no evidence shows that customers will be any more or less confused by a uniform percentage rate adjustment than with a differential reduction in the per minute rate for switched services or that such rates are more or less costly to administer. Further, she points out that the implementation of the direct assignment of WATS in 1987 was, in effect, a differential rate reduction. In that year we ordered reductions to rates affected by the direct

assignment of WATS costs instead of the annual SPF to SLU phase-down.

Further, Wand asserts that uniform reductions would permit AT&T-C to short change customers of some services while passing through phantom cost reductions to customers of other services, resulting in cross-subsidization and an adverse impact on the competitive marketplace.

4. Sprint

Richard A. Purkey testified on behalf of Sprint. Purkey, like the witnesses for DRA and MCI, takes the position that rate changes should not be uniform across all services but should reflect the changes in AT&T-C's access costs associated with each service category. He also contends that where service categories are disproportionately impacted by access rate changes, rate changes should reflect costs within service categories as well.

His testimony also points out that while AT&T-C claims to support uniform percentage rate adjustments in the present proceeding, Advice Letter (AL) 108 which it filed in response to D.88-08-066 (in which among other things we ordered a partial stay of D.88-06-036 and required certain tariff revisions to accomplish uniform percentage adjustments), fails to comply with our order directing uniform percentage adjustments because while it reduces MTS, WATS, 800, and SDN (software defined network) rates by an overall uniform 10.4%, rates within each of these broad service categories were not uniformly reduced. It does not, for example, reduce full and half-state WATS and 800 service rates uniformly and does not treat call set up rates for WATS uniformly with other rate reductions or uniformly with 800 service set up rates.

Purkey notes that AT&T-C explained its rate design variations with respect to WATS by stating that the application of a uniform percentage reduction to half state WATS rates would drive rates below cost. Purkey opines that to the extent such categories as full-state and half-state service or off-peak and business hour

costs differ, then the rate reduction should reflect the impact of the access charge change on those costs.

He states that application of a uniform percentage reduction departs from cost-based ratemaking and thus insures economically inefficient rates. He claims that the regulatory changes that gave rise to the flowthrough required in this proceeding have decreased MTS costs by approximately 11.4%, while those for WATS and 800 services have decreased by about 6%, and SDN services have decreased by between 7% and 8%.

Purkey claims that this Commission's directive with respect to rate reductions resulting from the direct assignment of the closed end of WATS/800 lines is analogous to the present issue. He cites Commission Resolution T-11091 at p. 5 where we found that the bulk of the access reductions for 1987 are properly attributed to WATS/800 services, and where we concluded that by a rate reduction only to WATS and 800 services, AT&T-C will continue to align its rates with its access expense.

Purkey states that the way to preserve the price to cost relationships which this Commission approved in D.86-11-079, the AT&T-C general rate proceeding, is to pass through costs in proportion to the access cost reductions experienced by each service. He says that to do otherwise allows AT&T-C to effect a major restructuring of rates of its switched services, which is compounded by AT&T-C's application of the "uniform" requirement for major service categories but not to the individual service category rates which this Commission approved.

Purkey also claims that uniform percentage rate reductions might reduce the price of individual services below costs which might then force non-dominant IECs (interexchange carriers) to set their prices below their costs, thereby weakening the non-dominant IECs and reducing competition in interexchange markets. Finally, he also points out that in the AT&T-C rate flexibility proceeding, I.85-11-013, this Commission has allowed

rate setting flexibility around a "reference rate". He argues that a uniform percentage rate reduction could result in reference rates that have little or no relationship to costs or competition, and that granting AT&T-C rate flexibility around such reference rates would permit AT&T-C to then increase rates that were set below costs, thus leading the Commission to erroneously conclude that such services are not subject to sufficient competition to warrant long-term relaxed regulatory treatment. He says such below cost rate setting will impact on market entry and the growth and financial health of non-dominant IECs.

Finally, Purkey disputes our findings of fact regarding customer confusion and increased administrative costs were proportional distribution of cost savings to be adopted. He points out that each of the ALs which AT&T-C has filed in this proceeding, 97, 100, 101, and 108, included widely divergent percentage rate reductions to various rate elements and he asserts that no evidence of customer confusion or increased administrative cost has been shown to exist as it relates to ongoing rate reductions.

5. TURN

TURN did not present a witness in this phase of the rehearing, but filed a post-hearing brief in which it, like the other parties except AT&T-C, argues that this Commission should order a proportionate rate reduction because a uniform percentage adjustment for switched services will shortchange users of MTS and impose a competitive disadvantage on the other common carriers (OCCs). TURN asserts that residential ratepayers, who represent the majority of MTS users, will unfairly subsidize AT&T-C's efforts to gain a competitive edge in its WATS and 800 service offerings, and that competition in interexchange markets will be impeded if the uniform percentage adjustment is authorized.

TURN disputes AT&T-C's claim that there are historical rate relationships which ought to be maintained, arguing that the relationship between MTS and WATS rates has actually fluctuated

over the past several years, and that, as AT&T-C's Stechert conceded, MTS and 800 service are not very cross-elastic anyway, and thus there is no relevance to any such relationship. Further, TURN states that this Commission has already granted AT&T-C some level of rate flexibility by its decision in D.87-07-017, and should not permit further modification of AT&T-C's current rate design in light of that imminent ability to adjust rates.

B. Discussion

As all the parties have pointed out, the greatest proportion (around 80%) of the cost reductions which AT&T-C is being directed to flow through to its customers in this proceeding, is attributable to access charge reductions stemming from the annual SPF to SLU transition. This transition is a means of apportioning NTS costs between toll and local services. Specifically, this annual shift affects the CCLC element of access charges which AT&T-C and other IECs pay the local exchange carriers.

We determined that AT&T-C's present rates were reasonable in its last rate proceeding. Now those rates must be reduced in some way to reflect these cost reductions, especially the SPF to SLU reductions. In contrasting the effects of the two proposals for reducing rates, uniform and proportional, the essential argument of the parties before us in the present phase of this proceeding is about whether it is more important to preserve the relationship of overall rates between AT&T-C's major switched service categories or to preserve the relationship between each rate and its underlying cost. We are convinced that Ordering Paragraph 3 in D.88-06-036 which ordered uniform rate reductions is unreasonably inconsistent with our previous policy in this area and that it should be amended to instead require proportional rate adjustments which will preserve the relationship of rates to costs.

We disagree with AT&T-C's suggestion that adoption of a proportional rather than a uniform rate reduction necessarily

ignores this Commission's long-standing rate design goals in favor of blind adherence to a single automatic cost-factor adjustment. We do not deny the importance of the many rate design factors we cited in D.84-06-111, such as rate relationships, elasticity of demand and related revenue repression, and general effects on customers. However, it must be remembered that it is not the purpose of the present proceeding to redesign rates, but only to return certain overcollections to AT&T-C's ratepayers. Furthermore, as AT&T-C itself points out, this Commission intended that the SPF to SLU phase-down which accounts for the major portion of these rate changes be accomplished uniformly and without any significant alteration of AT&T-C's established rate design. Contrary to AT&T-C's interpretation, we believe the best way to avoid significant alteration of the established rate design is to preserve the relationship of rates to costs where that is feasible.

This position is not a change from any earlier one. Our policy with respect to SPF to SLU has been, since its inception, one of "gradually and moderately diminishing access services revenue requirement". (D.85-06-115 at p. 40.) A policy of gradual and moderate change is consistent with our general policy to move telephone rates toward costs. It is inconsistent, however, with a policy which would alter the relationship of rates to costs every year of the phase-down without providing rate design hearings. AT&T-C's claim that there is a clear and convincing precedent for a uniform percentage adjustment misconstrues our SPF to SLU policy. The "precedent" it refers to consists of two years, 1986 when a uniform percentage adjustment would not have altered the relationship of rates to costs because we had not yet implemented the WATS/800 closed end cost assignment thereby removing half the CCLC charges from these services, and 1987 when we only implemented the WATS/800 cost assignment. The 1988 phase-down is the first one where this rate/cost relationship has been specifically before us.

Sprint's Purkey testified, based on workpapers filed with the Commission by AT&T-C with AL 100 and 101, that AT&T-C's overall 10.37% 1988 access cost savings is attributable to its major switched service categories in the following percentages of expected 1988 pre-flowthrough revenues:

Service	Percentage
MTS	11.41%
WATS	6.09
800	5.93
SDN	7.53

We believe that these figures reasonably represent the change in the relationship of rates to costs for each of these service categories resulting from cost changes experienced by AT&T-C through June 30, 1988. However, as AT&T-C pointed out in its comments to the ALJ's proposed decision filed in this matter on November 15, 1988, these percentages do not reflect further flow-through adjustments ordered after June 30, 1988; i.e., adjustments due to D.88-07-022 which increased AT&T-C's access expenses to provide support for the intrastate High Cost Fund, in D.88-08-061 which reduced the revenue requirement of General Telephone of California, Inc. (GTEC) and thereby decreased AT&T-C's access expenses. Further, the percentages cited by Purkey do not reflect the 1989 SPF to SLU reduction which AT&T-C will receive. Therefore, we will adopt these percentages as appropriate through June 30, 1988 and direct AT&T-C to file a rate design based on these figures, but further adjusted on a proportional basis to reflect its later expense changes.

AT&T-C's comments propose a methodology which would add its 1988 cost reductions and its 1989 cost reductions and would then apply that reduced amount in determining the appropriate tariff rates for 1989. Because these 1988 and 1989 figures are based on different volumes, this methodology is inappropriate since it could result in AT&T-C passing through less than its actual cost

reduction. Instead, we will direct AT&T-C to develop its tariffs to be effective January 1, 1989, by beginning with 1988 rates which incorporate expense savings due to the 1988 SPF to SLU phase-down and other smaller rate changes reflected in Advice Letters 100 and 101, and expense savings due to GTEC attrition reflected in Advice Letter 109; and to then add 1989 rate changes, including the proportional effects of the 1989 SPF to SLU reduction and any other adjustments this Commission may order.

We are troubled by Stechert's testimony that it is AT&T-C's intent to comply with Ordering Paragraph 3 of D.88-06-036 only to the extent that uniformly spread rates will, in AT&T-C's opinion, cover costs. This position presents two obvious problems. First, as we found in D.88-08-066, such an "interpretation" of Ordering Paragraph 3 would permit AT&T-C to deviate from the clear requirement of that ordering paragraph that rates be uniform. Second, even if it were somehow reasonable to deviate from the plain language of our order in that way, AT&T-C's cost decisions apparently would be premised upon cost data which are not before us in this proceeding. Before we could adopt such a rate spread it would be necessary, as DRA points out, for AT&T-C to present cost evidence in support of such a rate design deviation in a proceeding at which other parties were provided the opportunity to test the accuracy of AT&T-C's cost claims, as we required of Pacific Bell in the NRF for local exchange companies proceeding, I.87-11-033. Although, we are not here retaining the uniform rate reduction we previously ordered, we are still concerned with how AT&T-C will implement the adopted rate reduction <u>within</u> each service category. The approach Stechert testified about with respect to implementation of our prior order is not satisfactory. Absent an evidentiary record, we agree with Sprint's Purkey that there is no basis for AT&T-C to deviate from these adopted percentages for any rate within the service categories. Rates within service

categories should uniformly reflect the proportional effect of the CCLC change on the service category.

Although any rate flexibility granted in A.87-10-039 would allow AT&T to alter the cost/rate relationship in the future, it is the purpose of our 7-year SPF to SLU phase-down to pass cost savings through to customers on a service category basis. We therefore intend for AT&T to minimize the discrepancy between costs and rates, at least through 1992, by applying a proportional percentage adjustment to all its subsequent SPF to SLU filings.

Further, we agree with the applicants for rehearing of this matter that there is no evidence in the record to support a conclusion that a uniform percentage rate adjustment for switched services will minimize customer confusion and administrative costs. We will therefore modify D.88-06-036 by striking Finding of Fact 89.

Finally, we note that in addition to the comments we received to the ALJ's proposed decision from AT&T-C, we also received and considered comments from MCI and Sprint. As a consequence of the comments of these two parties we have clarified the second ordering paragraph, below.

C. Procedural Issues

1. Effect of this Order

Because of the need to incorporate this decision into AT&T-C's rate flexibility decision in A.87-10-039, we will make this decision effective today. However, it should be kept in mind that our resolution of the issues for which rehearing has been granted is only partial as a result of this decision. Further hearings on November 28, 1988 address the remaining issues regarding treatment of memorandum account sums.

2. Service List

An updated service list is attached to this decision as Attachment A. This is the official service list for this

proceeding until such time as it is updated further by the Commission or an ALJ.

Findings of Fact

1. MCI's post-hearing brief was not filed on time.

2. It is the Commission's general policy to move the rates for telephone services toward costs.

3. The majority of cost savings which AT&T-C is being directed to flow through to its customers is due to the annual SPF to SLU phase-down.

4. The cost savings to AT&T-C from the SPF to SLU phase-down arises from reductions in the CCLC.

5. AT&T-C's basic switched service categories, WATS, 800 Service, MTS, and SDN, do not benefit uniformly from reductions in the CCLC.

6. A service category rate reduction which reflects the cost savings for that category would retain the relationship between AT&T-C's costs and its rates; a uniform rate reduction would change those relationships.

7. The discrepancy between costs and rates can be minimized during the remainder of the SPF to SLU phase-down by applying rate changes which reflect the cost savings for each service category realized from the phase-down.

8. There is no evidence in the record to support Finding of Fact 89 in D.88-06-036 which states that a uniform rate reduction for AT&T-C's switched service rates will minimize customer confusion and administrative costs.

9. In order to incorporate this decision into the AT&T-C rate flexibility decision, this decision should be effective at once.

Conclusions of Law

1. Acceptance of MCI's late-filed brief will not prejudice any party.

2. Ordering Paragraph 3 of D.88-06-036 is inconsistent with the general Commission policy of moving rates closer to costs insofar as it requires uniform rate reductions rather than proportional rate reductions based upon the cost differences attributable to reductions in CCLC charges.

3. Proportional rate reductions based upon cost differences attributable to reductions in CCLC charges stemming from present and subsequent SPF to SLU cost adjustments would be consistent with general Commission policy.

4. Finding of Fact 89 in D.88-06-036 should be stricken for lack of factual basis.

O R D E R

IT IS ORDERED that:

1. MCI's late-filed post-hearing brief is accepted.

2. The first sentence of Ordering Paragraph 3 of D.88-06-036 is amended to read as follows:

> Within 10 days of the effective date of this order AT&T-C shall file an advice letter with revised tariff sheets to reflect a proportional percentage adjustment of its ongoing rates and surcharges for switched services consistent with the discussion, findings, and conclusions of this decision. The effective date of the tariff revisions should be January 1, 1989.

These tariff sheets shall be effective on January 1, 1989. All future SPF to SLU filings shall reflect this same proportional percentage adjustment methodology. Individual rate elements within each service category shall uniformly reflect the proportional effect of the CCLC change on that service category.

A.85-11-029 *

ATTACHMENT A

MASTER LIST
A.85-11-029
[illegible] I.D. #L02867
[illegible]VISED 10/28/88

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CORRECTION

THIS DOCUMENT HAS

BEEN REPHOTOGRAPHED

TO ASSURE

LEGIBILITY

2. Ordering Paragraph 3 of D.88-06-036 is inconsistent with the general Commission policy of moving rates closer to costs insofar as it requires uniform rate reductions rather than proportional rate reductions based upon the cost differences attributable to reductions in CCLC charges.

3. Proportional rate reductions based upon cost differences attributable to reductions in CCLC charges stemming from present and subsequent SPF to SLU cost adjustments would be consistent with general Commission policy.

4. Finding of Fact 89 in D.88-06-036 should be stricken for lack of factual basis.

O R D E R

IT IS ORDERED that:

1. MCI's late-filed post-hearing brief is accepted.

2. The first sentence of Ordering Paragraph 3 of D.88-06-036 is amended to read as follows:

> Within 10 days of the effective date of this order AT&T-C shall file an advice letter with revised tariff sheets to reflect a proportional percentage adjustment of its ongoing rates and surcharges for switched services consistent with the discussion, findings, and conclusions of this decision. The effective date of the tariff revisions should be January 1, 1989.

These tariff sheets shall be effective on January 1, 1989. All future SPF to SLU filings shall reflect this same proportional percentage adjustment methodology. Individual rate elements within each service category shall uniformly reflect the proportional effect of the CCLC change on that service category.

3. The challenge to Finding of Fact 89 of D.88-06-036 by applicants for rehearing is accurate. Finding of Fact 89 is stricken.

This order is effective today.

Dated December 19, 1988, at San Francisco, California.

STANLEY W. HULETT
President
DONALD VIAL
FREDERICK R. DUDA
G. MITCHELL WILK
JOHN B. OHANIAN
Commissioners

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

Victor Weisser, Executive Director

A.85-11-029

ATTACHMENT A

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PHASE ONE
OPINION AFTER REHEARING

By Decision (D.) 88-09-033 we granted a further hearing in this matter limited to six issues (identified at page 7 of that decision). A prehearing conference was held on September 28, 1988 at which time Administrative Law Judge (ALJ) Colgan announced that because of the amount of time which the complete resolution of these complex issues might require, the rehearing would be bifurcated with a first phase hearing solely addressing the question of revisions to rate reductions for the ongoing rates of AT&T Communications of California, Inc. (AT&T-C), (i.e. whether the uniform reduction adopted in D.88-06-036 for all switched services is appropriate or whether a change to a proportional reduction based on the cost reduction for each of these services ought to be adopted instead). This bifurcated treatment assured that this decision on the rate reduction question could be issued in time to be reflected in the decision on AT&T-C's rate flexibility proposal which is also issued today. In the Phase II hearings we will address matters which need not be decided in time for inclusion in the rate flexibility decision, namely, whether the Commission should adopt a method other than a prospective surcredit for returning to AT&T-C's ratepayers AT&T-C expense savings accrued before January 1, 1988, and whether, if a surcredit is adopted it should be uniform for all switched services or proportional to AT&T-C's reduction in costs for each service.

The rate reductions being addressed in Phase I, the ongoing rate reduction phase, include the $163.6 million in annual revenue requirement reductions reflecting prior Commission

decisions which reduced the access charges AT&T-C pays[1] and the revenue savings to AT&T-C from implementation of the Tax Reform Act of 1986, which this Commission had ordered AT&T-C not to flow through immediately, as well as a $4.4 million annual revenue reduction adopted in the second phase of this Commission's review of AT&T-C's 1986 test year results of operations.

The Phase I rehearing of the present matter was held on October 19, 1988. AT&T-C, US Sprint Communications Company (Sprint), MCI Telecommunications Corporation (MCI), and the Commission's Division of Ratepayer Advocates (DRA), each presented the testimony of one witness. Eighteen exhibits were identified and all but three of those were received during the hearing. With the concurrence of the ALJ those three exhibits, Exhibit RH 12, RH 17, and RH 18 were late-filed. Copies were served on all parties and these exhibits were received on October 24, 1988. This phase was submitted upon the filing of post-hearing briefs on October 28, 1988. Five parties filed briefs, the four parties named above and Toward Utility Rate Normalization (TURN), a consumer organization representing the interests of residential ratepayers.

MCI's brief was not timely received by our Docket Office. However, MCI filed a motion requesting that the Commission accept its late-filed brief which explains that all other parties and the ALJ were timely served, but that MCI's messenger reached the Docket Office late due to office absences and traffic delays. Since no party will be prejudiced by the acceptance of this late-filed brief, we will order it to be accepted.

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1 The greatest part of this reduction is due to the annual incremental change from the subscriber plant factor (SPF) method of apportioning non-traffic sensitive costs between toll and local services, to a subscriber line usage (SLU) method.

assignment of WATS costs instead of the annual SPF to SLU phasedown.

Further, Wand asserts that uniform reductions would permit AT&T-C to short change customers of some services while passing through phantom cost reductions to customers of other services, resulting in cross-subsidization and an adverse impact on the competitive marketplace.

4. Sprint

Richard A. Purkey testified on behalf of Sprint. Purkey, like the witnesses for DRA and MCI, takes the position that rate changes should not be uniform across all services but should reflect the changes in AT&T-C's access costs associated with each service category. He also contends that where service categories are disproportionately impacted by access rate changes, rate changes should reflect costs within service categories as well.

His testimony also points out that while AT&T-C claims to support uniform percentage rate adjustments in the present proceeding, Advice Letter (AL) 108 which it filed in response to D.88-08-066 (in which among other things we ordered a partial stay of D.88-06-036 and required certain tariff revisions to accomplish uniform percentage adjustments), fails to comply with our order directing uniform percentage adjustments because while it reduces MTS, WATS, 800, and SDN (software defined network) rates by an overall uniform 10.4%, rates within each of these broad service categories were not uniformly reduced. It does not, for example, reduce full and half-state WATS and 800 service rates uniformly and does not treat call set up rates for WATS uniformly with other rate reductions or uniformly with 800 service set up rates.

Purkey notes that AT&T-C explained its rate design variations with respect to WATS by stating that the application of a uniform percentage reduction to half state WATS rates would drive rates below cost. Purkey opines that to the extent such categories as full-state and half-state service or off-peak and business hour

ignores this Commission's long-standing rate design goals in favor of blind adherence to a single automatic cost-factor adjustment. We do not deny the importance of the many rate design factors we cited in D.84-06-111, such as rate relationships, elasticity of demand and related revenue repression, and general effects on customers. However, it must be remembered that it is not the purpose of the present proceeding to redesign rates, but only to return certain overcollections to AT&T-C's ratepayers. Furthermore, as AT&T-C itself points out, this Commission intended that the SPF to SLU phase-down which accounts for the major portion of these rate changes be accomplished uniformly and without any significant alteration of AT&T-C's established rate design. Contrary to AT&T-C's interpretation, we believe the best way to avoid significant alteration of the established rate design is to preserve the relationship of rates to costs where that is feasible.

This position is not a change from any earlier one. Our policy with respect to SPF to SLU has been, since its inception, one of "gradually and moderately diminishing access services revenue requirement". (D.85-06-115 at p. 40.) A policy of gradual and moderate change is consistent with our general policy to move telephone rates toward costs. It is inconsistent, however, with a policy which would alter the relationship of rates to costs every year of the phase-down without providing rate design hearings. AT&T-C's claim that there is a clear and convincing precedent for a uniform percentage adjustment misconstrues our SPF to SLU policy. The "precedent" it refers to consists of two years, 1986 when a uniform percentage adjustment would not have altered the relationship of rates to costs because we had not yet implemented the WATS/800 closed end cost assignment thereby removing half the CCLC charges from these services, and 1987 when we only implemented the WATS/800 cost assignment. The 1988 phasedown is the first one where this rate/cost relationship has been specifically before us.

Sprint's Purkey testified, based on workpapers filed with the Commission by AT&T-C with AL 100 and 101, that AT&T-C's overall 10.37% 1988 access cost savings is attributable to its major switched service categories in the following percentages of expected 1988 pre-flowthrough revenues:

Service	Percentage
MTS	11.41%
WATS	6.09
800	5.93
SDN	7.53

We believe that these figures reasonably represent the change in the relationship of rates to costs for each of these service categories resulting from cost changes experienced by AT&T-C for 1988. Therefore, we will adopt these percentage change figures and direct AT&T-C to file a rate design which reflects them.

We are troubled by Stechert's testimony that it is AT&T-C's intent to comply with Ordering Paragraph 3 of D.88-06-036 only to the extent that uniformly spread rates will, in AT&T-C's opinion, cover costs. This position presents two obvious problems. First, as we found in D.88-08-066, such an "interpretation" of Ordering Paragraph 3 would permit AT&T-C to deviate from the clear requirement of that ordering paragraph that rates be uniform. Second, even if it were somehow reasonable to deviate from the plain language of our order in that way, AT&T-C's cost decisions apparently would be premised upon cost data which are not before us in this proceeding. Before we could adopt such a rate spread it would be necessary, as DRA points out, for AT&T-C to present cost evidence in support of such a rate design deviation in a proceeding at which other parties were provided the opportunity to test the accuracy of AT&T-C's cost claims, as we required of Pacific Bell in the NRF for local exchange companies proceeding, I.87-11-033. Although, we are not here retaining the uniform rate reduction we previously ordered, we are still concerned with how AT&T-C will

implement the adopted rate reduction within each service category. The approach Stechert testified about with respect to implementation of our prior order is not satisfactory. Absent an evidentiary record, we agree with Sprint's Purkey that there is no basis for AT&T-C to deviate from these adopted percentages for any rate within the service categories. Rates within service categories should uniformly reflect the proportional effect of the CCLC change on the service category.

Although any rate flexibility granted in A.87-10-039 would allow AT&T to alter the cost/rate relationship in the future, it is the purpose of our 7-year SPF to SLU phase-down to pass cost savings through to customers on a service category basis. We therefore intend for AT&T to minimize the discrepancy between costs and rates, at least through 1992, by applying a proportional percentage adjustment to all its subsequent SPF to SLU filings.

Finally, we agree with the applicants for rehearing of this matter that there is no evidence in the record to support a conclusion that a uniform percentage rate adjustment for switched services will minimize customer confusion and administrative costs. We will therefore modify D.88-06-036 by striking Finding of Fact 89.

C. Procedural Issues

1. Effect of this Order

Because of the need to incorporate this decision into AT&T-C's rate flexibility decision in A.87-10-039, we will make this decision effective today. However, it should be kept in mind that our resolution of the issues for which rehearing has been granted is only partial as a result of this decision. Further hearings on November 28, 1988 address the remaining issues regarding treatment of memorandum account sums.

2. Service List

An updated service list is attached to this decision as Attachment A. This is the official service list for this

proceeding until such time as it is updated further by the Commission or an ALJ.

Findings of Fact

1. MCI's post-hearing brief was not filed on time.

2. It is the Commission's general policy to move the rates for telephone services toward costs.

3. The majority of cost savings which AT&T-C is being directed to flow through to its customers is due to the annual SPF to SLU phase-down.

4. The cost savings to AT&T-C from the SPF to SLU phase-down arises from reductions in the CCLC.

5. AT&T-C's basic switched service categories, WATS, 800 Service, MTS, and SDN, do not benefit uniformly from reductions in the CCLC.

6. A service category rate reduction which reflects the cost savings for that category would retain the relationship between AT&T-C's costs and its rates; a uniform rate reduction would change those relationships.

7. The discrepancy between costs and rates can be minimized during the remainder of the SPF to SLU phase-down by applying rate changes which reflect the cost savings for each service category realized from the phase-down.

8. There is no evidence in the record to support Finding of Fact 89 in D.88-06-036 which states that a uniform rate reduction for AT&T-C's switched service rates will minimize customer confusion and administrative costs.

9. In order to incorporate this decision into the AT&T-C rate flexibility decision, this decision should be effective at once.

Conclusions of Law

1. Acceptance of MCI's late-filed brief will not prejudice any party.

2. Ordering Paragraph 3 of D.88-06-036 is inconsistent with the general Commission policy of moving rates closer to costs insofar as it requires uniform rate reductions rather than proportional rate reductions based upon the cost differences attributable to reductions in CCLC charges.

3. Proportional rate reductions based upon cost differences attributable to reductions in CCLC charges stemming from present and subsequent SPF to SLU cost adjustments would be consistent with general Commission policy.

4. Finding of Fact 89 in D.88-06-036 should be stricken for lack of factual basis.

O R D E R

IT IS ORDERED that:

1. The Commission's Docket Office shall accept MCI's late filed post-hearing brief.

2. The first sentence of Ordering Paragraph 3 of D.88-06-036 is amended to read as follows:

> Within 5 days of the effective date of this order AT&T-C shall file an advice letter with revised tariff sheets to reflect a proportional percentage adjustment of its ongoing rates and surcharges for switched services consistent with the discussion, findings, and conclusions of this decision. The effective date of the tariff revisions should be January 1, 1989.

These tariff sheets shall be effective on January 1, 1989. All future SPF to SLU filings shall reflect this same proportional percentage adjustment.

2. Ordering Paragraph 3 of D.88-06-036 is inconsistent with the general Commission policy of moving rates closer to costs insofar as it requires uniform rate reductions rather than proportional rate reductions based upon the cost differences attributable to reductions in CCLC charges.

3. Proportional rate reductions based upon cost differences attributable to reductions in CCLC charges stemming from present and subsequent SPF to SLU cost adjustments would be consistent with general Commission policy.

4. Finding of Fact 89 in D.88-06-036 should be stricken for lack of factual basis.

O R D E R

IT IS ORDERED that:

1. The Commission's Docket Office shall accept MCI's late filed post-hearing brief.

2. The first sentence of Ordering Paragraph 3 of D.88-06-036 is amended to read as follows:

> Within 10 days of the effective date of this order AT&T-C shall file an advice letter with revised tariff sheets to reflect a proportional percentage adjustment of its ongoing rates and surcharges for switched services consistent with the discussion, findings, and conclusions of this decision. The effective date of the tariff revisions should be January 1, 1989.

These tariff sheets shall be effective on January 1, 1989. All future SPF to SLU filings shall reflect this same proportional percentage adjustment methodology. Individual rate elements within each service category shall uniformly reflect the proportional effect of the CCLC change on that service category.

A.85-11-029

ATTACHMENT A

MASTER LIST-PHASE II
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C.P.U.C. I.D. #L02867
REVISED 10/28/88

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3. The challenge to Finding of Fact 89 of D.88-06-036 by applicants for rehearing is accurate. Finding of Fact 89 is stricken.

This order is effective today.

Dated _____, at San Francisco, California.