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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Investigation on the regulatory framework for InterLATA Telecommunications Market.	I.85-11-013 (Filed November 13, 1985)
Application of AT&T Communications of California, Inc. for limited regulatory flexibility.	A.87-10-039 (Filed October 30, 1987)

(For appearances see Appendix A.)

I N D E X

CORRECTION

THIS DOCUMENT HAS

BEEN REPHOTOGRAPHED

TO ASSURE

LEGIBILITY

I N D E X

O P I N I O N

I. Summary

Today's decision grants, in part, AT&T Communications of California, Inc.'s (AT&T-C) request for limited regulatory flexibility in accordance with the guidance we set forth in D.87-07-017. We allow AT&T-C both upward and downward flexibility in its rate bands. However, in instances where the requested flexibility is greater than ± 15%, we limit the authorized rate band to 15% above and below the reference rates. In instances where AT&T-C has requested less than 15% flexibility, rate bands are adopted as proposed at hearings. Since AT&T-C's reference rates will change as a result of other decisions we make today, we will order a compliance filing by AT&T-C to incorporate its new reference rates and rate bands that we authorize today.

We adopt AT&T-C's proposed definition of new services which will be allowed to be introduced via the advice letter process after uniform costing methodology is developed in an application. However, we will not allow AT&T-C's PRO California application to be the forum for developing a uniform costing methodology for new services. By AT&T-C's own admission, PRO California is not a "new service" and therefore an inappropriate vehicle to develop uniform costing methodology for all future new services.

We order that the advice letter process for new services must take the full forty days allowed under General Order (GO) 96-A instead of a shortened period as proposed by AT&T-C.

Finally, we adopt CACD's proposed monitoring plan to aid the Commission in "observing" the effects of the flexibility we grant AT&T-C today.

II. Procedural Background

By its Application (A.) 87-10-039, AT&T-C seeks approval of its plan for limited regulatory flexibility consistent with the Observation Approach defined by the Commission in its Interim Opinion of July 8, 1987 (D.87-07-017). D.87-07-017 was our first decision in Investigation (I.) 85-11-013, which we opened in 1985 to establish a framework for consideration of whether, and on what terms, regulatory flexibility should be granted to AT&T-C, the dominant firm in the interLATA telecommunications market. Originally, in I.85-11-013, our approach was to determine that AT&T-C's market power was greatly attenuated or absent before easing regulation of AT&T-C. Parties filed extensive comments and reply comments stating their positions on AT&T-C's market power and the state of competition in California. In D.87-07-017, after reviewing these comments, we recognized that it would not be possible, even after extensive proceedings, to reach any concrete conclusions or predictions about AT&T-C's market power. Therefore, we laid out the parameters of the Observation Approach which would allow AT&T-C to file an application reducing the need for conclusions regarding market power prior to implementing regulatory change.

Under the Observation Approach, the effects of regulatory flexibility would be measured rather than predicted. Limited flexibility would be granted initially and the results closely monitored to assess actual market place responses and any benefits or costs to ratepayers. As we stated in D.87-07-017, the pricing flexibility which we would be willing to grant initially under such an Observation Approach would be relatively limited because of our concerns about the potential adverse impacts of AT&T-C using such flexibility to wield market power.

In D.87-07-017 we offered AT&T-C the option to file an application following the original approach envisioned in the

I.85-11-013 in which the granting of flexibility would rest on a prior determination that AT&T-C's market power was too weak to allow it to engage in anti-competitive practices. (Also known as the Prediction Approach.)

In addition to offering AT&T-C the choice of filing an application under either the Prediction Approach or the Observation Approach, the Commission also initiated the development of a monitoring plan in D.87-07-017. In compliance with Ordering Paragraph 2 of D.87-07-017 the Commission Advisory and Compliance Division (CACD) filed a report, presenting a monitoring program which CACD believed would enable the Commission to measure and assess the impact flexibility may have on AT&T-C's competitors and customers of interLATA services in California. The proposed monitoring plan was the outcome of workshops participated in by many parties. CACD's proposed monitoring plan and parties' comments on that plan will be discussed in a later section below.

On October 30, 1987, AT&T-C opted to file an application under the Observation Approach. The Division of Ratepayer Advocates (DRA) filed its opposition to AT&T-C's original application, arguing that AT&T-C's submission of financial and cost data was incomplete, and that AT&T-C had failed to address certain matters required by D.87-07-017. Several other protests were filed to that application by the following parties: General Telephone Company of California, U.S. Sprint Communications Company (US Sprint), MCI Telecommunications Corporation (MCI), Toward Utility Rate Normalization (TURN), Pacific Bell, and several independent telephone companies. Some of these protestants also argued that AT&T-C had not provided sufficient cost justification to support its application for rate flexibility. AT&T-C replied to these protests on December 8, 1987, requesting a waiver of those sections of Rule 23 of the Commission's Rules of Practice and Procedure which required a detailed cost presentation by AT&T-C.

Additionally, AT&T-C sought a ruling from the Commission on the completeness of its application.

On December 21, 1987, the assigned Commissioner issued his ruling which directed AT&T-C to amend its original application. AT&T was ordered to comply with Rules 23(c) and 23(e) by amending its application "to provide three intrastate rate of return summaries, using a depreciated rate base for 1988, showing intrastate results if (1) rates were raised the maximum amount requested for all services for all of 1988, (2) rates were lowered the maximum amount requested, and (3) rates were maintained at the midpoints." (Assigned Commissioner Ruling, p. 3.) The ruling also concluded that Rules 23(c) and 23(j), requiring information be provided by rate classifications, should be waived. Likewise, the requirements of Rules 23(f), 23(i), and 23(l), were also waived.

On February 3, 1988, AT&T-C filed its amended application in order to comply with the requirements of the assigned Commissioner's December ruling. As allowed by the assigned Commissioner ruling, several parties filed comments on AT&T-C's amended application: DRA, TURN, MCI, US Sprint, California Association of Long Distance Telephone Companies (CALTEL), and Pacific Bell.[1] In its comments, DRA requested and was granted an opportunity to file additional reply comments.

On April 6, 1988, AT&T-C submitted a letter to the then assigned Administrative Law Judge (ALJ) and all parties of record offering modifications to its initial proposal. Additionally, AT&T-C sought the ALJ's support in conducting a settlement conference in an effort to resolve outstanding issues without the need for additional comments or hearings. The ALJ gave AT&T-C and all parties until May 10, 1988 to continue its settlement discussions, requiring submission of a joint status report. By

1 Pacific Bell later withdrew its protest on April 14, 1988.

letter dated May 10th, 1988, AT&T-C with the concurrence of all parties, requested additional time to continue settlement discussions. AT&T-C requested until May 31, 1988 to submit another joint status report outlining any agreements which may be reached and stating whether there is any reason to continue settlement discussions. On May 31, 1988 AT&T-C informed the ALJ that further settlement discussions would not be productive, and proposed that further comments be solicited on AT&T-C's proposal.

A prehearing conference was scheduled for June 16, 1988 where the ALJ established the schedule for the remainder of this proceeding. AT&T-C was ordered to serve testimony incorporating any modifications to its amended application on July 15, 1988. In addition, AT&T-C was instructed to file a separate document or "position paper" addressing whether hearings were necessary for each element of its proposal. Any additional comments on monitoring plan issues were also to be included in that position paper. All other parties were required to file testimony and position papers on August 26, 1988. (Later extended to August 30, 1988.) As to each issue of AT&T-C's proposal parties were instructed to state in their position papers whether they believed hearings were necessary and their basis for that opinion.

On August 9, 1988, MCI filed a motion to compel responses to information requests and for adjustment to the procedural schedule. The ALJ directed MCI and AT&T-C to meet and confer immediately in an effort to informally resolve their discovery dispute. Their dispute centered on the detail of cost data that AT&T-C should be required to provide parties under the Observation Approach. The parties were unable to reach agreement. In addition, US Sprint filed a similar motion to compel on September 1, 1988. AT&T-C filed its response to MCI's motion on August 22, 1988 and to US Sprint's motion to compel on September 9, 1988.

On September 16, 1988 the ALJ issued a ruling resolving both discovery motions and determining which issues would be addressed in hearings. While still asserting that cost data was irrelevant under the Observation Approach, AT&T-C offered to provide cost data restricted to long run incremental costs (LRIC) on a service-by-service basis in the spirit of compromise. The ALJ adopted AT&T-C's suggested compromise regarding the motions to compel.

Based on evaluation of the position papers filed by the parties, the ALJ ruled that three issues would be addressed in hearings and were the proper subject for rebuttal testimony. Those issues were: (1) should upward flexibility be allowed in the rate bands? (2) what is the appropriate width of the rate bands? and (3) what conditions should control AT&T-C's offering of new services? Other issues regarding AT&T-C's proposal, were believed by the ALJ to be adequately addressed by the parties' position papers. However, parties were allowed to file additional comments on these issues in their final briefs in this proceeding.

Hearings commenced on October 3, 1988 and concluded on October 6, 1988. This matter was submitted upon the filing of concurrent opening briefs on October 18, 1988 and concurrent reply briefs on October 25, 1988. The parties filing briefs in this proceeding included AT&T-C, US Sprint, MCI, DRA, CALTEL, and TURN. Finally, in compliance with the ALJ's order, AT&T-C submitted late-filed Exhibit 17. No party has objected to the admission of Exhibit 17 into evidence. Mr. Sidney Webb, while participating in the hearings, did not file either opening or reply briefs.

Comments

Comments on the ALJ's proposed decision were filed by MCI, US Sprint, TURN, and DRA. Reply comments were filed by AT&T-C and DRA. These comments have been reviewed and carefully considered by the Commission. Any changes required by the comments have been incorporated in this opinion.

III. Summary of AT&T-C's Current Proposal

In order to understand better the sections to follow we will now briefly describe AT&T-C's current proposal. Our summary of AT&T-C's proposal here is not an endorsement of the entire package. Our endorsement or rejection of each of the elements of AT&T-C's proposal will be discussed in later sections of this decision.

Fundamentally, AT&T-C seeks approval of rate bands around the rates adopted by the Commission in AT&T-C's current rate case (A.85-11-029), and the ability to change rates and introduce new services through established advice letter filing procedures. AT&T-C maintains that this would afford it some relaxation of present regulatory restraints while still providing sufficient protection to AT&T-C's California customers and competitors.

The first component of AT&T-C's proposal are rate bands for each rate element of its Message Toll Service (MTS), Wide Area Telephone Service (WATS), 800 service, and Private Line Service, including a limited band for new services. AT&T-C's proposed rate bands for its MTS, WATS, and 800 service are set forth in Appendix B to this decision. AT&T-C proposes a rate band of plus or minus 10% for all private line service elements. Additionally, AT&T-C proposes that any new service offering will have an upward flexibility no greater than 10% above its original price, and a downward flexibility set at or above the LRIC for the new service.

The second basic element of AT&T-C's proposal is the flexibility to introduce new services, in a manner which AT&T-C believes is more consistent with the streamlined procedure currently allowed all of AT&T-C's interexchange competitors. AT&T-C has returned to the definition of new services of its original application, meaning an offering which customers perceive as a new service and which has a combination of technology, access, features, or functions that distinguishes it from any existing service.

The third basic element of AT&T-C's proposal is the adoption by the Commission of a standardized costing methodology which AT&T-C will use in support of future advice letter filings. Following the adoption of this standardized methodology, AT&T-C

proposes to provide appropriate cost information with any advice letter filing seeking to revise a rate outside of an approved rate band or when it introduces a new service. Given the time frame of this proceeding, AT&T-C recognized and urged that the Commission not approve such a standardized costing methodology in this proceeding. AT&T-C recommends that the issue be addressed in AT&T-C's A.88-08-051, its request to provide AT&T-C PRO California. AT&T-C acknowledges, however, that its PRO-California does not meet its own definition of a new service.

The fourth basic element of AT&T-C's proposal is a request for, in its view, limited exceptions from existing advice letter filing procedures. First, AT&T-C seeks a 5-day notice period to adjust rates within approved rate bands. AT&T-C maintains that its competitors currently enjoy this limited notice period for any rate changes. Second, AT&T-C requests a 20-day notice period for any revision of a rate element below the lower band of an approved rate band, and for any reduction of an existing rate for which no rate band has been established, whenever that revision is consistent with a national plan already approved by the Federal Communications Commission (FCC).

The fifth basic element of AT&T-C's proposal is a monitoring plan. AT&T-C supports the CACD recommended monitoring plan in all respects except the scope of its proposed pilot program. The details of AT&T-C and other parties comments on CACD's monitoring plan will be discussed in a later section of this decision. The final element of AT&T-C's proposal consists of several additional commitments by AT&T-C designed to assure the Commission that AT&T-C cannot abuse what it views as limited flexibility outlined above. AT&T-C commits to: (1) maintain statewide average rates; (2) introduce all new services on a statewide basis; (3) make only four revisions within approved rate bands per service per year; (4) not impose restrictions on the resale and sharing of its services; (5) not abandon any service

except by formal application to the Commission; (6) not seek to withdraw any service from a community on a geographically discriminatory basis; (7) use the formal application process for any new service submission or for the revision of existing service where that submission or revision departs from the approved standard costing methodology; and (8) use the formal application process for any service submission that utilizes a combination of existing tariff services discounted in order to provide a competitive response to a specific customer.

AT&T-C believes that its proposal, summarized above, meets all of the requirements of the Observation Approach as defined in D.87-07-017. In the sections to follow we will discuss the concerns of other parties regarding AT&T-C's proposal.

IV. Should "Upward Flexibility" be Allowed in the Rate Bands?

Parties have disagreed since AT&T-C filed its original application in October, 1987 as to whether AT&T-C should be allowed upward flexibility from its current rates in a rate band proposal under the Observation Approach. It is our understanding that disagreement over this issue was a major reason the parties were unable to settle this case. Both sides of this controversy rely on D.87-10-017 to support their view.

A. DRA's Position

DRA believes that AT&T-C should be granted no upward flexibility from current rates. DRA believes that present rates should represent the upward cap in the rate bands. DRA points to various sections of D.87-07-017 to support its concern regarding the dangers of upward flexibility.

> "Based on widespread agreement among regulatory economists, we posited in the OII that the effects of loosening of interLATA regulation would hinge on the extent of AT&T-C's market power. If pricing flexibility is granted while AT&T-C retains significant market power, it may

> engage in various types of anticompetitive pricing practices. It may increase its return above levels realized by truly competitive firms through the formation of an oligopolistic market with price following by the OCCs. On the other hand, it could undercut the OCCs by predatory pricing practices supported by cross-subsidization from noncompetitive services." (D.87-07-017 mimeo. p. 7.)

DRA argues that the Commission recognized that the ratepayers, AT&T-C, and the other common carriers (OCCs) had potentially conflicting as well as common interests. DRA believes that the Commission acknowledged that a rate flexibility plan requires a balancing of these interests. A plan such as AT&T-C has proposed in DRA's view, would benefit AT&T-C and some ratepayers with high volume and elastic demand and could harm other ratepayers with low volume or inelastic demand as well as the OCCs.

DRA notes that the Commission offered AT&T-C two alternatives for seeking relaxed regulation. D.87-07-017 invited AT&T-C to file a proposal under either the Prediction Approach developed in I.85-11-013 or the Observation Approach developed in D.87-07-017. Under the Prediction Approach, the Commission directed AT&T-C to demonstrate a reduction in market power and to use such measures to help predict the outcome of any flexibility. DRA interprets this decision as allowing AT&T-C greater flexibility the more convincing its demonstration of lack of market power under the Prediction Approach. However, under the Observation Approach, DRA notes that the Commission would not require any showing of the absence of market power. The Observation Approach would require a monitoring program and permit less pricing flexibility initially. Thus, in DRA's view the Commission offered AT&T-C a tradeoff between price flexibility and a demonstration of the absence of market power. However, DRA maintains that the Commission did not offer specific guidelines to define the degree of pricing flexibility appropriate under each approach. Therefore, DRA

believes that the Commission intended to proceed cautiously because of its repeated concerns regarding AT&T-C's possible abuse of its market power.

DRA acknowledges that the Commission stated that if AT&T-C proposed rate bands with midpoints set at the rates approved in the pending AT&T-C rate case (A.85-11-029), then AT&T-C was not required to file further "detailed cost studies" (Id., p. 68). DRA maintains that this requirement seemingly allows AT&T-C greater discretion if it accepts the 1986 rate case rates as midpoints than if it chooses midpoints which are even slightly different. DRA believes that such an interpretation is clearly incorrect and that the Commission's language reinforces its interest in limiting rate flexibility. DRA notes that with this language, the Commission is expressing strong interest in using the 1986 rate case rates as a reference. With the delay of regulatory flexibility until 1989, DRA points out that the 1986 rates do not necessarily reflect changes in input prices and productivity which has occurred in the interim between the test year 1986 and the present.

DRA argues that in determining the regulatory flexibility that should be granted to AT&T-C under the Observation Approach, the Commission must realize there is some inherent risk to the ratepayer. Indeed, the Commission expressed a concern about "the potential harm to ratepayers of allowing companywide flexibility" (Id., p. 5). Additionally, DRA argues that the Commission, by calling for a monitoring plan to track the effects of requested flexibility, clearly recognized the risks of granting a dominant carrier regulatory flexibility. By accepting DRA's proposed cap at current rates, while at the same time allowing other customer's rates to be lowered, DRA claims the Commission will reduce the potential adverse effects of rate flexibility while retaining nearly all of its benefits. DRA concurs with the Commission's goal of bringing the benefits of a competitive telecommunications market to California. DRA also agrees that while the goal of the

Commission was not to protect AT&T-C's rivals, the OCCs, nonetheless, their existence is vital for effective competition in California (Id., p. 18). DRA believes upward flexibility will hinder the development of effective competition.

Further, DRA believes that there should be a slow transition from the current rate design to one in which competition drives prices toward costs. Because calling patterns of customers have evolved as a result of historical rate design, both customers and telecommunications providers would be disrupted by sudden change in the rate relationships among services. DRA claims this is further support for their proposal to cap the rate bands at current rates.

DRA argues that allowing AT&T-C to change its rates up and down within the rate band with a cap at current rates would provide the obvious benefit of raising no customer's rates while allowing some customers' rates to decrease. DRA points to its recent motion to reopen AT&T-C's general rate case because DRA believes AT&T-C is currently earning in excess of its authorized rate of return. Existing rates provide AT&T-C with a reasonable rate of return, in DRA's view, justifying no circumstance where AT&T-C would need upward flexibility. DRA asserts that by denying the company the ability to increase its rates above current rates in noncompetitive services, the Commission would reduce the ability of AT&T-C to engage in predatory pricing and other anti-competitive pricing policies.

DRA does not believe that AT&T-C provided any convincing evidence as to why it needs upward flexibility. AT&T-C alleges that it needs the ability to raise its rates to bring rates more in line with costs. But in DRA's view, the record indicates that the cost of providing services was below the bottom of the proposed rate bands. DRA is not persuaded by AT&T-C's argument that it needs to be able to raise its rates in the event of future cost increases. DRA points to Exhibit 17 to show that the trend of

AT&T-C's network costs is lower rather than higher costs. In addition, since current rates are well above current incremental costs, DRA maintains prices could increase significantly before AT&T-C would have to increase its rates. Further, DRA points to the testimony of AT&T-C witness Stechert, anticipating increased productivity for AT&T-C. The margin between current costs and current rates, combined with expected productivity gains associated with competition, will in DRA's view, more than offset any potential increases in costs during the initial phase of rate flexibility. Therefore, DRA claims there is no need for upward flexibility at this time.

Finally, DRA raises the question of whether the Commission can legally grant AT&T-C upward pricing flexibility. DRA cites Public Utilities (PU) Code § 454:

> "(a) ...no public utility shall raise any rates or so alter any classification, contract, practice, or rule as to result in any increase in any rate, except upon a showing before the Commission and a finding by the Commission that the increase is justified."
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> * * *
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> "(c) The Commission shall permit individual, residential, public utility customers affected by a proposed rate increase to testify at any hearing on the proposed increase..."

AT&T-C's proposal allows it to raise residential and other rates within the rate band using procedures similar to advice letter filings with provisions for comments within a specified number of days. DRA acknowledges that it could be argued that the proposed procedure constitutes a showing within the meaning of § 454. However, DRA believes that it would be a far better practice for the Commission to conduct public hearings before any

increase in residential rates were allowed. This, in DRA's view, is another reason not to grant any upward flexibility.

Further, DRA cites PU Code § 454.2[2] for the proposition that the Legislature has only authorized zones of rate freedoms or rate bands for the transportation industry. DRA suggests that since the Legislature amended PU Code § 454 to exclude passenger stage corporations from the provisions of that section, supports DRA's argument that the flexibility sought by AT&T-C in this proceeding must fall within the provisions of § 454. DRA argues that the problems surrounding the need for public hearings before any rate increase is granted can be solved neatly if the Commission simply adopts DRA's position and forbids upward rate flexibility.

B. TURN's Position

Like DRA, TURN maintains, as it has from the beginning of this proceeding, that upward flexibility is inconsistent with the laws of California. TURN cites PU Code §§ 451 and 454(a) for the proposition that all public utility charges must be just and reasonable, and the utility carries the burden of proving that such a rise in rates is justified.

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2 PU Code § 452.2 reads as follows:

"Notwithstanding Section 454, the commission may, upon application, establish a 'zone of rate freedom' for any passenger stage transportation service which the commission finds is operating in competition with another substantially similar passenger stage transportation service or competitive passenger transportation service from any other means of transportation, if the Commission finds that these competitive transportation services will result in reasonable rates and charges when considered along with the authorized zone of rate freedom. An adjustment in rates or charges within a zone of rate freedom established by the Commission is hereby deemed just and reasonable. The Commission may, upon protest or on its own motion, suspend any adjustment in rates or charges under this section and institute proceedings pursuant to Section 491."

TURN argues that just and reasonable rates connotes some narrow range of reasonableness, but that range is heavily dependent upon the relationship that particular rate shares with rates for other services or service elements. TURN notes that AT&T-C's guiding principles recognize the importance of historical rate relationships. Under a rate flexibility scheme, that relationship is subject to flux, making it possible to distort those historical relationships. Thus, in TURN's view, it is impossible to determine the reasonableness of rates into the future, unless the Commission can conclude that even if AT&T-C were to exercise its upward flexibility to the absolute limit of every service element, the resulting rates would be reasonable regardless of the circumstances surrounding the increase. Unless the Commission can do this, TURN asserts that the Commission is empowering AT&T-C with the ability to charge rates which are not just and reasonable.

TURN also cites PU Code § 728 to support its position that upward flexibility is illegal. TURN notes that after a hearing, if the Commission finds the rates demanded by a utility are not just and reasonable, the Commission "...shall determine and fix, by order, the just, reasonable, or sufficient rate, classifications, rules, practices, or contracts to be thereafter observed and in force" (PU Code § 728). TURN argues that the language of § 728 implies that rate flexibility is not within the realm of just and reasonable rates. The Code's reference to "rate" as opposed to "rates" is instructive in TURN's view. The remaining directives within the Code § are all plural which reinforces TURN's notion that the Legislature intended that only a single rate, not a rate band with many possible rates, could be deemed just and reasonable in considering the entire array of rates for services and the relationship between those services.

TURN believes that in light of the language found in these code sections, the Commission would be imprudent to follow a path of rate flexibility, particularly upward flexibility, without

a clear directive from the Legislature. TURN argues that the necessary and convenient clause of PU Code § 701 is a general mandate for the Commission's power which should not be used to circumvent the Legislative intent behind other sections of the PU Code.

c. AT&T-C's Position

AT&T-C maintains that upward pricing flexibility, within limited rate bands to be approved by the Commission, was clearly intended by the Commission as part of the Observation Approach and is not prohibited by any law, rule, or regulatory principle. AT&T-C points out that such upward flexibility is a central element of the Observation Approach and is necessary for any Commission determination of whether competition in the intrastate interLATA market could be an eventual substitute for traditional rate base, rate of return regulation. Moreover, in AT&T-C's view, upward flexibility is absolutely essential if AT&T-C is to respond to the needs of its customers and to operate effectively in the long distance marketplace.

AT&T-C relies on D.87-07-017 to support its proposition that upward flexibility is an integral part of the Observation Approach. AT&T-C agrees that "...narrow rate bands around rates approved in AT&T-C's general rate proceeding...appear to be the most promising avenue of flexibility if the Observation Approach is followed." (Id., p. 5.) Further, AT&T-C quotes that decision for the proposition that a detailed assessment of AT&T-C's costs would only be necessary if AT&T-C requested a "change in the midpoints of the bands from rates to be adopted in A.85-11-029." (Id., p. 68.) AT&T-C asserts that the form of limited flexibility envisioned by the Commission most certainly includes the flexibility to adjust prices upward as well as downward within those bands. AT&T-C proposes that the rates adopted by the Commission in AT&T-C's general rate proceeding will constitute a reference point between the upper and lower limits of the proposed rate bands. Thus AT&T-C

coined the term "reference rates" to refer to the approximate midpoint of its rate bands.

AT&T-C disagrees strenuously with the assertions of DRA and TURN that upward pricing flexibility is illegal. AT&T-C discusses at length in its brief the dramatic changes that long distance telecommunications businesses have undergone since the breakup of the Bell System on January 1, 1984. AT&T-C suggests that both Federal and State Commissions have recognized that the sort of traditional regulation necessary for utilities to provide a monopoly services is no longer applicable to the highly competitive interLATA marketplace which has emerged. AT&T-C asserts that its competitors are nearly universally free of traditional rate base, rate of return regulation. AT&T-C points out that 28 of the nation's 39 multiLATA states have already granted AT&T-C some form of regulatory flexibility. (Exhibit B to AT&T-C's Application Amendment, February 3, 1988.)

AT&T-C claims that this Commission has also acknowledged the evolutionary development in the communications industry and is fully aware of the need to adjust existing forms of regulation to accommodate this transformation. Citing D.84-06-113, AT&T-C points out that the Commission relieved all of AT&T-C's competitors of the requirements of the traditional rate of return utility regulation. All of these interexchange companies are now free to introduce new services and to adjust prices up or down in response to the demands and pressures of the competitive marketplace, without prior Commission review. AT&T-C points out that no one has challenged the authority of this Commission to grant all other interexchange companies what amounts to complete ratemaking flexibility.

AT&T-C further cites D.84-06-113 for the proposition that the Commission's intention was, when it had gained more experience with this new competitive industry, to examine whether and to what extent AT&T-C should also be granted some degree of regulatory flexibility. (Id., p. 95.) AT&T-C asserts that the Observation

Approach, including upward pricing flexibility, is a reasonable and legally permissible first step in that process. AT&T-C alleges that there is nothing in the PU Code which binds this Commission to the use of a traditional rate base, rate of return form of regulation. It is obvious to AT&T-C, that the Commission has the same statutory discretion to consider flexible regulation for AT&T-C as it had in granting complete flexibility to the other interexchange companies.

AT&T-C believes that PU Code § 701[3] provides the Commission ample statutory authority to establish an appropriate and effective form of flexible regulation for all interexchange companies, including AT&T-C. AT&T-C believes that the Commission is not restricted to a cost of service form of regulation.

AT&T-C asserts that the Commission is not required to set rates which produce revenues exactly equal to a revenue requirement determined pursuant to a rate base, rate of return method of regulation. AT&T-C cites Federal case law for the proposition that the touchstone, at both the State and Federal level, for determining whether rates are just and reasonable is whether they fall within a so-called "zone of reasonableness" (Jersey Central Power and Light v FERC, (1985) 768 F 2nd 1500, 1503). AT&T-C argues that the zone is bounded at the lower end by the investors' interest against confiscation, (FPC v Natural Gas Pipeline, (1942) 315 US 575, 585). AT&T-C cites Farmer's Union Central Exchange versus FERC, (1984) 734 F 2nd 1486, 1502), for the proposition that the upper end of a zone of reasonableness is bounded by the

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3 Section 701 states:

"The commission may supervise and regulate every public utility in the State and may do all things, whether specifically designated in this part or in addition thereto, which are necessary and convenient in the exercise of such power and jurisdiction."

consumer's interest against exorbitant rates. AT&T-C believes that any proposed alternative to cost-of-service regulation must result in a reasonable balance between those consumer and investor interests. AT&T-C believes that the Commission's Observation Approach recognizes the existence of competition and is designed to test how effective that competition is in driving prices toward costs, into the zone of reasonableness. Further, AT&T-C maintains that the comprehensive monitoring plan recommended by CACD offers the Commission a sufficient mechanism for detecting and correcting any failure of interLATA market forces to accomplish this task. AT&T-C does not believe that the Commission is abdicating its responsibility by recognizing the competitive realities that now exist in the long distance communications business. On the contrary, AT&T-C asserts that the public interest will be more adequately served by permitting AT&T-C to exercise limited flexibility in adjusting its rates upward or downward, within the approved bands, in response to the demand and constraints of the competitive marketplace.

AT&T-C does not believe that certainty regarding the degree of competition is necessary prior to the grant of any regulatory flexibility, citing TURN v PUC, 22 3d 529 (1978). That case dealt with TURN's appeal of the Commission's decision to implement local measured service in certain geographic areas. AT&T-C states that TURN alleged that the rate change at issue constituted automatic rate increases with no justification that such rates are just and reasonable. AT&T-C argues that the court found that where practical experience would provide the required answers, it was not unreasonable to implement the rate change requested and monitor the results to obtain hard data.

AT&T-C maintains that the Commission is confronted with a similar fact pattern in this proceeding. AT&T-C cites D.87-07-017 for the proposition that the Commission has recognized the impracticality of obtaining information on AT&T-C's market power

and has proposed a limited experiment to develop practical experience and information on that issue via its Observation Approach. Second, AT&T-C points out that the Commission has required a comprehensive monitoring program which in conjunction with its continuing regulatory authority, will allow the Commission to act should any problem arise. Finally, AT&T-C argues that the Commission has before it in this proceeding a sufficient record to find that this experiment in regulatory flexibility will offer a reasonable and fair method for setting rate bands. AT&T-C points out the Commission has made it absolutely clear that it reserves the right to withdraw any pricing flexibility if it determines, at anytime, that the marketplace is unable to effectively control AT&T-C's behavior (D.87-07-017, p. 4). AT&T-C argues that the Commission's selection of limited flexibility and its proposed monitoring plan constitutes a reasonable discharge of its responsibility to maintain rates that are just and reasonable.

AT&T-C suggests that this "first step" of granting AT&T-C limited regulatory flexibility is not a total abandonment of rate of return regulation. AT&T-C contends that the limited pricing bands proposed by AT&T-C are directly related to the rates which the Commission has authorized in AT&T-C's rate case. The Commission's adopted rate will serve as the reference point for the rate band thus allowing the Commission to establish just and reasonable rates, according to AT&T-C. AT&T-C argues that the Commission has ample statutory authority and discretion to grant the degree of flexibility that they have requested in this proceeding.

AT&T-C claims that limited pricing flexibility, both upward and downward, is essential for several reasons. First, AT&T-C believes it needs the freedom to make adjustments within service categories to more closely match prices to cost. Second, AT&T-C claims to need the freedom to make price adjustments between service categories to respond more effectively to competition by

lowering some prices and raising others. Third, AT&T-C claims it needs the freedom to adjust prices to assure a reasonable return. Without the ability to adjust prices in both directions, AT&T-C believes it will have no opportunity to react effectively to the demands of its customers and to respond to the competitive pressures of the interLATA marketplace.

In conclusion, AT&T-C argues that the preclusion of upward pricing flexibility would essentially destroy the fundamental purpose of the Observation Approach. If the Commission's intention is to grant some flexibility and observe the impact of AT&T-C's exercise of that flexibility in order to determine if the marketplace is sufficiently competitive to control AT&T-C's behavior, upward flexibility is necessary for there to be a meaningful test. As AT&T-C Stechert testified:

> "...the Commission has recognized that if competition is effective, market forces will maintain prices at reasonable levels. However, in order to protect ratepayers against the possibility that competition is not fully developed and an effective substitute for regulation, the Commission may wish to set an interim ceiling on prices--but that ceiling must be high enough to permit a fair opportunity to observe whether competition is able to control market behavior. If the ceiling is set too low, the observed outcome will reveal little concerning the vigor of competition." (Exhibit 1 p. 5.)

D. Other Parties' Position

Other parties that participated actively in the hearings do not oppose the concept of upward flexibility for AT&T-C. MCI, US Sprint, CALTEL, and Mr. Sidney Webb, all agree that AT&T-C should be allowed some amount of upward rate flexibility. However, the degree of that upward flexibility is an issue that all parties have varying opinions on and will be discussed in the section to follow regarding the width of rate bands.

E. Discussion

We agree with AT&T-C that we stated our position clearly in D.87-07-017 that we would entertain a proposal which included upward pricing flexibility. We purposely used the term midpoint rather than cap in discussing the relationship we expected AT&T-C's rate bands to have with the rates adopted in its most recent general rate case. In our numerous references to pricing flexibility in that prior decision, we made no caveat suggesting that it was only downward flexibility which we intended. We intended the Observation Approach to effectively replace the extensive data requirements and analysis necessary prior to granting flexibility under the Prediction Approach. Because of our concerns about potential adverse impacts if AT&T-C uses such flexibility to wield market power, the pricing flexibility which we would be willing to grant initially under the Observation Approach would be relatively limited. But at no time did we suggest that only downward flexibility would be appropriate for consideration.

We believe that AT&T-C has adequately rebutted the arguments of illegality that DRA and TURN have raised on this issue. We note that the purpose of the Observation Approach is to in fact observe AT&T-C's behavior once that flexibility is granted. Therefore, we believe that granting AT&T-C some limited form of both upward and downward flexibility will result in just and reasonable rates. We believe we have ample authority under the PU Code and case authority to grant this limited flexibility. We disagree with TURN's assertion that public witness hearings were necessary before granting AT&T-C some limited upward flexibility. AT&T-C may or may not choose to exercise the upward flexibility that we grant them today. The purpose of the Observation Approach is to give AT&T-C an opportunity to respond to the marketplace in setting prices around its current rate case prices.

We emphasize our commitment to carefully monitor the effects of the flexibility we grant AT&T-C today both upward and

downward. As we stated in D.87-07-017 we will not hesitate to rescind what we give today if AT&T-C behaves in a way that is detrimental to the interests of ratepayers. While we here endorse the concept of upward flexibility, the amount of that flexibility, both in an upward and downward fashion will be discussed in the section to follow.

V. What is the Appropriate Width of the Rate Bands?

A. Is The Cost Data That AT&T-C Made Available To Other Parties Sufficient To Justify The Size of Its Proposed Rate Bands Under The Observation Approach?

1. Background

The debate over whether AT&T-C has adequately cost-justified the width of its proposed rate bands has been controversial throughout this proceeding. Prior to the commencement of hearings MCI and US Sprint filed motions to compel production of cost data. The debate focuses on what the Commission meant in D.87-07-017 when it said that "detailed" cost studies were not necessary under the Observation Approach. How "detailed is detailed" is the question the parties could not resolve. As discussed earlier in this decision, the ALJ ruling of September 16, 1988 ordered production of the results of the LRIC studies on a service-by-service category, i.e. MTS, WATS, etc. MCI and US Sprint continue to maintain that that information ordered produced is inadequate to determine whether in fact AT&T-C could possibly price certain rate elements below costs under its rate flexibility proposal.

2. MCI's Position

MCI has consistently maintained in its statement of position, testimony, and briefs that the cost data AT&T-C has provided regarding its rate bands is insufficient for the Commission to determine whether the width of those rate bands are

just and reasonable. MCI stresses that it has supported the concept of relaxed regulation for AT&T-C, including pricing flexibility for new and existing services. However, MCI believes that the record developed in this proceeding conclusively demonstrates that the particular rate bands proposed by AT&T-C do not, in all cases, satisfy the requirements of the Observation Approach. MCI asserts that the evidence, limited though it was, shows that AT&T-C's rate bands do not cover the cost of providing a service on a rate element by rate element basis. Within each service there are many rate elements. For example, within the MTS service there are many mileage rate elements. MCI argues that the rate band around each rate element must be above cost. MCI disputes AT&T-C's assertion that so long as the service as a whole is priced above costs, no harm can occur.

MCI calls AT&T-C's proposal the "blind faith approach" rather than the Observation Approach endorsed by this Commission in D.87-07-017. MCI asserts that AT&T-C itself raises the issue of cost coverage for its proposed rate bands. But then AT&T-C claims that when other parties attempted to determine whether AT&T-C's proposed rate bands do, in fact, cover costs, AT&T-C went back to its earlier argument that its costs are not an appropriate issue under the Observation Approach. MCI asserts that the Commission's determination that detailed cost studies were not necessary under the Observation Approach was not meant to preclude any analysis of AT&T-C's costs.

MCI argues that in order to prevent cross-subsidization and other anti-competitive practices each proposed rate band must cover the cost of providing a service on an rate element by rate element basis. MCI agrees that the Observation Approach does not require a finding that a competitive market exists before granting any pricing flexibility to AT&T-C. However, MCI urges a cautious approach to any relaxation of the regulatory procedures currently

applied to AT&T-C. MCI witness Wand testified, "...absent a finding that AT&T-C lacks market power, the need to examine AT&T-C's underlying costs is essential to prevent the specific anti-competitive practices identified by the Commission" (Exhibit 12, p. 2). MCI asserts that if AT&T-C is permitted to implement rate bands with floors below the cost of a particular rate element, it will allow AT&T-C to set certain rates below cost and cross-subsidize if it chooses to do so. MCI believes that they have demonstrated that below-cost pricing for certain rate elements may inhibit competition and cause some AT&T-C ratepayers to cross-subsidize others, within the same service. For example, because AT&T-C's short-haul rates tend to be priced below cost, MCI believes the effect of allowing AT&T-C's proposed rate band would cause some ratepayers within an MTS service to subsidize others. MCI believes this same potential for cross-subsidization exists in the 800 and WATS markets as well. MCI relies on its Exhibit 14, admitted into evidence under seal, to support its views. Exhibit 14 consists of tables derived from the cost data that AT&T-C provided to MCI pursuant to the September 16th ALJ Ruling.

MCI disagrees with AT&T-C's assertion that the concept of cross-subsidization does not really apply within a service. MCI argues that the record establishes that the same potential for anti-competitive pricing exists within a service as well as between services.

MCI claims that AT&T-C does not dispute that many of its individual rate elements are priced below cost at the lower end of the proposed rate bands. For example, AT&T-C's witness Mr. Parker, acknowledged that most of the rate elements for the night and weekend portion of MTS are priced below cost at the lower end of the proposed band. Parker also verified that the first mileage band for the day portion of MTS is also priced below cost. (Tr. Vol. 2, p. 249.)

MCI believes that the testimony of its witness Wand demonstrates, based on the summary cost results provided by AT&T-C, that many of the proposed rate bands do not cover the cost of providing a service on a rate-element by rate-element basis.

MCI disagrees with the ALJ's Ruling of September 16th to the extent that it required AT&T-C to provide an LRIC analysis on a service-by-service as opposed to a rate-element by rate-element basis. MCI argues that the summary cost results that were provided by AT&T-C are in fact not responsive to the ALJ's Ruling in its brief. The cost data, in MCI's view, fails to allow, as ordered by the ALJ, "...enough analysis to determine if services are being offered below cost..." (ALJ Ruling of September 16, 1988, p. 3.)

MCI argues that the 4-page summary provided to MCI pursuant to the ALJ Ruling falls far short of permitting any kind of reasonable analysis of whether AT&T-C's proposed rate bands allow services to be offered below cost. The summary was supposed to represent AT&T-C's LRIC for MTS, WATS, and 800 Service. MCI witness Wand testified that the summary identifies AT&T-C's access cost and network cost on a per-minute and per-message basis for each service. She states that all incremental costs other than access costs are provided under a single item, AT&T-C network incremental cost. (Tr. Vol. 4, p. 403.) MCI continues to object to the fact that AT&T-C provided MCI with no underlying calculations which could be used to verify the summary results.

In addition, MCI believes that the reliability of the cost summary provided by AT&T-C is in serious doubt. Several errors were uncovered by MCI witness Wand and US Sprint witness Purkey after receiving the cost summary shortly before hearings commenced. MCI argues that in the absence of an opportunity to review any of the underlying numbers, the parties and the Commission cannot be sure whether there may be additional inadvertent errors that remain undiscovered.

Even more significantly, MCI claims that the parties and the Commission have no way to verify that all appropriate components were in fact included in the cost summary results. MCI points to the testimony of AT&T-C witness Parker for the proposition that it is impossible to determine what components were included in the cost summary. (MCI opening brief p. 13.) MCI points to the confusion during the hearings as to whether or not, for example, the cost study prepared by AT&T-C included a component for return on capital. MCI argues that neither the parties nor the Commission have any way of making an independent determination of which components were or were not included in the cost study. Based on these circumstances, MCI argues that AT&T-C's summary cost studies cannot be relied upon to support the proposed rate bands as reasonable under the Observation Approach.

3. US Sprint's Position

US Sprint basically agrees with MCI that AT&T-C has inadequately justified its costs supporting the lower end of the proposed rate bands through its scanty cost data. US Sprint argues that in failing to provide any more than minimal cost information, AT&T-C places great reliance on the Commission's language at page 68 of D.87-07-017 where the Commission states that it "would be willing to consider limited flexibility relative to the rate structure which will be adopted in A.85-11-029 [AT&T-C's rate case], using the Observation Approach, without a requirement that detailed cost studies be submitted and scrutinized." US Sprint asserts that the Commission concluded that a "detailed assessment of AT&T-C's cost would be necessary if AT&T-C requests a change in the midpoint of the band from the rates to be adopted in A.85-11-029...such assessment would be necessary in order to determine the reasonableness of the requested changes" (Id., p. 68).

US Sprint believes that midpoints as discussed in D.87-07-017 must represent exact midpoints of the rate bands. US Sprint points to AT&T-C witness Stechert's testimony where he stated, "If you define midpoints in a technical fashion, to mean symmetrical pricing upwards and downwards, then the flexibility we have asked for is not around the midpoint" (Tr. Vol. 1, p. 54). US Sprint objects to AT&T-C's creation of a new term, reference rates, instead of midpoints. US Sprint argues that AT&T-C's interpretation of midpoints to mean reference rates has no support in any Commission decision. US Sprint submits that AT&T-C has requested a change in the midpoint of its bands, by proposing more downward flexibility than upward flexibility in its bands.

US Sprint argues that although the Commission indicated it would not require AT&T-C to provide "detailed" cost information under the Observation Approach, AT&T-C has supplied its own definition of "detailed" as meaning little or no verifiable information. US Sprint, like MCI, disputes the usefulness accuracy and adequacy of the summary results of AT&T-C's LRIC studies provided pursuant to the ALJ Ruling of September 16th, 1988.

US Sprint sought cost information in order to test the assumptions used by AT&T-C to establish its bands. US Sprint witness Purkey believes that the price bands proposed by AT&T-C are not limited because AT&T-C's flexibility request appears to equal 60% of the amount of AT&T-C's nonaccess/billing expenses, including return on investment. (Exhibit 8, p. 10.) US Sprint witness Purkey testified that "the Commission and US Sprint have no way of knowing what costs AT&T-C considered in its study, or whether it included all costs relevant to such an analysis" (Exhibit 9, p. 2).

US Sprint objects that AT&T-C summarized its incremental costs, other than access costs, in a single-line item in the cost study results it provided to interested parties. No detail was provided regarding underlying assumptions or inputs to the models

used in the cost studies. Likewise, US Sprint objects to the fact that no underlying calculations were provided. US Sprint argues that the Commission has no way to verify AT&T-C's promise that it will not exercise its requested pricing flexibility in such a manner as to allow any service offering to be priced below its LRIC.

US Sprint alleges that AT&T-C has merely created an illusion of sufficient cost data to justify its proposed bands. Therefore, US Sprint concludes that the inadequate cost data provided makes it impossible for the Commission to determine whether the rate bands are in fact just and reasonable.

4. TURN's Position

TURN likewise objects to the limitations of the cost data that was allowed in this proceeding. TURN argues that consumers are understandably concerned about possible cross-subsidies from the relatively noncompetitive residential services (MTS, particularly short-haul) to more competitive WATS services. Competitors are understandably worried about predatory pricing, in TURN's view. TURN believes that AT&T-C's response to these concerns in this proceeding has boiled down to a simple "trust us."

TURN alleges that without providing the full methodology behind its self-serving cost studies, AT&T-C is allowed to claim that it will not price any service below its LRIC level. TURN questions this "trust us" theme that runs through much of AT&T-C's testimony. TURN believes this "trust us" approach is insufficient for a finding that the rates are just and reasonable.

5. DRA's Position

DRA had joined in the motions of US Sprint and MCI requesting additional cost information from AT&T-C. Like other parties, DRA believes the cost data provided by AT&T-C has not been tested or scrutinized. DRA believes that it would be inappropriate for the Commission to rely solely on AT&T-C's reported costs. At

best, in DRA's view, AT&T-C's cost figures can be used as general guidelines. However, DRA argues that there is enough doubt about the validity of these studies, brought out during the hearings, to justify keeping the lower limits of the rate bands well above the costs reported by AT&T-C.

6. AT&T-C's Position

AT&T-C argues that the Observation Approach is expressly designed to avoid the submission and analysis of extensive cost data. AT&T-C believes that the cost data it provided to other parties pursuant to the ALJ Ruling is adequate. AT&T-C points out that the Commission specifically considered the question of whether AT&T-C should be required to provide cost studies (incremental or fully distributed) in conjunction with an application for regulatory flexibility under the Observation Approach, and concluded that such a demonstration would be unnecessary. AT&T-C cites the much quoted portion of D.87-07-017 that states detailed cost studies will not be necessary. Further, AT&T-C relies on the assigned Commissioner's Ruling of December 21, 1987 which stated that detailed cost studies would not be necessary under the Observation Approach. AT&T-C continues to maintain that the use or request for detailed cost studies are irrelevant to a proposal under the Observation Approach and expressly contrary to D.87-07-017 and the assigned Commissioner's Ruling. AT&T-C asserts that the cost data supplied on a service-by-service basis pursuant to the ALJ Ruling of September 16th, 1988 is adequate to determine if services are being offered below cost, yet avoiding the detailed cost studies that the Observation Approach was supposed to preclude. AT&T-C believes that it is beyond dispute that a detailed cost study as requested by the other parties is not required by the Observation Approach. Therefore, AT&T-C has not attempted to address in any detail its underlying cost of providing

service and asserts that no such submission or analysis is required in support of its proposal for limited regulatory flexibility.

7. Discussion

We agree with AT&T-C that it is time to put aside the issue of cost studies in this proceeding. The purpose of the Observation Approach was to avoid the burden of producing detailed cost studies. We believe that the compromise endorsed by the ALJ in her September 16, 1988 Ruling is a reasonable one. While both witnesses for MCI and US Sprint complained that they did not receive adequate cost data to challenge the proposed rate bands of AT&T-C, they in fact did manage to discuss the width of the rate band in their testimony and propose modifications to those bands.

To have excluded cost analysis completely would have been inappropriate, but likewise the level of detail sought by MCI and Sprint would not have allowed us to move forward expeditously with this proceeding and would have evolved AT&T-C's application into a process more appropriate if the Prediction Approach was being used.

The Observation Approach, by definition, will allow us to determine if flexibility granted to AT&T-C today benefits or harms its competitors and consumers. We believe the Observation Approach, taken as a whole, supports our finding that the rate bands we adopt today are just and reasonable without the provision of detailed cost studies. We will, however, consider the concerns of the parties based on cost data available to them, regarding the width of the rate band in the section to follow.

B. How Limited Should The Rate Bands Be Under The Observation Approach?

All parties to this proceeding rely on language in D.87-07-017 to support their diverse views on this subject. The question truly boils down to "how limited is limited" regulatory flexibility. Particularly because of the limited cost data that

AT&T-C. Using that data she prepared tables that were attached to her testimony (Exhibits 13 and 14). She testified as follows:

> "A review of those tables shows that, in many instances, the floors of the bands fall below the costs calculated by AT&T-C. This is true for MTS, WATS, and 800 Services. For example, in the case of MTS daytime rates the proposed floors for the initial minute appear to be below cost for the first mileage band; in the evening and night periods the floors would permit below cost pricing in the majority of mileage bands. The same pattern appears for additional minutes of calling. In the case of WATS the proposed floor for full state WATS falls substantially below cost after 40 hours of usage, and for half-state WATS after 15 hours of usage. The proposed floors for 800 service are below cost for all off-peak usage. In addition, I should say that I have not had the opportunity to review the model which AT&T-C used to produce the cost estimates." (Exhibit 13, pp. 4-5.)

MCI argues that below cost pricing, if allowed, will impede competition in certain markets, thereby depriving ratepayers of the ultimate benefits of a more competitive marketplace. Therefore, MCI recommends that the Commission adjust the floor of the rate bands so that each rate element is at least equal to the cost of that service.

2. <u>US Sprint's Position</u>

US Sprint believes that AT&T-C's development of its modified rate bands in terms of cents upward and downward from the reference rates is inappropriate. US Sprint argues that stating the scope of flexibility in cents, rather than as a percentage of the reference rate, may inadvertently grant AT&T-C automatically increasing price flexibility over time. US Sprint explains that when reference rates are adjusted downward for expected access charge reductions, AT&T-C's modified price bands stated in cents remain the same, and AT&T-C's flexibility in relation to the reference rate automatically increases. For example, US Sprint

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parties believe was allowed in this proceeding, there is an united belief that the rate bands requested by AT&T-C are not "limited."

1. MCI's Position

MCI urges the Commission to order AT&T-C to adjust its rate bands so that the floor of each rate element is at least equal to the cost of service identified by AT&T-C in its summary cost studies. MCI argues that these summary cost results are the only cost data in this proceeding.[4] While MCI cannot verify the accuracy of the cost summaries, MCI believes that for purposes of this proceeding, the rate bands should be adjusted so that the lower limit of each rate band is no less than the cost of service calculated by AT&T-C on a broad service category basis. Assuming the summaries are correct, MCI believes that this will prevent cross-subsidy and other anticompetitive pricing actions which harm both ratepayers and a viable competitive marketplace.

Additionally, MCI believes that where existing rates are already below cost, the rate band floors should be equivalent to the current rate. MCI contends that in no event should AT&T-C be permitted to reduce further below cost its rates that already are below cost. MCI points out that AT&T-C has stated on several occasions in this proceeding that one of the reasons for pricing flexibility is to move rates closer to costs. MCI argues that if AT&T-C is allowed to implement rate bands with the lower limit even further below costs than current rates, the dangers of cross-subsidies and predatory pricing will be increased. MCI witness Wand performed an analysis of the summary cost data provided by

4 AT&T-C did not offer its LRIC studies in evidence. However, both MCI and US Sprint used that data to develop their own exhibits, which were received under seal, analyzing the relationship of AT&T-C's costs to the proposed rate bands.

AT&T-C. Using that data she prepared tables that were attached to her testimony (Exhibits 13 and 14). She testified as follows:

> "A review of those tables shows that, in many instances, the floors of the bands fall below the costs calculated by AT&T-C. This is true for MTS, WATS, and 800 Services. For example, in the case of MTS daytime rates the proposed floors for the initial minute appear to be below cost for the first mileage band; in the evening and night periods the floors would permit below cost pricing in the majority of mileage bands. The same pattern appears for additional minutes of calling. In the case of WATS the proposed floor for full state WATS falls substantially below cost after 40 hours of usage, and for half-state WATS after 15 hours of usage. The proposed floors for 800 service are below cost for all off-peak usage. In addition, I should say that I have not had the opportunity to review the model which AT&T-C used to produce the cost estimates." (Exhibit 13, pp. 4-5.)

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2. US Sprint's Position

US Sprint believes that AT&T-C's development of its modified rate bands in terms of cents upward and downward from the reference rates is inappropriate. US Sprint argues that stating the scope of flexibility in cents, rather than as a percentage of the reference rate, may inadvertently grant AT&T-C automatically increasing price flexibility over time. US Sprint explains that when reference rates are adjusted downward for expected access charge reductions, AT&T-C's modified price bands stated in cents remain the same, and AT&T-C's flexibility in relation to the reference rate automatically increases. For example, US Sprint

suggests in a hypothetical presented in its testimony, 10% reduction in MTS reference rates. US Sprint argues that such a reduction in reference rates automatically increases the scope of AT&T-C's flexibility by 11%. It is US Sprint's position, in order to avoid unintended automatic increases in pricing flexibility under the Observation Approach, that rate bands should be defined as percentages of established reference rates.

US Sprint witness Purkey testified as follows:

> "It is US Sprint's position that if the Commission grants AT&T-C's application for regulatory flexibility under the Observation Approach, that the rate bands approved for AT&T-C's MTS (including coin), WATS, 800, and private line rate schedules should not exceed plus or minus five percent (5%) of the reference rate for each of the rate elements for which AT&T-C has requested flexibility. The 5% rate band should be applied uniformly to the rate elements of all service category for which AT&T-C has sought flexibility, with AT&T-C's identified reference rates used as midpoints. To the extent that AT&T-C wishes to maintain its MTS Dial Station and Coin Sent Paid Rates, in respectively whole cent or nickel increments, AT&T-C could be allowed to round to the next whole cent or nickel when the 5% band would not allow AT&T-C any flexibility for a particular band."

US Sprint argues that the 5% band would limit the excessive flexibility requested by AT&T-C while still providing AT&T-C with substantial incentive to achieve operating efficiencies. Likewise, the narrowed degree of downward pricing flexibility will reduce, although not eliminate, opportunities for AT&T-C to price predatorily during the initial period of rate flexibility. US Sprint argues that its proposal is consistent with AT&T-C's principle of "rate stability" and would also allow AT&T-C to retain existing rate relationships, because the 5% band would have as midpoints AT&T-C's rates from its rate case.

3. CALTEL's Position

CALTEL argues that AT&T-C's original rate bands from its October 1987 application should be adopted by the Commission. CALTEL believes that AT&T-C should be provided a level of upper rate flexibility equal to the level of any downward rate flexibility it is provided. CALTEL understands that the initial reference rates for the rate bands are those flowing from the rate base/rate return analysis undertaken by the Commission in AT&T-C's most recent rate case (A.85-11-029). Further, CALTEL contends that those reference rates will be adjusted to reflect decreasing levels of access charges paid by AT&T-C to local exchange carriers (LECs) as the LECs continue the SPF to SLU transition. In CALTEL's view, if the Commission is truly interested in "observing" AT&T-C's conduct under "limited rate flexibility" and the effect of that conduct on the marketplace, it should adopt symmetrical rate bands by which reference rates adopted in the general rate case form the midpoints rather than almost the high points of the bands.

CALTEL's other area of concern regarding the rate bands relates to the relationship of this proceeding to the upcoming rehearing on D.88-06-036 which will determine the method of refunding prior overcollections to AT&T-C's customers. CALTEL acknowledges that this issue may be beyond the scope of this proceeding, but argues that rate flexibility and the manner in which refunds are provided to ratepayers are inextricably interwined. CALTEL argues that the danger is for refunds to lower rates below the floors of the rate bands proposed by AT&T-C. CALTEL urges that any refunds ordered pursuant to the rehearing on D.88-06-036 not permit AT&T-C to assess a tariff rate that is less than the bands adopted today. If that is allowed, CALTEL argues that the net effect would be to reduce the reference rates to reflect rate refunds. CALTEL points out that AT&T-C witness Stechert testified that it was not AT&T-C's desire to do so.

4. TURN's Position

TURN argues that AT&T-C's proposal is unsupportable as "limited" rate flexibility. For example, TURN points out that AT&T-C requests a rate band for directory assistance services of 56% (i.e., 28% upward and downward). TURN argues that this hardly can be characterized as limited under the Observation Approach. In fact, TURN argues that a band of this size would be hard to justify even under the more liberal Prediction Approach offered to AT&T-C as an option in D.87-07-017.

TURN maintains that many other rate bands under AT&T-C's proposal call for flexibility of over 10% in either direction from the reference rates. TURN argues that the percentage of flexibility over "controllable" network costs is actually twice that amount when one considers that access charges, a fixed cost, account for more than 50% of the expense of providing IEC services. TURN finds it difficult to accept that AT&T-C could maintain that downward flexibility of roughly 20% of its controllable costs and not drop prices below the LRIC of those services. TURN suggests that the Commission must seriously question the veracity of the reference rates established in AT&T-C's last rate case if this is true.

TURN disagrees with AT&T-C's assertion that a penny of upward flexibility for the initial minute of MTS use is "the absolute minimum flexibility possible." TURN argues that for electric and gas utilities, customers are commonly charged for uses in fractions of a penny. Contrary to AT&T-C's belief, TURN claims that such a billing system has not created confusion for customers. Obviously, in TURN's view, pennies turn into millions of dollars in the provision of utility services in California and it urges the Commission not to simply assume that a penny is the bare minimum flexibility possible.

Additionally, AT&T-C's proposed upward flexibility of only one penny applies to only the initial minute of use. Since

toll calls typically average more than 6 minutes, the "limited" nature of AT&T-C's band quickly broaden for most calls. TURN argues that there is not much protection for the ratepayers in such a scheme.

TURN also challenges AT&T-C's rate bands as too broad because the flexibility plan fails to provide for an automatic flow through of any future productivity savings to consumers, even though AT&T-C readily admit that such savings are probable. TURN questions AT&T-C's wish to exercise rate flexibility in order to "obviate the need" for traditional rate of return regulation, and thereby saving ratepayers the cost of regulation (Exhibit 1, p. 4). TURN argues that ratepayers have fought AT&T-C for years to receive rate reductions which are long overdue. TURN maintains that AT&T-C's proposal offers no mechanism whereby ratepayers might readily receive the rate reductions which AT&T-C boasts of in its testimony (Exhibit 2, p. 2). Instead, in TURN's view, AT&T-C's proposal requires ratepayers to rely on the generosity of AT&T-C and the hope that competitive forces will prod AT&T-C into returning some fraction of those productivity savings to the consumer. (TURN's opening brief, p. 11.)

TURN continues to object to any program of rate bands generally. However, TURN sets forth in its brief what it views as a more reasonable and more limited approach to rate flexibility if the Commission insists on going down that road. TURN suggests that AT&T-C initially be granted 5% downward flexibility for all of its services and service elements. TURN argues that this proposal is consistent with arguments presented both by DRA and US Sprint as to the LRIC levels of AT&T-C's services. This approach applies a truly limited band which, in TURN's opinion, grants AT&T-C some meaningful flexibility. TURN points out that AT&T-C and its competitors are no more than a percentage point or two apart for MTS services. (TURN's Opposition, Attachment G.) In TURN's view 5 percentage points could easily cover any foreseeable changes to the

competitive environment which might drive rates further down. TURN asserts that 5% flexibility over all of its costs actually grants AT&T-C roughly 10% flexibility over its controllable costs.

If the Commission truly believes that some upward flexibility is both legal and justified, TURN recommends that such upward flexibility be confined to WATS service and be limited to 5%. TURN argues that if the Commission believes that upward flexibility will truly test the competitive strength of AT&T-C, then it should be confined to its most competitive service, WATS. TURN cites testimony of AT&T-C's witnesses indicating that WATS is the most competitive service AT&T-C offers. (Tr. Vols. 1 and 2, pp. 121, 200, 247.) TURN argues the importance of WATS customers as more sophisticated business customers as opposed to the residential customers who are major users of MTS and directory services. This distinction will lessen the possibility that unwitting customers of AT&T-C will be harmed by an unjustified rise in rates.

Further, TURN points out that for the purposes of monitoring, WATS service represents CACD's best chance of deciphering the possible forces behind a rate increase. Current rates are safely above LRIC, the users of the service are the most informed consumers, and the service is perceived to be rather competitive. Consequently, should AT&T-C raise its rates for this service and CACD cannot then identify a discernable increase in costs, TURN believes the Commission would be in a position to conclude that the service is not quite as competitive as hoped. The Commission could then hold off on upward flexibility for other services until the WATS market exhibits more competitive behavior.

TURN recommends that this upward flexibility could be granted by providing a waiver of up to 5% of AT&T-C's January 1989 SPF to SLU access charge flow-through to WATS customers. Using the SPF to SLU flow-through of access charges is desirable because it will promote rate stability, which TURN points out is supposedly

one of AT&T-C's guiding principles in its request for rate flexibility.

TURN recommends that these proposed rate bands should not be altered until at least 12 months of monitoring data has been gathered by CACD and the Commission staff is satisfied that all of the necessary data has been provided by AT&T-C and other parties. TURN further recommends that no less than 90 days following this determination, AT&T-C may file an advice letter proposing additional flexibility. TURN argues that the burden of proof in this process clearly falls on AT&T-C to prove that the existing level of flexibility is justified and that greater flexibility would be beneficial to ratepayers.

Finally, TURN proposes that rate flexibility should not be implemented until ratepayers receive their long overdue refunds from AT&T-C. TURN argues that if AT&T-C in fact believes that rate flexibility will enhance its ability to compete at some risk to the ratepayer, then it should at least refund the money currently due ratepayers. Since the form of the refunds will be decided in a separate proceeding (Rehearing of D.88-06-036 in A.85-11-029), the Commission would be imprudent, in TURN's view, to order rate flexibility without a clearer picture of the final reference rates to be used for the rate bands. TURN argues that the record in this proceeding leaves it far from clear that a significant reduction in rates would still leave the reference rates above the LRIC of providing the service. (Tr. Vol. 3, pp. 288-306.)

5. DRA's Position

DRA continues to maintain that only downward flexibility should be granted to AT&T-C. DRA recommends 5% downward flexibility for MTS service and 10% downward flexibility for all other services. DRA argues that its rate bands are narrow, meeting the Commission's request for "limited" rate flexibility. DRA argues that AT&T-C's rate bands are extremely broad. Citing one example, DRA points out that for an average MTS call AT&T-C

requests a total of 22% of existing rates as its rate band. DRA argues that this is extremely large when one considers that access charges make up 60% of AT&T-C's cost and are beyond the control of AT&T-C. Thus, DRA maintains that the rate bands are actually 55% of the costs that AT&T-C controls. In fact, AT&T-C requests rate bands that are as large as 56% of existing rates. DRA maintains that this is a significant degree of flexibility and is not consistent with the Commission's call for limited rate flexibility under the Observation Approach.

DRA argues that its proposal of only allowing downward flexibility as a workable solution to the possibility of cross-subsidy and predatory pricing. With only downward flexibility AT&T-C will not have the ability to fund price cuts in competitive markets by increasing its prices in inelastic, less competitive markets. DRA's proposal of allowing downward flexibility while capping rates at the 1986 test-year rate case levels reduces the means by which AT&T-C could fund cross-subsidies from less competitive to more competitive services. DRA argues that since the Commission will not know in which market segments AT&T-C still retains market power, DRA believes capping the upper limit of pricing flexibility at current rates is reasonable.

6. AT&T-C's Position

AT&T-C argues that the rate bands it has proposed are reasonable. AT&T-C's requested rate bands are produced in Appendix B to this decision. AT&T-C quotes D.87-07-017 "...narrow rate bands around rates approved in AT&T-C's general rate proceeding, A.85-11-029, appear to be the most promising avenue if the Observation Approach is followed." (Id., p. 5.) AT&T-C's witness Stechert testified that the rate bands proposed are "sufficiently limited in scope to meet the Commission's goal of protecting ratepayers and competitors' interests while at the same time permitting enough flexibility to test whether the marketplace is

competitive enough to control the behavior of AT&T-C." (Exhibit 1, p. 7.)

As evidence of the limited nature of its proposed bands, AT&T-C points out that its proposal is directly related to the rates adopted by the Commission in D.88-06-036, AT&T-C's most recent rate case. AT&T-C notes that the Commission has granted limited rehearing and AT&T-C will adjust the reference rates to reflect any change in rates resulting from that rehearing proceeding. AT&T-C's witness Stechert testified that AT&T-C does not intend to change its reference rates for rate band purposes to reflect any refund directed by the Commission as a result of that rehearing. (Tr. Vols. 314-315.)

AT&T-C maintains that an important limitation on the minimum spread for AT&T-C's proposed rate bands is the fact that AT&T-C's current billing system is limited to whole cent increments. The flexibility requested for the MTS initial minute in mileage steps 0 to 20, 21 to 40, and 41 to 70, is 0 cents upward and only one cent downward, the minimum that can be billed to customers with AT&T-C's current billing system. (Exhibit 1, p. 7.) Likewise, the upward flexibility for MTS initial minute mileage steps 71 to 100, 101 to 150, 151 to 300, and over 300 is also set at one cent. Similarly, the rate band for MTS additional minutes is + one cent for the mileage step 0-20, 21-40, and 41-70. (Exhibit 3, Attachment C.) Finally, for coin services, AT&T-C requests upward flexibility of only 5 cents for all mileage steps, being the minimum possible for coin phones, and asks to limit its downward flexibility to 5 cents for the first three mileage steps. AT&T-C argues that another feature of the limited scope of its proposed rate band is that they are asymmetric, with greater downward than upward flexibility for all of AT&T-C's public switched network services. AT&T-C made this adjustment hoping to address the concerns of those parties who believed AT&T-C would lower long-haul rates to meet competition and raise short-haul

while others do not. AT&T-C contends that an adjustment to rate bands for access costs fails to recognize the contribution above cost built into various rate elements and thus overstates the rate band width relative to cost when access costs are excluded.

The second assumption implicit in the parties' analysis is that no rate element is currently set below cost. AT&T-C remarks that this is obviously untrue. AT&T-C maintains that the Commission has long refused to allow AT&T-C to raise certain rates to a level which recovers cost in consideration of various social goals. The proposed access cost adjustment in such a case is pure fantasy in AT&T-C's view. For example, AT&T-C points out that MTS directory assistance is currently priced below its access cost. An adjustment to limit the proposed rate band to a percent of nonaccess cost would make no sense in AT&T-C's view because such a band would never permit these rates to recover all costs.

Finally AT&T-C's witness Parker testified at length that AT&T-C will not price any of its services, i.e., MTS, WATS, 800 Service and Private Line, below the LRIC for that service.

7. Discussion

We agree with the parties that the dispute over the width of the rate bands centers on what we meant when we used the term "limited" rate flexibility in D.87-07-017. We are sympathetic to the arguments of the parties that the rate bands are too broad in some instances. On the other hand, we wish to give AT&T-C enough flexibility today to fulfill its desire to respond more quickly in its markets and have something for our monitoring plan to monitor.

We agree with AT&T-C that asymmetrical rate bands are consistent with the Observation Approach. We do not take the term midpoint as literally as some parties propose. We find AT&T-C's development of the term "reference rate" as reasonable and consistent with D.87-07-017. We note that the asymmetrical rate bands are the result of AT&T-C's attempts to accommodate other parties' concerns. Therefore, we will adopt AT&T-C's rate bands as

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rates where there is allegedly little or no competition. (Exhibit 3.) AT&T-C also proposes an asymmetric rate band for MTS discount (evening and night/weekend). AT&T-C suggests that 5% of upward flexibility should be allowed, yet only 2% of downward flexibility is sought for evening discount and 4% for the night/weekend discount.

Likewise, AT&T-C's proposal requests asymmetric treatment for AT&T-C's WATS and 800 services. Increases for WATS are limited roughly to 5% while decreases of 15% are proposed. AT&T-C requests that for 800 service, increases are restricted to 5% while decreases of 10% are allowed for on-peak usage. AT&T-C proposes no decreases in the 800 band in off-peak time period usage. As another example of the reasonableness of its rate bands, AT&T-C points out that AT&T-C proposes no rate band for the per-message charges for WATS and 800 service. For private line service, AT&T-C proposes asymmetrical rate band of plus or minus 10%. AT&T-C maintains that no party to this proceeding has objected to such a rate band for private line services, except to the extent that a party generally opposes any upward flexibility.

AT&T-C objects to the attempt of several parties to transform its request for rate bands into a discussion of bands around costs. AT&T-C disagrees that it should be precluded from varying its rates more than its underlying costs may vary. AT&T-C argues that there are several assumptions of fact necessary to the contentions of the other parties. First, AT&T-C says it must be assumed that current rates exactly equal the sum of access cost, network cost, and billing cost. Second, it must be assumed that no rate element is currently set, or should be set, below cost. AT&T-C argues that neither of these assumptions is true.

The first assumption that current rates are set to equal the sum of access cost, network cost, and billing cost is not true because currently some rate elements provide a positive contribution above cost to the overall operation of the company

while others do not. AT&T-C contends that an adjustment to rate bands for access costs fails to recognize the contribution above cost built into various rate elements and thus overstates the rate band width relative to cost when access costs are excluded.

The second assumption implicit in the parties' analysis is that no rate element is currently set below cost. AT&T-C remarks that this is obviously untrue. AT&T-C maintains that the Commission has long refused to allow AT&T-C to raise certain rates to a level which recovers cost in consideration of various social goals. The proposed access cost adjustment in such a case is pure fantasy in AT&T-C's view. For example, AT&T-C points out that MTS directory assistance is currently priced below its access cost. An adjustment to limit the proposed rate band to a percent of nonaccess cost would make no sense in AT&T-C's view because such a band would never permit these rates to recover all costs.

Finally AT&T-C's witness Parker testified at length that AT&T-C will not price any of its services, i.e., MTS, WATS, 800 Service and Private Line, below the LRIC for that service.

7. Discussion

We agree with the parties that the dispute over the width of the rate bands centers on what we meant when we used the term "limited" rate flexibility in D.87-07-017. We are sympathetic to the arguments of the parties that the rate bands are too broad in some instances. On the other hand, we wish to give AT&T-C enough flexibility today to fulfill its desire to respond more quickly in its markets and have something for our monitoring plan to monitor.

We agree with AT&T-C that asymmetrical rate bands are consistent with the Observation Approach. We do not take the term midpoint as literally as some parties propose. We find AT&T-C's development of the term "reference rate" as reasonable and consistent with D.87-07-017. We note that the asymmetrical rate bands are the result of AT&T-C's attempts to accommodate other parties' concerns. Therefore, we will adopt AT&T-C's rate bands as

proposed with certain limitations. We believe the limitations we are imposing should alleviate the concerns of the other parties.

First, we find merit in tying the rate bands to percentage points of increase and decrease as suggested by several parties. However, we believe AT&T-C's desire to establish rate bands in penny increments is reasonable given its current billing structure. Even though AT&T-C has presented its proposed rate bands in cents instead of percentages (see Appendix B), we can determine that many of the proposed bands are in the 5-10% range. However, as pointed out by DRA and TURN, other rate bands present a much higher percentage change. We will order AT&T-C to adjust its rate bands so that no rate band is greater than ± 15%. We do not give AT&T-C permission to increase or decrease any rate band which is currently at a lower level in either or both directions up to that 15% level. The ± 15% cap/floor will only apply to rate bands that are currently larger than that. Likewise, we are not requiring symmetrical rate bands in all instances. The 15% cap/floor can be applied in one direction only.

In keeping with AT&T-C's need to bill by penny increments we will allow AT&T-C to increase this ± 15% band only if it is necessary to round to the nearest penny.

We realize this degree of flexibility is greater than that advocated by most parties and less, in certain instances, then that requested by AT&T-C. We are convinced that our compromise is a reasonable one. Given the evidence, we believe our approach will produce just and reasonable rates.

We caution AT&T-C that a pattern of below cost pricing, if it were to occur, would be a serious matter. As we stated in D.87-07-017, allegations of anticompetitive pricing of specific services can be handled on a case-by-case basis should the need arise. As AT&T-C has pointed out, certain rates are currently below costs, notably directory assistance, because of prior

Commission action. We expect AT&T-C to use the flexibility we grant it today to improve that situation, not make it worse.

We have not attached our adopted rate bands as an Appendix to this decision because other proceedings we will decide this year will impact the reference rates that form the basis for the rate bands.

The Phase I opinion on the rehearing of D.88-06-036 also being issued today will impact those reference rates. Likewise, the year-end SPF to SLU and access flow through cost adjustments (Advice Letter 113) will alter the reference rates.

We therefore will order AT&T-C to file an advice letter within ten days of the effective date of this order with tariff sheets reflecting reference rates which incorporate the changes discussed above. In addition, AT&T-C's tariff sheets shall include tables of rate bands both in cents and percentages for each of its rate elements consistent with the limitations discussed above.

In addition, in the event AT&T-C does not apply to change the rate bands during 1989, we wish to give direction regarding the 1989 year end SPF to SLU adjustment which will be effective January 1, 1990. We will allow the rate bands to remain the same absolute size in cents as they are January 1, 1989, after the Janaury 1, 1990 SPF to SLU adjustment. For this purpose only we will permit the percentage size of the January 1, 1989, rate bands to be increased proportionately. We do this so that the continued reduction in costs which AT&T-C receives due to the SPF to SLU adjustment will not affect the range of flexibility as expressed in dollars and cents we grant to AT&T-C today.

Finally, whatever refund mechanism is adopted in the rehearing of D.88-06-036, shall not be incorporated into the reference rates for AT&T-C's rate bands.

C. How Should Changes Within and Below The Adopted Rate Bands Be Implemented?

1. AT&T-C's Position

AT&T-C requests that it be allowed to change rates within an approved rate band on five days' notice through advice letter filings. AT&T-C acknowledges that this would require a waiver of Sections IV, V, and VI of General Order (GO) 96-A. AT&T-C points out that this waiver has already been granted to AT&T-C's competitors. AT&T-C refers to D.84-01-037 stating that "The provisions of GO 96-A are waived only to the extent of Section IV, relating to filed and effective dates; Section V, procedure in filing tariff sheets which do not increase rates or charges; and Section VI, procedure in filing increased rates. In all other respects, tariffs shall be filed in accordance with GO 96-A. Tariff filings will be effective five days after filing" (Id., p. 7). For changes within its rate bands approved by this decision, AT&T-C is seeking only what its competitors already have, five-day effective dates for tariff changes.

AT&T-C seeks 20 days' notice for a reduction in existing rates below the approved rate bands. AT&T-C maintains that currently under GO 96-A they would be entitled to reduce rates using the 40-day notice period.

2. US Sprint's Position

US Sprint proposes that if its rate bands (5% upward and downward) are adopted by the Commission, then US Sprint would agree that rate changes within their proposed bands could be approved upon five-day notice. (Exhibit 8, p. 20.) However, if greater flexibility than US Sprint has recommended is approved, US Sprint urges the full review period currently provided under GO 96-A should be required to allow the Commission staff and interested parties adequate time to verify that AT&T-C's price change would not result in rates set below cost.

US Sprint is adamantly opposed to allowing rate bands to be lowered by the advice letter process. US Sprint poses the question of why should the Commission bother setting bands if the lower limit has no meaning? US Sprint points out that the testimony in this proceeding has focused on the relationship between the flexibility requested in one service and the flexibility requested in another service. In particular, US Sprint claims that concerns have been raised regarding the possibility of predatory pricing and cross-subsidization. US Sprint argues that the limited banding concept of the Observation Approach will be destroyed if AT&T-C is not required to justify changes be they downward or upward in the rate bands through the application process.

3. MCI's Position

MCI likewise is concerned about AT&T-C's proposal to change the lower bound of rate bands approved by this decision via the advice letter process. MCI argues that the first time AT&T-C proposed such a plan regarding lowering the rate bands was in its rebuttal testimony. MCI disagrees with AT&T-C's attempt to characterize this recommendation as a clarification of AT&T-C's proposal for revision to existing services. Further, MCI believes this proposal is inconsistent with the Observation Approach and should be rejected.

MCI agrees that under the Observation Approach, AT&T-C can request limited pricing flexibility, including relaxation of certain procedures currently in place. However, MCI believes that AT&T-C's proposal goes far beyond that and in fact makes the lower end of any approved rate band illusory. MCI witness Wand testified "I don't understand the purpose of a lower band if [AT&T-C is] lowering the rates below that band." (Tr. Vol. 4, p. 421.)

MCI agrees with Sprint witness Purkey who testified that allowing the lower end of the rate bands to be lowered by advice letter violates the concept of the Observation Approach. This is

particularly true if the purpose of the Observation Approach to monitor the results of the granted price bands. If AT&T-C is allowed to price outside of those bands, whether it is upward or downward pricing flexibility, then the monitoring plan will have little effect. MCI urges that any change in the rate bands approved by this decision today only be allowed through the application process where the full impact of those proposed new rate bands can be determined, and any changes that may be necessary to the monitoring plan can be deliberated.

4. CALTEL's Position

CALTEL disagrees with AT&T-C's proposal that changes within preapproved rate bands be effective on 5-days notice. CALTEL believes that the effective date should be no less than 14 days after the date of filing. CALTEL argues that even in an era of "limited regulatory flexibility", the nation's dominant long distance carrier should not be permitted to change rates without some opportunity for review by affected consumers and competitors. CALTEL asserts that a 14-day effective date would permit those entities an adequate period of time to review the tariff changes and raise issues of concern with CACD should they be warranted. By contrast, with the 5-day effective date, CALTEL argues that any party wishing to express concerns with regard to such a tariff filing would have to do so practically on the date of receiving the tariff filing through the US Mail. (CALTEL's Statement of Position, dated August 26, 1988, pp. 2-3.)

CALTEL also disagrees with AT&T-C's proposal to reduce the lower end of its approved price rate bands by advice letter. CALTEL suggests that the Commission should evaluate AT&T-C's proposal in light of all of the requests set forth in AT&T-C's application. CALTEL draws a distinction between a company like AT&T-C seeking limited rate flexibility in the form of rate bands and a company like Southern California Gas Company still subject to rate base, rate of return regulation and who may not alter its

rates without a formal order of the Commission. CALTEL suggests that AT&T-C is seeking to have the best of both worlds, i.e., to escape the rate base, rate of return regulation applicable to monopoly utilities while at the same time enjoying the benefits of filing procedures designed for rate reductions by monopoly utilities. CALTEL argues that while an abbreviated procedure for rate reduction (below authorized rates) may be appropriate for an entity that solely provides monopoly services, it is hardly appropriate for an entity such as AT&T-C which provides services in many markets and enjoys quasi-monopoly status in some.

CALTEL suggests that AT&T-C's request is inconsistent with the notion of limited rate flexibility. CALTEL believes that the Commission should have some time to "observe" AT&T-C's conduct in setting rates within the rate bands for existing services before it permits AT&T-C to introduce pricing plans and rate reductions below the lower end of the rate band by advice letter. CALTEL proposes that a 2-year period of observation be adopted and that AT&T-C be required to file application for new pricing plans for that same period.

5. TURN's Position

As discussed previously in an earlier section, TURN believes that the proposed rate bands should continue in effect unchanged until at least 12 months of monitoring data has been gathered by CACD. In addition, TURN believes that the Commission staff should be satisfied that all of the necessary data has been provided by AT&T-C. TURN suggests that no less than 90 days following this determination, AT&T-C may file an advice letter proposing additional flexibility.

6. DRA's Position

DRA has no objection to allowing changes within the approved rate bands on 5-days notice through tariff filing. However, DRA believes it is imperative that changes to those rate bands, including reductions, be done through our application

process. DRA argues that the intent of establishing rate bands was to allow AT&T-C to have flexibility within certain constraints. DRA points out that the Commission made it clear that any widening of existing rate bands would be predicated on the result of the Observation Approach. (D.87-07-017, p. 14.) DRA urges that any widening, either upward or downward, of the rate band be accomplished through an application so that the Commission can reflect on the outcome of the flexibility already granted, before approving any greater flexibility.

7. Discussion

We find it reasonable for AT&T-C to be allowed to make changes within rate bands approved by today's decision on short notice through advice letter filings.

While we are sympathetic to CALTEL's argument that 5 days allows for virtually no checking by other parties of AT&T-C's submission, we are hopeful that only requests that fall within the rate bands approved today will be sought. Therefore, we order that changes within the rate bands may be made on 5 days' notice and will waive GO 96-A accordingly. We note that if the 5-day notice provision is changed for the non dominant interexchange carriers pursuant to our Rulemaking (R.) 85-08-042, it should likewise change for AT&T-C. AT&T-C shall serve such advice letters by express mail on any party who so requests.

We are concerned with the problems raised by other parties with AT&T-C's proposal to lower the rate bands through the advice letter process. We believe it is necessary for us and the parties to obtain data through the monitoring plan of AT&T-C's behavior before increased flexibility is allowed.

Therefore, we agree with the parties who recommended that during this initial stage of limited rate flexibility, the flexibility is limited to what is approved today. AT&T-C must use the formal application process if it wishes to make adjustments to the lower end or the upper end of its rate bands. As AT&T-C's

reference rates are altered over time by other Commission actions, the proportional size of the rate bands, around those reference rates must remain consistent with today's decision.

Finally, we are concerned about customer notice of the flexibility we grant AT&T-C today. We note that MCI and US Sprint are not currently required to notify their customers prior to changing their rates; the 5-day advice letter filing is all that is required. Therefore, it would be burdensome and impractical to require AT&T-C to give its customers advance notice of each time it exercises flexibility.

We are aware that customers require effective notice of price changes in order to exercise their options in a competitive market. This is especially true where customers subscribe to a particular service rather than choose frequently among alternate providers. Within the price flexibility bands, we are providing AT&T-C with the same options for rate changes now exercised by its competitors. We are unaware of any significant problems with customer notice and price changes as practiced, for example, by U.S. Sprint and MCI.

As with the other interexchange carriers, we will not specify a particular manner by which AT&T-C must notify customers of rate changes. However, as with its competitors, we will expect AT&T-C to make full use of the media and other means to inform customers promptly when AT&T-C exercises flexibility. While it is true that customer dissatisfaction with such notice is a reason to leave AT&T-C for a competitor (and thus provides a strong incentive to AT&T-C), we will also continue to track customer complaints regarding AT&T-C and the other carriers through our Consumer Affairs Branch and the Public Advisor's Office.

To the extent that AT&T-C contracts or specific service agreements with customers may include prices subject to pricing flexibility, AT&T-C should include clear notice of the applicable flexibility and its terms in the contract or service agreement.

Finally, we will also require AT&T-C to send out a notice to its customers explaining the rate flexibility granted by this decision in the first practicable billing cycle. AT&T-C shall work with our Public Advisor's office in developing the text of that notice.

VI. What Conditions Should Control AT&T-C's Offering of New Services?

A. What Should the Definition of New Services be and Where Should the Costing Methodology for New Services be Developed?

1. AT&T-C's Position

AT&T-C has returned to its original definition for "new services," found in its original application of October 1987. AT&T-C defines a new service as an offering which customers perceive as a new service and which has a combination of technology, access, features, or functions that distinguishes it from any existing services. In D.87-07-017 the Commission directed that for purposes of granting initial regulatory flexibility, repricing or repackaging of an existing service would not be considered a new service.

Thus, AT&T-C acknowledges that the definition does not classify an optional calling plan which discounts existing service

reference rates are altered over time by other Commission actions, the proportional size of the rate bands, around those reference rates must remain consistent with today's decision.

Finally, we are concerned about customer notice of the flexibility we grant AT&T-C today. We note that MCI and US Sprint are not currently required to notify their customers prior to changing their rates; the 5-day advice letter filing is all that is required. Therefore, it would be burdensome and impractical to require AT&T-C to give its customers advance notice of each time it exercises flexibility.

We are aware that customers require effective notice of price changes in order to exercise their options in a competitive market. This is especially true where customers subscribe to a particular service rather than choose frequently among alternate providers. Within the price flexibility bands, we are providing AT&T-C with the same options for rate changes now exercised by its competitors. We are unaware of any significant problems with customer notice and price changes as practiced, for example, by U.S. Sprint and MCI.

As with the other interexchange carriers, we will not specify a particular manner by which AT&T-C must notify customers of rate changes. However, as with its competitors, we will expect AT&T-C to make full use of the media and other means to inform customers promptly when AT&T-C exercises flexibility. While it is true that customer dissatisfaction with such notice is a reason to leave AT&T-C for a competitor (and thus provides a strong incentive to AT&T-C), we will also continue to track customer complaints regarding AT&T-C and the other carriers through our Consumer Affairs Branch and the Public Advisor's Office.

To the extent that AT&T-C contracts or specific service agreements with customers may include prices subject to pricing flexibility, AT&T-C should include clear notice of the applicable flexibility and its terms in the contract or service agreement.

rates as a new service. Although AT&T-C has returned to its original definition, in its Statement of Position filed July 15, 1988 AT&T-C had proposed a definition which categorized optional calling plans as new services. Because of the opposition to this modified definition by DRA, MCI, Sprint, and TURN, AT&T-C at hearings returned to its original definition, in the rebuttal testimony of Mr. Parker.

AT&T-C argues that its proposed definition of new services is reasonable. AT&T-C acknowledges that it has committed not to introduce a new service through the advice letter procedure until the Commission adopts a standardized costing methodology. AT&T-C requests that the Commission adopt its definition of new service and address the issue of what standardized costing methodology to adopt in A.88-08-051, the PRO California proceeding. AT&T-C makes this recommendation despite the fact that its own witness Parker acknowledged that PRO California does not meet AT&T-C's recommended definition of a new service. PRO California is a discounted optional calling plan. AT&T-C's rationale for doing the costing methodology for new services in a proceeding that is not itself a new service is the fact that the costing methodology study must be done anyway both for the PRO California optional calling plan and for AT&T-C's MEGACOM 800 service (A.88-07-020). AT&T-C argues that since it will have to expend considerable resources on the presentation of its costing methodology in the PRO California proceeding, it is an efficient use of AT&T-C's resources to establish a costing methodology for all advice letter filings for new services that AT&T-C intends to make under the regulatory flexibility granted today.

2. CALTEL's Position

CALTEL urges the Commission to reject AT&T-C's proposal that its PRO California application be the forum for developing standardized costing and pricing methodologies for future new service applications. CALTEL points out that AT&T-C admits that

PRO California is not a new service as AT&T-C presently defines the term. Additionally, CALTEL does not believe that costing methodology developed in a proceeding such as PRO California, where the service being evaluated is simply a repricing of an existing service, will be of any use to the Commission in developing procedures for cost analysis of a true new service. CALTEL argues that the Commission must evaluate the cost methodology for a new service in a proceeding by which AT&T-C seeks to introduce a new service by its own definition.

CALTEL points to one final reason for requiring that the application by which costing methodologies are developed for new services be an actual new service application. CALTEL believes that the scope of the definition of new services itself will need additional work. CALTEL points out that AT&T-C has recognized that its proposed definition of new services has not been employed in any other regulatory proceeding. (Tr. Vol. 2, p. 234.) CALTEL further asserts that AT&T-C itself admits that this definition has been fraught with controversy since it was originally proposed and that the controversy has not disappeared. CALTEL believes it is inevitable that there will be controversy over whether the first "new service" proposed by AT&T-C actually falls within the definition which AT&T-C asks the Commission to adopt in this proceeding. CALTEL maintains that the definition will have to be refined and quite obviously that should be done in a proceeding where an actual new service is before the Commission for evaluation. Therefore, CALTEL believes that the Commission should address both the refining of the definition of new services and the costing methodology for new services in one application. CALTEL submits that PRO California is not the appropriate application.

3. US Sprint's Position

US Sprint argues that AT&T-C's new services definition is ill-defined. US Sprint claims that although AT&T-C says it has returned to its new services definition contained in its original

application, several new elements are added. US Sprint argues that it is not entirely clear why these elements are necessary or advisable and how they fit into the overall picture of new services.

US Sprint joins in the opposition to the PRO California application as the forum for development of uniform costing methodology for new services.

4. MCI's Position

MCI asserts that AT&T-C has only recently returned to its definition of new services that embodied the principles laid out in D.87-07-017. MCI supports this definition for new services that was contained in AT&T-C's application of October 30, 1987 and was readopted by AT&T-C in Mr. Parker's rebuttal testimony. At the same time, MCI vigorously opposes AT&T-C's proposal to use its pending PRO California application as the test case for cost methodology for all future new service filings. MCI points out, as did all other parties to the proceeding, that AT&T-C has acknowledged that PRO California is not a new service under AT&T-C's recommended definition. Witness Parker acknowledged that it is merely a pricing option. MCI maintains that AT&T-C has failed to provide any justification for why it should depart from its own definition and use PRO California, rather than a truly new service to develop a uniform cost methodology.

Further, MCI suggests that in light of the controversy over the definition of new services, it would make more sense for the costing methodology and the refinement of the definition to be done in an application that meets the new service definition as currently proposed. This would permit the Commission in MCI's view to refine and sharpen the definition so it would have some use in future proceedings. (Tr. Vol. 2, p. 235.) MCI argues that if the Commission were to use the PRO California application as the test case for new services, the Commission might be vulnerable to claims of denial of due process. MCI argues that a truly new service

should be the test case, wherein parties will be provided an opportunity to litigate fully the appropriate guidelines for new services and the appropriate costing methodology.

5. DRA's Position

DRA joins with all other active participants in this proceeding in opposing the use of the PRO California application as the test case for cost and pricing methodology for new services. DRA believes its concern is quite different from those of AT&T-C's competitors. DRA maintains that AT&T-C's competitors such as US Sprint and MCI wish to ensure that the price of AT&T-C's new services are not too low. DRA on the other hand, in addition to concerns regarding anticompetitive pricing, wants to ensure that prices are not too high. This is why, in its view, a costing and pricing standard must be developed in the first application for a new service under AT&T-C's proposed definition. DRA believes it is dangerous to attempt to develop a cost and pricing standard for a pricing option plan such as PRO California and hope that it also applies to new services. DRA urges that the Commission wait until AT&T-C files an application for a new service that meets its own proposed definition before a costing and pricing standard is developed. PRO California, in DRA's view is an inappropriate vehicle.

6. TURN's Position

TURN states that it is pleased that AT&T-C has returned to its original definition of a new service. However, TURN, like the other parties, is dismayed that AT&T-C proposes to use its application for PRO California as a forum for establishing a cost methodology for new services when PRO California is admittedly not a new service. TURN argues that this logical inconsistency is particularly troubling when one considers that AT&T-C's definition of new services will be making its maiden voyage in a subsequent application. If a cost methodology is already in place as an outcome of the PRO California application, when such a truly new

service is introduced, it may prove difficult to apply a costing methodology which did not have to consider the vagaries of costing a new service.

7. Discussion

We first turn to D.87-07-017 for guidance on the issue of new services.

> "We would want to be sure that the services under consideration are indeed new services and not merely variations of existing services disguised in an effort to escape traditional regulation. Explicit and clear definition of new services must be provided. The extent to which AT&T-C may automatically possess market power in the areas of new services, either because of its market power in other areas or for other reasons, must also be addressed." (Id., p. 64.)

We are relieved to see that AT&T-C has returned to its original definition that is consistent with the guidelines stated above. However, we share the dismay of the other parties in AT&T-C's recommendation that PRO California is an appropriate vehicle to determine the uniform costing methodology for new services, when AT&T-C has acknowledged that PRO California does not meet its definition of new services. Therefore, we agree with the position of CALTEL, US Sprint, MCI, DRA, and TURN on this issue. AT&T-C has made no compelling showing of why the costing methodology for new services should be handled in its PRO California application. In fact, the only reason AT&T-C puts forward is since it has to do costing methodology in PRO California, it therefore would like it to be applicable to all future filings. This is not an adequate reason. While we adopt AT&T-C's proposed definition of new services, we agree with CALTEL that, in fact, in the first application of a new service this definition will most probably be refined and improved. This is another reason why we believe it is imperative that costing methodology and a refinement of the definition be handled in an

application that AT&T-C itself believes fits its definition of new service.

Additionally, we note that the PRO California application is moving forward expeditiously. We are concerned about the ability of other parties to effectively participate in that proceeding. Since the costing methodology will guide future applications for new services, we believe it is important that the first new service application, not PRO California, proceed at a pace that allows all interested parties to participate in an effective manner. Therefore, we conclude that PRO California is not the appropriate vehicle for costing methodology to be resolved for new services. However, we do not intend to invalidate Ordering Paragraph 11 of D.88-11-053 where we designated PRO California as the proceeding for interested parties to address the reasonableness and propriety of AT&T-C's interim rates for MEGACOM and MEGACOM 800.

When AT&T-C desires to file an application for its first new service under regulatory flexibility it will be that application where all parties may participate in first, development of costing methodology for future new services and second, refinement of the new services definition.

B. How Should New Services be Introduced once Costing Methodology has been Resolved and How Quickly?

1. AT&T-C's Position

Once the issue of costing methodology is resolved, AT&T-C proposes to file requests for new services through the advice letter procedure, with some modifications. Currently, the advice letter process as laid out in GO 96-A allows for approval of new services on 40 calendar days' notice. In addition to the requirements of GO 96-A, AT&T-C proposes to provide standard costing data (using the uniform costing methodology) with all advice letter filings. However, AT&T-C seeks an amendment to

GO 96-A requesting that a new service or a revision to an existing service that has already been approved by the FCC be approved on only 20 days' notice. AT&T-C acknowledges that this would require a waiver of Sections IV and V of GO 96-A. (AT&T-C Exhibit 4, p. 13.) AT&T-C argues that a reduced notice period as requested is appropriate because "an initial opportunity to review the essential nature of the proposal would already have occurred during the review of the filing before the FCC." AT&T-C cites D.84-01-037 for the proposition that the Commission has already waived these sections for AT&T-C's competitors. AT&T-C argues that its major competitors compete on a national level with AT&T-C. Thus, AT&T-C claims that every filing before the FCC is scrutinized closely by its competitors. AT&T-C claims that the essential nature of any proposal that is part of a national program of AT&T-C would be revealed in AT&T-C's FCC filing. Therefore, AT&T-C concludes it would be appropriate for the California filing to be reviewed in less time.

For new services that are not part of an FCC review, AT&T-C acknowledges that the timeframe set out in GO 96-A is appropriate, i.e., 40-day review period.

2. CALTEL's Position

The issue of AT&T-C's introduction of new services is the issue of most concern to CALTEL in this proceeding. CALTEL believes that AT&T-C should be required to introduce new services by application rather than by advice letter. CALTEL argues that with the adoption of rate bands, AT&T-C would have been provided a significant level of rate flexibility and correspondingly, the Commission would have been provided with the challenge of observing and evaluating AT&T-C's conduct with that rate flexibility. CALTEL believes it is inappropriate for the Commission, consumers, and AT&T-C's competitors to be burdened with having to quickly respond to AT&T-C's filing of advice letters by which it seeks to introduce new services. CALTEL recognizes that AT&T-C has narrowed its

proposed definition of new services, but nonetheless believes that AT&T-C should bear the burden of proof that the approval of such a new service will be in the public interest.

CALTEL points out that as a practical matter, the burden placed on AT&T-C's competitors will be substantially greater if AT&T-C is permitted to introduce new services by advice letter rather than by application.

CALTEL points out that when an application is filed, the burden of proof falls squarely on AT&T-C, protests may be filed in a 30-day timeframe, and most importantly the relief requested can only be granted by an order of the Commission. By contrast, CALTEL points out that advice letters filed pursuant to GO 96-A take effect 30 days after filing unless suspended by the Commission, and must be protested within 20 days of filing. More importantly, the practical effect is that a party protesting an advice letter bears a burden of establishing that the advice letter should be suspended. This is unlike the application situation where the burden is on where it should be, on the applicant, or AT&T-C.

CALTEL argues that the advice letter procedure operates in practice to provide even less time for a protest than that set forth under the existing rules. In addition to the shortened time to protest an advice letter, parties may not have been advised of the existence of the proposed advice letter until several days after the filing itself. Unless a particular party has arranged to have all such advice letters served on it by the utility, the usual means of obtaining such notice is through the Commission's Daily calendar. For example, the Commission's Daily Calendar for a particular date contains notice of advice letter filings for several preceding days. Parties must also account for the time for the Daily Calendar to reach their office through the mail. Therefore, in reality, parties have as few as 10 days to prepare and file protests given these constraints. By contrast, a party considering protesting an application have 30 days from the date of

when the application first appears in the Commission's Daily Calendar.

Additionally, CALTEL points out that while the advice letter procedure places substantial burdens on the protestants, there is no corresponding public benefit by the reduced time period. Protests that are frivolous can be rejected under Rule 8.2 just as easily as they can under GO 96-A, according to CALTEL.

Finally, CALTEL notes that the new service proposals which AT&T-C wishes to introduce by advice letter, may well have been months or even years in preparation. Thus, while AT&T-C may take as long as it wants developing the operational details and the pricing and marketing strategies for a particular new product, interested parties are expected to formulate a response to that proposal somewhere between 10 and 20 days after first being apprised of it. CALTEL argues that this does not make sense.

CALTEL urges that by requiring applications, the protestants will have at least 30 days and the Commission may have as long as it needs to consider whether the new service should be authorized. This gives the Commission the option to choose in some cases to disregard any protest and approve the application expeditiously or in other cases set the matter for formal public hearings. CALTEL urges that the Commission not give up the broad array of options it possesses when the proposal is in the form of an application.

Finally, CALTEL proposes that AT&T-C be required to introduce new services by application for a 2-year period. CALTEL points out that controversy surrounding new services is likely to exist for some time until AT&T-C and other parties arrive at some understanding of the precise definition of new services. Therefore, CALTEL suggests that after a 2-year period by which all new services will be introduced by application, the Commission can determine whether the requirement should be continued or not.

In the event the Commission does not adopt CALTEL's proposal that all new services should be introduced through the application process, CALTEL particularly opposes AT&T-C's suggestion that the advice letter review time should be reduced to a mere 20 days when the FCC has already reviewed such a service. CALTEL points out that this proposal of AT&T-C's would leave its competitors with only a few days to prepare and file a protest to any such advice letter. The Commission and CACD would similarly be constrained in CALTEL's view from taking any action with respect to those proposals. CALTEL argues that we have not yet "observed" enough to permit AT&T-C this extreme level of flexibility.

Moreover, CALTEL points out that this Commission has in the past rejected state filings by AT&T-C which were "consistent with the national plan already approved by the FCC." CALTEL concludes that this Commission wishes to continue to conduct its separate review of such plans. CALTEL argues that it makes little sense to sharply reduce the opportunity of interested parties to offer comments to this Commission with respect to such plans.

3. US Sprint's Position

US Sprint does not oppose the use of the advice letter process under GO 96-A for AT&T-C's introduction of new services, if the services are truly new and after the costing methodology has been resolved in the first new service application. However, like all other parties to the proceeding, US Sprint takes strong exception to AT&T-C's proposal that the time to review services already approved by the FCC be shortened to a mere 20 days. US Sprint argues that AT&T-C is asking this Commission to defer its power, authority, and jurisdiction over certain of AT&T-C's services to the FCC. US Sprint argues that AT&T-C has not demonstrated any compelling reason for this Commission to accede authority to the FCC in this instance.

4. MCI's Position

MCI does not oppose the notion of advice letter filings for true new services once costing methodology has been resolved in the first application. However, MCI does oppose the 20-day review period for any new service that has already been introduced and approved by the FCC. MCI argues that this 20-day notice period conflicts with PU Code § 455. Section 455 provides that any revision which does not increase a rate: "Shall become effective on the expiration of 30 days from the time of filing thereof with the Commission or such lesser time as the Commission may grant...."

MCI believes that there would have to be a change in the underlying statutes before the Sections of GO 96-A which AT&T-C seeks to have waived, could be allowed.

Further, MCI asserts that AT&T-C has made no showing that prior approval of a service proposal by the FCC justifies a shorter than 40-day review period for advice letter filings. MCI witness Wand testified that AT&T-C's assumption that less review time is necessary for new or existing services already approved by the FCC is flawed. (Tr. Vol. 4. p. 421.) There is no basis to assume that any review which may have taken place at the interstate jurisdiction would be relevant to an intrastate filing. MCI points out that AT&T-C's intrastate offering would not have been reviewed before the FCC. Further, MCI maintains that the underlying cost data provided in connection with an FCC filing would be different than cost data developed for an intrastate service. MCI concludes that the different cost data provided at each jurisdiction would require a separate review at the intrastate level even if a prior review took place at the FCC. Therefore, MCI urges that the Commission not allow the 20-day shortened period for review.

5. DRA's Position

DRA urges that the time to review a new service filing should be at least 45 days. DRA maintains that several tasks must be accomplished in this timeframe. First, it must be determined if

the new service meets the definition of a new service. Second, it must be determined that the general costing and pricing methodology developed in the first new service application, is applicable for the new service in question. Third, that pricing and costing methodology must be applied. Fourth, the cost information provided by AT&T-C must be examined. Fifth, the parties must prepare and submit protests if necessary. Sixth, the Commission must review the findings and positions of the parties involved. DRA argues that the above scenario in their view would take at least 45 days. DRA acknowledges that the current Commission practice under GO 96-A allows for a 40-day period. However, DRA believes that the possibility that rates for substitute services could go up, a possibility that is generally prohibited in filing under GO 96-A, requires a small amount of additional time to determine the cost and benefits of a new service. DRA beleives its request for an additional 5 days is reasonable and will not harm AT&T-C.

DRA joins in opposition to AT&T-C's proposal that advice letters become effective within 20 days if that plan has received prior FCC approval. DRA argues that the Commission must not allow itself to relinquish its authority over intrastate telecommunication policy to the Federal Government. DRA urges the Commission to consider new service advice letter filings as to the cost and benefits that each service would bring to California. This review process necessarily takes time.

Finally, DRA points out that there are significant differences in cost between the intrastate and the interstate telecommunications market. For example, DRA states that access charges are different. DRA argues that there may be other costs or factors such as competition, technological differences, and legal restrictions that differ between the Federal and State jurisdictions. (DRA closing brief pp. 6-7.)

6. TURN's Position

TURN joins in the unanimous opposition to AT&T-C's request to have new services reviewed in the shorter than the current advice letter time frame. TURN points out that simply using an advice letter for the introduction of a new service is a major enhancement of AT&T-C's flexibility. TURN finds AT&T-C's distinction that several of these new services have previously been reviewed and challenged at the Federal level to be hardly comforting. The distinctions between the Federal and State requests for new services could be so fraught with problems that it would take more time to resolve than the additional 10 to 20 days sought by parties for Commission review of any new service. Therefore, TURN concludes that the Commission should give CACD and interested parties at least 30 to 40 days to review any new service proposal introduced by AT&T-C.

7. Discussion

We note that all parties except for CALTEL seem able to live with the introduction of new services by AT&T-C through the advice letter process. This of course assumes that standard costing methodology has been resolved in its first new service application as discussed in the prior section. CALTEL's concerns do have merit, and therefore even though we adopt the advice letter process for new services today we note that for any particular advice letter filing we retain the option to require AT&T-C to file an application instead if the protests so warrant. The Commission will make that determination on a case-by-case basis.

Likewise we are persuaded by the parties that AT&T-C's request to have a shortened time period for services approved by the FCC is without merit. AT&T-C's concern for speed must be balanced against the rights of other parties to be allowed effective participation in our process. That effective participation necessitates timing that makes participation meaningful.

Further, MCI and US Sprint are two of the very parties that would ordinarily participate in the FCC process. They, like all other participants in our proceeding, are adamantly opposed to a shortened review process. Several parties point out that there may be substantial differences between the intrastate and interstate filings for the same services. We agree that the review that the FCC does for a new service may be very different than the review done here at our Commission.

We do not find DRA's request for a 45-day period compelling. We will authorize advice letter filings for new services under the rules of GO 96-A, allowing a 40-day period before the new service is authorized. However, we caution AT&T-C that advice letters for new services fraught with controversy will be rejected and instead AT&T-C will be ordered to file an application. AT&T-C must not abuse the flexibility we grant them today in introducing new services. For clarification, this advice letter process that we today approve will not take effect until AT&T-C has presented its standard costing methodology for new services in an application for a new service as discussed above. Only after the Commission has approved that costing methodology may AT&T-C begin to present its new service requests through the advice letter process.

C. What Rate Bands Should be Adopted for New Services?

1. Parties' Positions

AT&T-C's proposes that any new service offering be allowed an upward flexibility no greater than 10% above its original price, and a downward flexibility set at or above the LRIC for the new service. This was not an issue of particular focus during the hearings or in the parties' briefs. It seems reasonable to assume that parties' positions regarding rate bands for new services are the same as their positions on rate bands for existing services unless otherwise stated.

US Sprint specifically argues that any new service introduced should be limited to the same 5% price band (upward and downward) proposed by US Sprint for AT&T-C's existing services. (Exh. 8, p. 22.)

MCI does not specifically address the appropriate size of rate bands for new services. We assume that MCI believes that the rate bands at least should cover costs on an element by element basis, and does not oppose some upward flexibility. In addition, MCI witness Wand testified that "The Commission should...use the application for the first new service that is consistent with this guideline as the test case for determining how truly new services should be regulated." (Exhibit 13, p. 7.) It could be inferred from this testimony, that MCI recommends that the issue of width of rate bands for new services be deferred until the first new services application.

Likewise, CALTEL does not specifically address the issue of rate band widths for new services. However, since CALTEL is quite adamant in its belief that all new services should be reviewed by the formal application process for at least the next two years, it is reasonable to assume that CALTEL does not endorse AT&T-C's proposal at this time.

Since both TURN and DRA oppose any upward flexibility for existing services, it is reasonable to infer a similar objection to upward flexibility for new services.

2. Discussion

None of the parties, including AT&T-C, spent much time developing the record on this issue. Logically, it makes sense to treat rate bands for new services in a manner consistent with what we have adopted today for existing services. We do not wish the parties to litigate, for example, the appropriateness of upward flexibility every time AT&T-C attempts to introduce a new service.

However, the first new service (not PRO-California) AT&T-C attempts to introduce will be through the formal application process with an extensive and thorough examination of AT&T-C's costing methodology. Likewise, we have ordered that the definition of new services may be refined in that first application. It is reasonable, therefore, to defer the approval of rate band widths until that first new services application.

Parties are cautioned that we do not expect them to relitigate the overall policy regarding rate bands adopted today.

VII. Should the Commission Adopt CACD's Proposed Monitoring Plan?

A. Background

In D.87-07-017, the Commission ordered CACD (then the Evaluation and Compliance Division) to conduct workshops and develop a monitoring plan which would enable the Commission to measure and assess the impact flexibility may have on AT&T-C's competitors and customers of interLATA services in California. (Id., Ordering Paragraph 2.) The Commission believed a monitoring plan was an important prerequisite to any grant of flexibility. CACD held the required workshops and filed its monitoring plan on November 18, 1987. CACD believes its proposal will help the Commission achieve the objectives outlined in D.87-07-017.

CACD held its first workshop on August 31, 1987. Prior to that date, CACD requested that AT&T-C distribute its draft application for regulatory flexibility to all workshop participants to help the development of a monitoring plan. The draft application (which eventually became A.87-10-039) outlined the flexibility AT&T-C intended to request from the Commission and recommended a monitoring plan which it believed would complement the flexibility it was seeking.

CACD reports that all participants emphasized that their involvement in the workshops should not be construed by the Commission as support for AT&T-C's regulatory flexibility. With

this understanding, CACD believes the participants talked constructively about the monitoring plan suggested by AT&T-C. At the conclusion of the session, AT&T-C was requested to revise the monitoring plan it proposed, taking into consideration the numerous suggestions made by the workshop participants. CACD directed AT&T-C to obtain comments from the workshop participants and submit a revised monitoring plan 10 days in advance of the second workshop.

CACD held the second workshop session on October 19, 1987. CACD reports that during this session, participants thoroughly discussed the revised monitoring plan and assessed the merits and shortcomings of each measurement presented in its various exhibits before they were adopted, rejected, or modified. No one requested further workshops.

The workshop participants agreed that only CACD's recommendations should be presented in the report to the Commission filed November 18, 1987. Comments on CACD's proposed monitoring plan were filed 20 days thereafter.

The ALJ determined in her September 16, 1988 ruling, that the monitoring plan would not be a subject for cross-examination at hearings, but that parties' suggestions regarding the monitoring plan as laid out in their position papers and briefs would be given consideration by the Commission. Thus, parties have been given several opportunities (as recently as October 25, 1988 in their reply briefs) to update their positions on CACD's proposed monitoring plan over the past year.

In its report, CACD emphasizes that its proposed monitoring plan "<u>does not in any way</u> suggest a method, scientific or otherwise, to isolate changes in specific measures which would enable the Commission to draw causal relationships between such changes and the flexibility exercised by AT&T-C." (CACD Report, pp. 4-5.) CACD believes the Commission recognized this problem in D.87-07-017 noting "that the observation of the results of

regulatory flexibility may present difficulties similar to those we encountered in trying to set criteria for the measurement of current market power." (Id., p. 4.) CACD believes the proposed monitoring plan presents several helpful indicators which, collectively, can aid the Commission in assessing how well the interLATA market is working. CACD believes it should be up to the Commission to decide whether and how the monitoring program results can be used in later decisions to either reduce, maintain, or increase the amount of flexibility granted AT&T-C.

CACD recommends that the Commission require CACD to publish an annual report presenting the results of the monitoring program 60 days after receipt of the first year's monitoring results.

The attachments to CACD's monitoring plan report are included in this decision as Appendix C. These attachments would form the basis of CACD's annual report under its monitoring plan.

The exhibits are designed to show data as they would appear in the annual report. The attachments to the exhibits clearly specify the actual (raw) data to be submitted, much of which is confidential; it also recommends to the Commission which carriers should be ordered to supply the data requested.

CACD believes interested parties should be given an opportunity to comment on that annual report. CACD proposes that the annual report should thoroughly aggregate or otherwise arrange the data submitted by various parties to guard against inadvertent release of any confidential information.

CACD believes the proposed monitoring plan, based largely on workshop discussions, is consistent with the flexibility AT&T-C is seeking in A.87-10-039. (CACD Report, p. 6.)

CACD's proposed monitoring plan has two major components. The first suggests indicators which would help the Commission detect changes in the status of AT&T-C's competitors, after limited flexibility is granted to AT&T-C. The second component suggests

indicators which would help the Commission detect important changes in the degree of customer service and satisfaction.

In D.87-07-017, the Commission recognized that it is necessary to monitor the impact regulatory flexibility may have on AT&T-C's competitors. CACD recommends in its report that the Commission adopt the following exhibits (and their associated attachments) to help meet this objective:

EXHIBIT 1 - Ease of Market Entry and Exit

EXHIBIT 2 - Customer Choice Among Substitutable Services

EXHIBIT 3 - Competitive Capacity to Serve (Intrastate Circuit Miles Installed and Planned)

EXHIBIT 4 - Competitive Capacity to Serve (Switching Capacity)

EXHIBIT 5 - OCC Size and Growth Potential (Revenue by Service Category)

EXHIBIT 6 - OCC Size and Growth Potential (Interstate and Intrastate Minutes of Use)

EXHIBIT 7 - OCC Market Share (Revenue by Service Category)

EXHIBIT 8 - OCC Market Share (Interstate and Intrastate Minutes of Use)

CACD believes these exhibits, viewed collectively, should help inform the Commission about significant changes in the status of interLATA competition after AT&T-C is granted some flexibility. CACD emphasizes that it will be very difficult to analyze whether changes in the indicators being monitored directly result from the flexibility exercised by AT&T-C.

CACD believes the information requested for these exhibits will not be unreasonably burdensome or onerous to the various parties who would be required to provide them.

Furthermore, CACD notes that the data shown in these exhibits is presented in a manner which ensures that confidential information is not disclosed on a company-specific basis.

The Commission recognized that it is necessary to monitor the impact regulatory flexibility may have on California consumers (D.87-07-017.) CACD therefore devoted a significant amount of workshop time exploring which variables should be included in the monitoring plan to achieve this objective. CACD believes the following exhibits may be helpful in this regard:

EXHIBIT 9 - Private Line Installation Commitments Met

EXHIBIT 10 - Private Line Held Orders

EXHIBIT 11 - Failure Rate Per 100 Private Line Circuit Terminations

EXHIBIT 12 - Number of Troubles Reported on Intrastate Private Line Circuits

EXHIBIT 13 - Average Duration (Hours) Per Trouble (Private Line)

EXHIBIT 14 - Percent of Troubles Fixed in Less than 48 Hours (Private Line)

EXHIBIT 15 - Customer Satisfaction (Commission Complaints)

EXHIBIT 16 - Percent of Calls Not Blocked (POP-POP)

EXHIBIT 17 - Percent of Calls Not Blocked (POP-LSO/Tandem)

EXHIBIT 18 - Average Speed of Answer

EXHIBIT 19 - Customer Satisfaction Survey

However, CACD points out in its report, only AT&T-C has committed to providing the information needed for these exhibits. CACD states it is doubtful from the workshop proceedings whether Other Common Carriers (OCCs) will be able to readily and easily

furnish the same information. Before imposing a potentially burdensome and onerous requirement on the OCCs, CACD recommends that the Commission adopt a Pilot Program suggested by DRA. Under this Pilot Program, DRA would work with AT&T-C over the course of six months to "test" the overall viability of Exhibits 9 through 19.

CACD recommends that if the Commission adopts this Pilot Program, DRA should be required to submit a report to all workshop participants within 60 days after the end of the 6-month test period. This report should discuss:

1. Whether it was burdensome to obtain the data required in Exhibit 9 through 19.
2. Whether the data collected provided meaningful results.
3. Whether OCCs should be required to furnish the same data.
4. Whether other measures are necessary.
5. Other matters regarding the Pilot Program that DRA believes are important.

CACD recommends that all parties be allowed to comment on DRA's report. CACD proposes that comments be submitted to CACD and served on all parties within 20 days. CACD proposes that the Commission should then issue a Resolution adopting a set of exhibits and attachments to be used to help the Commission detect changes in the overall degree of customer service and satisfaction after AT&T-C is granted limited flexibility.

Acknowledging the directive in D.87-07-017 to consider the effect of regulatory flexibility on universal service, CACD believes there is no likely measurable link between the two. CACD maintains it is difficult to link customers' decisions to abandon, retain, or subscribe to local exchange telephone service with changing conditions in the interLATA market which may be attributed to the actions of AT&T-C. Therefore, CACD recommends that specific

universal service indicators should not be included in the monitoring plan.

Finally, CACD believes that, because of limited resources, the Commission should seriously consider utilizing its data processing capabilities to ensure the monitoring program is implemented efficiently and effectively. In its report, CACD offered to work with the Commission's Data Processing staff, and the various carriers which would be required to submit data, to develop the procedures necessary to achieve this objective.

B. AT&T-C's Position

AT&T-C endorses CACD's monitoring plan as being fully consistent with the Observation Approach and, along with other reports regularly submitted by AT&T-C, will permit the Commission to sufficiently monitor the marketplace and detect impacts on customers and competition.

AT&T-C acknowledges that the Commission relinquishes no regulatory authority if it were to grant the pricing flexibility proposed by AT&T-C. AT&T-C concedes that the Commission can modify the flexibility granted at any time, quoting that the Commission "...would not hesitate to rescind the flexibility granted earlier if it appears that the ratepayers are being harmed by the granted regulatory changes. The ultimate result may be a completely deregulated AT&T-C, the status quo, or some partial but continuing regulation." (D.87-07-017, p. 4.)

AT&T-C maintains that it was clear from the workshop discussions that DRA's pilot program concept was intended to be a part of the evolving monitoring plan and not a prerequisite to granting AT&T-C flexibility. Furthermore, AT&T-C argues that the six-month "report and comment" procedure after the pilot program recommended by CACD should relate only to the issue of whether OCCs should be required to provide the same consumer data as AT&T-C. AT&T-C contends that while it may be useful for DRA to assess the first six months' results for trends or impacts, DRA's analysis

should not be part of CACD's proposed six-month "report and comment" procedure, the only appropriate issue being whether the OCCs must also supply data. AT&T-C supports CACD's proposal that there will be an opportunity at the end of one year's accumulation and evaluation of results to modify and/or enhance the measurement tools to ensure their validity, relevance and appropriateness as a measure of the interexchange telecommunications market.

AT&T-C opposes US Sprint's suggestions for additions to the monitoring plan (US Sprint's proposal is discussed below) to identify AT&T-C's ability to impact individual customer groups with price changes thereby cross-subsidizing competitive services with revenues from non-competitive services. AT&T-C describes US Sprint's proposal as "an elaborate plan that attempts to monitor price changes for thirty-eight customer groups." (AT&T-C Opening Brief, p. 41.) AT&T-C argues that this plan would require an enormous amount of data through an extensive sampling process. AT&T-C claims accumulation of the data would be "extremely burdensome at best," and argues it does not possess the required data to identify the customer groups chosen by US Sprint. (Id., pp. 41-42.) AT&T-C claims that US Sprint acknowledges that even if the data were collectible, it would not be clear whether the changes are a result of competitive forces, changes in cost, or exercise of monopoly power.

C. <u>US Sprint's Position</u>

US Sprint argues that CACD's proposed monitoring plan contains serious flaws, and does not accurately reflect the discussions in the workshops as it relates to collection and reporting of market share indicators.

US Sprint filed comments regarding the deficiencies of the monitoring plan on December 8, 1987. US Sprint alleges the exhibits developed by the CACD fail to collect and report absolute market share information as well as information regarding change in market share. US Sprint contends information regarding absolute

market share is critical to a complete evaluation of the response of the market to any flexibility granted AT&T-C. Further, according to US Sprint, the Exhibits developed by CACD fail to collect and report market share information by product segment. US Sprint argues the Commission, in D.87-07-017, explicitly recognized the need to collect measures of market power by customer segment. US Sprint presented in its December 1987 comments modified exhibits which reflect its recommended changes to correct the deficiencies relating to collection of market share information of the monitoring plan as presented in the CACD's Report.

Additionally, US Sprint proposed an additional set of measures for the monitoring plan in a letter dated November 23, 1987 to AT&T-C which would monitor the effects of AT&T-C pricing flexibility on distinct customer groupings. US Sprint circulated the proposed set of price indices to all parties participating in the workshops. Because of the very real possibility of cross-subsidy which arises from the Observation Approach, US Sprint argues the inclusion of these indices in the monitoring plan is essential to a thorough evaluation of market performance following the introduction of limited pricing flexibility.

US Sprint developed its price indices to evaluate the impact of AT&T-C's pricing flexibility on different customer groups. US Sprint's proposal would require that AT&T-C's customers be divided into various groups based on their location, the amount of calling, and whether they are residential or business users. US Sprint's plan then calls for a sample of customer billing information to be drawn for each group of customers. Included in this information, under US Sprint's recommendation, would be all calls placed by each sample customer. US Sprint proposes that whenever AT&T-C changes rates, these calls of customers would be rerated using the new AT&T-C rates to supposedly determine the price impact on different customer groups. US Sprint believes this procedure would create a price index for AT&T-C for each identified

customer group as well as an overall weighted index of AT&T-C's prices for service provided to all customers. US Sprint maintains that these indices can then be compared to determine both the overall price level for AT&T-C services, and the effect of price changes on the relative prices paid by various customer groups.

US Sprint proposes that the samples of customer billing information used to calculate the average prices or price index values would not be redrawn for each calculation of the price levels. US Sprint believes the sample bills should be drawn only once just prior to the granting of flexibility and the same bills and calling patterns would be used for subsequent calculations of the index values. US Sprint argues that this approach keeps the quantity weights used to combine individual prices to generate the overall index constant for the duration of the monitoring program. In US Sprint's view, this process would allow any changes in the index to be a clear result of changes in AT&T-C's rates. (Exhibit 8, Appendix 8.)

Finally, US Sprint believes CACD's monitoring plan is unclear about the mechanisms that will be in place for either the Commission, AT&T-C or interest parties to act upon the information collected. US Sprint maintains that the Commission should include clear procedures and an expeditious timetable following release of the monitoring plan results for the Commission to consider the effects of pricing flexibility and whether or not the flexibility should be increased, restricted, or otherwise modified.

D. MCI's Position

MCI believes that the monitoring plan recommended by CACD is consistent with the requirements of D.87-07-017, subject to certain qualifications. MCI consistently has maintained that the monitoring plan should not increase the regulatory burden on other interexchange carriers. MCI argues that as a consequence of granting relief to AT&T-C from current regulatory procedures, other

interexchange carriers should not be subjected to increased regulation.

MCI urges the Commission to review carefully the information requested by CACD to ensure that it is necessary in monitoring any flexibility granted to AT&T-C, not as a means of simply obtaining more information about the other interexchange carriers or their customers. Specifically, MCI believes that it should not be required to file the information contained in Exhibits 9 through 18 of the Monitoring Plan. (See Appendix C to this decision.) In MCI's view, these exhibits are designed to provide information about the impact of regulatory flexibility on AT&T-C's customers, and should not be used to elicit information about customers of MCI and US Sprint. Moreover, the Commission does not need to review information regarding the quality of service of the other interexchange carriers, according to MCI. MCI argues this exercise would increase the regulatory burden on the other interexchange carriers; at the same time, it would reveal no useful information on whether granting rate flexibility to AT&T-C has resulted in a degradation of service to its customers. For these same reasons, MCI also requests that its customers not be included in the survey proposed in Exhibit 19 of the monitoring plan. With these qualifications, MCI supports the adoption of CACD's monitoring plan.

E. DRA's Position

DRA expresses concern regarding the adequacy of CACD's proposed monitoring plan. DRA stresses that the monitoring plan should be considered supplementary to existing Commission staff access to the books and records of AT&T-C. DRA recommends that the adopted monitoring plan include language clearly affirming the Commission's right to continue to monitor AT&T-C through verification audits.

Likewise DRA urges that it be made clear that the monitoring plan does not exempt AT&T-C from any current reporting

requirements. (i.e., those reports currently required by General Orders, Statutes, Commission Decisions, etc.) For example, the recent AT&T-C general rate case decision (D.88-06-036) imposed several specific reporting requirements on AT&T-C. DRA believes the monitoring plan should be in addition to all current requirements, unless so specifically stated.

DRA believes the six-month Pilot Program it will conduct with AT&T-C should cover all the exhibits, not just Exhibits 9-19 dealing with the impact of flexibility on California consumers. Additionally, DRA suggests that all service and financial data should be collected from AT&T-C on a monthly basis and submitted to the Commission on a quarterly basis within 30 days after the end of each calendar quarter. DRA points out that some of the exhibits in the CACD report call for reporting time frames of as much as a year. DRA believes it would severely limit the six-month Pilot Program.

DRA agrees with US Sprint that some additional exhibits are needed for the monitoring plan. DRA believes CACD's proposed monitoring plan fails to include a way of monitoring the strategic behavior of AT&T-C directly.

DRA would carry US Sprint's proposal a step further and request that the data necessary to develop price indices for AT&T-C, should also be provided by the OCCs. However, DRA gives little detail regarding what these additional exhibits to the monitoring plan should be. DRA offers to work with the OCCs to "work out the details of collection and compilation of this data. In addition, the format for these exhibits as they are reported to the Commission can be worked out between DRA and the affected companies." (DRA Response to CACD's Report, filed December 8, 1987, pp. 9-10.)

Finally, DRA recommends that the monitoring plan should allow the Commission to add or delete information that it needs to adapt to changing market conditions. (DRA Opening Brief, p. 10.)

F. TURN's Position

TURN refers to "much needed changes" to CACD's monitoring plan in its brief. (TURN's Opening Brief, p. 1.) TURN filed comments on December 8, 1987, stating its views on CACD's proposal and addressed the monitoring plan in its opposition to AT&T-C's Application for Rate Flexibility, dated August 30, 1988.

TURN points out that the Commission conceded that monitoring presents the same difficulties as those encountered in attempting to measure market power as envisioned under the Prediction Approach. (D.87-07-017, p. 4.) TURN believes that not only will it be difficult to assess the competitive environment, the Commission will also have a difficult time trying to measure the impacts on ratepayers. TURN argues that for states already experiencing rate flexibility, the results have been difficult to decipher. (TURN Opposition, Attachment C, pp. 1-3.)

TURN maintains that following the "Observe and Monitor" approach also presents the Commission with the unlikely task of "unringing the bell." While the Commission has stated that it will not hesitate to rescind the flexibility granted TURN believes it is not likely to happen. TURN claims that DRA, CACD, and other parties would be hard pressed to derive enough intelligible data from the proposed monitoring plan to be able to convince this Commission to turn back the clock. To TURN's knowledge, no other state has stepped backwards from the initial flexibility granted AT&T-C.

One of the obvious problems in TURN's view, with monitoring an upward/downward flexibility plan is the inability to link the upward and downward movements in any meaningful fashion. TURN poses the following questions which it believes the proposed monitoring plan cannot answer. If AT&T-C lowers its WATS rates and subsequently raises some of its MTS rates, was that a response to competition or a perceived change in costs? If it was a response to a change in costs, which costs have changed? If it was based on

a variety of considerations (i.e., a likely scenario), what is CACD to make of the results? Even more puzzling, how is CACD to assess all of the dozens of likely AT&T-C rate designs which are likely to unfold between review periods?

TURN acknowledges that on the customer service side, the proposed monitoring plan is seemingly capable of measuring the current level of customer satisfaction, although TURN believes there is little effort made to differentiate between customer classes. Just because customers on the whole might be pleased, TURN argues the data provided may camouflage some customer classes which are not satisfied with the level of service provided by AT&T-C.

TURN endorses US Sprint's proposed additions to the monitoring plan. Further, TURN suggests that the Commission consider requiring both MCI and US Sprint to provide similar data at some point in the future. TURN realizes that providing this level of detail may be burdensome for the OCCs, but TURN believes a true assessment of AT&T-C's competitive response cannot be accurately made without a view of what the competition is doing.

Finally, TURN argues that the monitoring plan will not detect potential future impacts on service levels because it cannot analyze those investments which are not made which should be made in order to maintain the same level of service, 5-10 years down the road. For instance, TURN suggests that it AT&T-C lowers the rates of its most competitive services below cost, it may attempt to recover those expenses by foregoing needed capital investment on the MTS side of the house. TURN points out that the current monitoring plan makes no attempt to follow AT&T-C's investment levels or plans.

G. Discussion

First, we commend CACD for its efforts in developing its proposed monitoring plan. We note that the ALJ's rejection of US Sprint's original proposed addition to the plan to monitor the

effects of pricing flexibility on thirty eight customer groups has prompted US Sprint to modify its proposal in its comments on her proposed decision. US Sprint now proposes customer sampling of either 4 or 8 groups. While we agree with the Proposed Decision that US Sprint's original proposal was too burdensome, we find merit in the compromise put forth by US Sprint in its comments.

AT&T-C correctly points out in its reply comments that it would be inappropriate for us today to adopt US Sprint's new proposal raised for the first time in comments on the proposed decision. However, AT&T-C does express a willingness to meet with CACD and US Sprint to consider the feasibility of adding to the monitoring plan along the lines raised by US Sprint in its comments.

We believe the much more limited proposal made by US Sprint in its comments has merit. Therefore, we will direct CACD to conduct meetings or workshops within 45 of the effective date of this order, inviting all parties, to develop an additional report for the monitoring plan based on the four customer subgroups (MTS residential, MTS business, WATS, and 800) suggested by US Sprint in its comments. We authorize CACD to collect information from AT&T-C for an additional report in its monitoring plan at the same time it begins data collection for the rest of the report. We strongly encourage the parties to cooperate in developing a mutually acceptable addition to the monitoring plan along the lines laid out in US Sprint's comments.

We adopt today CACD's monitoring plan in full. Therefore, the exhibits and attachments in Appendix C will form the basis for CACD's annual report pursuant to its proposal, with whatever additions developed pursuant to the above discussion.

We note that parties' fears that our regulatory oversight and authority over AT&T-C is being weakened by this monitoring plan, are unfounded. We relinquish no regulatory authority over AT&T-C today. The monitoring plan, in conjunction with all

regulatory oversight we currently enjoy, will allow us to determine if the road toward rate flexibility is indeed the best one for California to take. Today's order gives AT&T-C a tremendous opportunity to break from the traditional form of regulation it has dealt with in California. In this new era of rate flexibility, we expect AT&T-C to be more cooperative, not less, in supplying the Commission staff, both DRA and CACD, with requested information. Likewise, unless specifically in conflict with an element of the authority we grant today, AT&T-C shall continue to meet all of its existing reporting requirements in effect here at the Commission.

We endorse the proposal to have a six-month Pilot Program for Exhibits 9-19, overseen by DRA. We disagree with AT&T-C that the only determination to be made at the conclusion of that Pilot Program is whether OCCs should also submit data. Refinements and changes to those exhibits can also be made at the end of the Pilot Program pursuant to the comment and resolution process CACD proposes. Thus, MCI and US Sprint need not supply information at this time as part of the monitoring plan. The issue remains open, whether they and other OCCs will have to do so at a future date.

We agree with CACD that its proposed monitoring plan will present us with several helpful indicators which collectively can aid us in assessing how well the interLATA market is doing. If after obtaining results we find that more information is needed, we can change the monitoring plan.

We recognize that even with today's adoption of CACD's monitoring plan with the addition already discussed, certain details will have to be worked out among the parties as to how data is actually going to be gathered and processed. CACD has recommended that our data processing capabilities be used to assist CACD in gathering data under the plan. We delegate to CACD the implementation of its proposed plan and instruct CACD to work with our Data Processing Staff and the parties to determine how the data should be submitted.

The results of the monitoring plan will be recorded data, which may be up to a year old. Thus, the results will be after the fact. It is not appropriate to withhold rate flexibility pending the implementation of the monitoring plan, particularly the Pilot Program which will be in effect for six months. We believe the limited flexibility granted today will result in relatively small changes occurring over an extended period of time.

VIII. Adoption of Non-Contested Issues

AT&T-C offered several additional commitments as conditions on its regulatory flexibility granted today. Since these commitments are not disputed by the other parties[5] and we believe they are in the public interest, we adopt them today. Therefore, as conditions of the authority we grant today, AT&T-C shall:

1. maintain statewide average rates;
2. introduce all new services on a statewide basis;
3. make a maximum of four revisions within approved rate bands per service per year;
4. not impose restrictions on the resale and sharing of its services;
5. not abandon any service except by formal application to the Commission;
6. not seek to withdraw any service from a community on a geographically discriminatory basis;
7. use the formal application process for any new service submission or for the revision

5 CALTEL objects to condition 3 requesting only two revisions per year. However, we find its objection without merit.

of existing service where that submission or revision departs from the approved standard costing methodology;

8. use the formal application process for any service submission that utilizes a combination of existing tariff services discounted in order to provide a competitive response to a specific customer.

Findings of Fact

1. No party has objected to the admission of late filed Exhibit 17 into evidence.

2. Upward pricing flexibility is consistent with the Observation Approach the Commission created in D.87-07-017.

3. At no time in D.87-07-017, did the Commission suggest that only downward pricing flexibility would be appropriate under the Observation Approach.

4. AT&T-C has adequately rebutted the arguments of TURN and DRA regarding the alleged illegality of upward pricing flexibility.

5. Because of concerns regarding the potential adverse impacts if AT&T-C uses rate flexibility to wield market power, it is reasonable to grant relatively limited rate flexibility.

6. The purpose of the Observation Approach is to monitor AT&T-C's behavior once flexibility is granted.

7. Public witness hearings are not necessary prior to granting AT&T-C some limited upward flexibility.

8. It is the Commission's intention to carefully monitor the effects of rate flexibility, both upward and downward, granted today.

9. The Commission stated in D.87-07-017 that it would not hesitate to rescind the flexibility granted to AT&T-C if it appears that ratepayers are being harmed by the granted regulatory changes.

10. One of the purposes of the Observation Approach was to avoid the production of detailed cost studies by AT&T-C.

11. The ALJ made a reasonable resolution of the parties discovery disputes over the level of detail of cost data that was required by AT&T-C, in ordering production of Long Run Incremental Cost Studies on a service-by-service basis.

12. The cost data provided was adequate for parties to argue for changes to the width of AT&T-C's rate bands.

13. The Commission intended that only limited regulatory flexibility be granted AT&T-C under the Observation Approach.

14. Assymetrical rate bands are consistent with the Observation Approach.

15. In order to alleviate the concerns of other parties and comply with the directive that the rate bands be limited, it is reasonable to alter AT&T-C's proposed rate bands in some instances.

16. There is merit in the suggestion of several parties that the rate bands should be tied to percentage points of increase and decrease.

17. AT&T-C's argument that it must establish its rate bands in at least penny increments is reasonable because of its current billing structure.

18. Many of AT&T-C's proposed rate bands are in the 5-10% range.

19. Some of AT&T-C's proposed rate bands indicate a substantially higher percentage change in one or both directions.

20. The parties' suggestion that the all rate bands be limited to 5-10% change is too limited.

21. It is reasonable for AT&T-C to adjust its bands so that no rate band changes more than 15% in either direction, except when necessary to round to the nearest penny.

22. It is not reasonable to give AT&T-C permission to adjust all its rate bands to $\pm$15%.

23. AT&T-C's proposed reference rates will be changed by other decisions granted today.

24. It is reasonable to require AT&T-C to file an advice letter reflecting the new reference rates and rate bands consistent with this order, showing both percentage and cent bands.

25. It is not reasonable to incorporate whatever refund mechanism that is finally adopted in the rehearing on D.88-06-036 into the reference rates for AT&T-C's authorized rate bands.

26. It is reasonable to allow the rate bands to remain the same absolute size in cents as they are on January 1, 1989, after the January 1, 1990, SPF to SLU adjustment.

27. AT&T-C's request to make changes within its approved rate bands on five days' notice through advice letter filings is reasonable so long as such advice letters are served by any party requesting it by overnight mail.

28. It is reasonable to require AT&T-C to send out a customer notice, developed with the Public Advisor's Office, regarding the flexibility granted today during the first practicable billing cycle.

29. AT&T-C has not made a convincing showing that the lower ends of its rate bands should be approved through the advice letter process.

30. It is reasonable to require AT&T-C to make adjustments to the upper or lower end of its rate bands by formal application.

31. AT&T-C's definition of a new service as an offering which customers perceive as a new service and which has a combination of technology, access, features, or functions that distinguishes it from any existing services, meets the guidelines stated in D.87-07-017.

32. By its own admission, AT&T-C's PRO California application pending before the Commission is not a new service.

33. AT&T-C has made no compelling showing why uniform costing methodology for new services should be developed in the PRO California application.

34. It is reasonable to assume that the definition of new services adopted today will be refined in the first new service application that will also determine costing methodology.

35. It is important to allow all interested parties to effectively participate in the first new service application where costing methodology for future filings will be determined.

36. Once uniform costing methodology is established in the first new service application, approval of future new services via advice letter filings is reasonable, allowing the effective date of the new services 40 days after filing unless otherwise authorized by the Commission.

37. If the protests to these advice letter filings so indicate, the Commission may require the filing of an application instead.

38. AT&T-C's proposal to shorten the review time to twenty days for new services already approved by the FCC is without merit because this Commission has a strong interest in maintaining its independent review for intrastate services.

39. The appropriate width of rate bands for new services is appropriately deferred to the first new services application since the record is minimal on this issue.

40. CACD's proposed monitoring plan adequately addresses our guidelines expressed in D.87-07-017, except for the area discussed in Finding of Fact No. 44.

41. The Commission is not relinquishing any regulatory authority over AT&T-C by its grant of limited regulatory flexibility today.

42. It is reasonable to conduct a six-month Pilot Program for Exhibits 9-19 of CACD's monitoring plan, overseen by DRA.

43. US Sprint's original suggested additions to the monitoring plan impose too great a burden on AT&T-C and CACD relative to the useful information that could be obtained.

44. US Sprint's modified proposal to add to the monitoring plan, first presented in its comments on the proposed decision, has merit.

45. It is reasonable to require CACD to conduct meetings or workshops to develop an additional report for the monitoring plan based on the four customer subgroups (MTS residential, MTS business, WATS, and 800) suggested by US Sprint in its comments.

46. It is necessary for CACD to work out the final details of implementing the monitoring plan, in consultation with our Data Processing staff and interested parties.

Conclusions of Law

1. Since no party objected to the receipt of late filed Exhibit 17 into evidence, it should be received.

2. Upward pricing flexibility, consistent with this decision is just and reasonable and should be adopted by the Commission.

3. The Commission should rescind or alter the flexibility granted today if it appears ratepayers are being harmed.

4. Under the Observation Approach, the Commission should not require detailed cost studies.

5. AT&T-C's proposed rate bands should be limited in keeping with the directives of D.87-07-017.

6. AT&T-C should establish its rate bands both in penny increments and percentage points.

7. AT&T-C should adjust its proposed rate bands so that no rate band changes more than 15% in either direction, except when necessary to round to the nearest penny for billing purposes.

8. AT&T-C's rate bands that change less than 15% in either direction should be adopted as proposed.

9. The 15% cap/floor should not preclude assymetrical rates.

10. Since AT&T-C's reference rates will change due to other pending Commission matters, a compliance filing should be ordered.

11. Whatever refund mechanism adopted in the rehearing on D.88-06-036 should not be incorporated into AT&T-C's reference rates.

12. The January 1, 1990 SPF to SLU adjustments should not change the range of flexibility as expressed in dollars and cents granted today.

13. AT&T-C's proposal to make changes within rate bands effective on five days' notice through advice letter filings should be adopted provided that AT&T-C serves its advice letters on any party so requesting by overnight mail.

14. Sections IV and V of GO 96-A should be waived in accordance with the preceding conclusion of law.

15. AT&T-C should provide customer notice through a bill insert developed with the Public Advisor's Office regarding the flexibility granted today during the first practicable billing cycle.

16. AT&T-C should be ordered to make changes to the rate bands adopted today through the formal application process.

17. AT&T-C's definition of new services as described in Finding of Fact 29 should be adopted.

18. AT&T-C's request that PRO California be the application where uniform costing methodology for new services is established should be denied.

19. The first new services application that meets our adopted definition should establish uniform costing methodology, refine the new service definition and allow all parties to effectively participate.

20. Once uniform costing methodology is established in AT&T-C's first new service application, future new service filings should be handled through the advice letter process with the effective date of the tariffs 40 days after filing.

21. The Commission should order the filing of an application instead of an advice letter for new services if warranted by the protests.

22. The Commission should not adopt AT&T-C's proposal to introduce new services approved by the FCC on twenty days' notice in California.

23. The appropriate width of rate bands for new services should be deferred until the first new service application is filed by AT&T-C.

24. The Commission should adopt AT&T-C's monitoring plan in full, including additions referenced in Conclusion of Law No. 27, including the six-month Pilot Program to be overseen by DRA.

25. AT&T-C should continue to meet all reporting requirements currently in effect by Commission decision, statute or rule.

26. US Sprint's original proposed additions to CACD's monitoring plan should not be adopted.

27. CACD should hold meetings or workshops to consider what additions should be made to the monitoring plan as raised in US Sprint's comments on the proposed decision.

28. CACD should work out the final details of implementing the monitoring plan in consultation with our Data Processing staff and interested parties.

O R D E R

IT IS ORDERED that:

1. Late filed Exhibit 17 shall be received in evidence.

2. AT&T-C is granted limited regulatory flexibility consistent with this decision and subject to the following conditions:

   a. AT&T-C shall adjust its proposed rate bands so that no rate band changes more than 15% in either direction from the reference rate, except when necessary to round to the nearest penny.

b. AT&T-C shall adjust its reference rates discussed in section (a) above pursuant to other year-end Commission actions. Whatever refund mechanism adopted in rehearing on D.88-06-036 shall not be incorporated into AT&T-C's reference rates. The January 1, 1990, SPF to SLU adjustment shall not affect the range of flexibility as expressed in dollars and cents granted today.

c. Sections IV and V of GO 96-A shall be waived to allow AT&T-C to make changes within its approved rate bands effective on five days' notice through advice letter filings, provided AT&T-C serves such advice letter filings on any requesting party by overnight mail. AT&T-C shall notify its customers of the flexibility granted today through a bill insert developed with the Public Advisor's Office during the first practicable billing cycle.

d. AT&T-C shall be required to use the formal application process to make any changes to the rate bands authorized today.

e. AT&T-C shall not use its PRO California application to develop a uniform costing methodology for future new service filings.

f. The advice letter process approved today for new services shall not take effect until AT&T-C has filed a new service application where uniform costing methodology shall be established, the new services definition shall be refined and all parties shall be allowed to effectively participate.

g. After uniform costing methodology is established in the first new service application, future new service filings shall be handled through the advice letter process under General Order 96-A.

h. AT&T-C shall maintain statewide average rates;

i. AT&T-C shall introduce all new services on a statewide basis;

j. AT&T-C shall make a maximum of four revisions within approved rate bands per service per year;

k. AT&T-C shall not impose restrictions on the resale and sharing of its services;

l. AT&T-C shall not abandon any service except by formal application to the Commission;

m. AT&T-C shall not seek to withdraw any service from a community on a geographically discriminatory basis;

n. AT&T-C shall use the formal application process for any new service submission or for the revision of existing service where that submission or revision departs from the approved standard costing methodology;

o. AT&T-C shall use the formal application process for any service submission that utilizes a combination of existing tariff services discounted in order to provide a competitive response to a specific customer.

3. CACD shall implement its proposed monitoring plan in full. CACD shall hold workshops within 45 days of the effective date of this order to determine what additions should be made to the monitoring plan, limited to the proposal made by US Sprint in its comments to the proposed decision. In addition, CACD shall inform all parties by letter of the final details of implementing the monitoring plan and the date for commencement of data collection for the monitoring plan.

4. AT&T-C shall continue to meet all Commission reporting requirements currently in effect.

5. Within ten days of the effective date of this order, AT&T-C shall file advice letter tariff sheets reflecting all the conditions discussed in this order. For administrative

convenience, AT&T-C shall consolidate the rate changes in the Phase I opinion on the rehearing of D.88-06-036 and Advice Letter 113 with changes in this decision to produce a set of consolidated tariff sheets. These tariffs sheets shall be effective on January 1, 1989.

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

APPENDIX A

List of Appearances

Applicant: Richard A. Bromley and Michael P. Hurst, Attorneys at Law, for AT&T Communications of California, Inc.

Protestants: Thomas J. MacBride, Jr., Attorney at Law, for California Association of Long Distance Telephone Companies; and Richard E. Potter and Kenneth K. Okel, Attorneys at Law, for GTE California, Inc.

Interested Parties: C. Hayden Ames, Attorney at Law, for Chickering & Gregory; Marlin Ard, Attorney at Law, for Pacific Bell; Mark Barmore, Attorney at Law, for Toward Utility Rate Normalization (TURN); Messrs. Pelavin, Norberg & Beck, by Alvin H. Pelavin, Jeffrey F. Beck, and Lizbeth M. Morris, Attorneys at Law, for Smaller Independent Telephone Companies; Peter Casciato, Attorney at Law, for Cable & Wireless, Inc.; Messrs. Orrick, Herrington & Sutcliffe, by Robert Gloistein, Attorney at Law, for Continental Telephone Company; John W. Witt, City Attorney, by William S. Shaffran, Deputy City Attorney, for City of San Diego; Alan M. Weiss, Attorney at Law, for MCI Telecommunications Corporation; Phyllis A. Whitten and Craig D. Dingwall, Attorneys at Law, for US Sprint Communications Company; Messrs. Davis, Young & Mendelson, by Jeffrey F. Beck, Attorney at Law, for Citizens Utilities Company of California, CP National, GTE West Coast Incorporated, Happy Valley Telephone Company, Hornitos Telephone Company, Kerman Telephone Company, Pinnacles Telephone Company, Roseville Telephone Company, Sierra Telephone Company, The Siskiyou Telephone Company, Tuolumne Telephone Company, The Volcano Telephone Company, and The Winterhaven Telephone Company; C. Kingston Cole, for Pacific Rim Group; Mary Lynn Gauthier, for Gauthier & Hallett; and Sidney J. Webb, for himself.

Division of Ratepayer Advocates: James S. Rood, Attorney at Law, and Thomas A. Doub.

Commission Advisory and Compliance Division: Kevin P. Coughlan.

(END OF APPENDIX A)

APPENDIX B

AT&T-C's Proposed Rate Bands

TABLE 1 - MTS Mileage Steps

MILEAGE STEP	DIAL STATION INITIAL MINUTE Reference Rate	DIAL STATION INITIAL MINUTE Rate Band	COIN DIAL INITIAL 3 MINUTES Reference Rate	COIN DIAL INITIAL 3 MINUTES Rate Band	EACH ADDITIONAL MINUTE FOR ALL CLASSES OF MTS SERVICE Reference Rate	EACH ADDITIONAL MINUTE FOR ALL CLASSES OF MTS SERVICE Rate Band
0-20	$.20	.19-.20	$ .55	.50- .60	$.10	.09-.11
21-40	.28	.27-.28	.75	.70- .80	.17	.16-.18
41-70	.30	.29-.30	.85	.80- .90	.18	.17-.19
71-100	.34	.32-.35	.90	.80- .95	.20	.18-.22
101-150	.36	.33-.37	1.00	.90-1.05	.21	.18-.23
151-330	.38	.35-.39	1.10	1.00-1.15	.24	.21-.26
OVER 300	.39	.36-.40	1.15	1.05-1.20	.24	.21-.26

TABLE 2 - MTS Discounts

	Current Discount	Rate Band
Evening	20%	18% - 25%
Night/Weekend	40%	36%[1] - 45%

TABLE 3 - MTS Operator Services

	Reference Rate	Rate Band
Calling Card	$ .50	.40 - .53
Station	1.00	.90 - 1.05
Person	3.00	2.80 - 3.15
Verify	1.00	.85 - 1.15
Interrupt	1.50	1.30 - 1.70
Dir. Asst.	.35	.25 - .45

TABLE 4 - WATS (zero rate band around per-message charge)

Hours of Usage	HALF STATE Reference Rate	HALF STATE Rate Band	FULL STATE Reference Rate	FULL STATE Rate Band
0 - 15	$9.66	8.21 - 10.14	$10.48	8.91 - 11.00
15 - 40	8.36	7.11 - 8.78	9.85	8.37 - 10.34
40 - 80	7.61	6.47 - 7.99	8.75	7.44 - 9.19
OVER 80	7.01	5.96 - 7.36	7.65	6.50 - 8.03

TABLE 5 - 800 Service (zero rate band around per-message charge)

Hours of Usage	HALF STATE Reference Rate	HALF STATE Rate Band	FULL STATE Reference Rate	FULL STATE Rate Band
M-F, 9a-9p	$11.55	10.40 - 12.13	$14.26	12.83 -14.97
ALL OTHER	5.20	5.20 - 5.46	6.55	6.55 - 6.88

1/ Correction of typographical error in AT&T-C's table based on testimony of AT&T-C's witness Parker.

(END OF APPENDIX B)

APPENDIX C

MONITORING THE IMPACT ON COMPETITION

Exhibits 1 through 8

Attachments 1 through 8

EXHIBIT 1

PURPOSE: To detect any change in the ease of market entry or exit.

DATA SOURCE: Applications for Certificates of Public Convenience and Necessity (CPCN) housed in CPUC's central files. The CACD staff will be responsible for collections and compiling the data.*

CARRIERS REPORTED: All non-dominant interLATA carriers.*

CPCN Applications Filed	Year 1986	1987	1988	Total
No. CPCN Appl. Filed				
% Change from Prev. Year				
No. CPCNs Granted				
% Change from Prev. Year				
No. CPCN Appl. Denied				
% Change from Prev. Year				
No. CPCN Appl. Pending Dec.				
% Change from Prev. Year				
Avg. Assets Claimed in Appl.				
% Change from Prev. Year				
Avg. Liability Claimed in Appl.				
% Change from Prev. Year				
No. Cert. Carriers End of Year				
% Change from Prev. Year				
No. CPCNs Withdrawn				
% Change from Prev. Year				

* See Attachment 1

ATTACHMENT 1

It is recommended that the CACD staff compile the data below, separately for each year beginning with 1985. Since the information is already available to the general public, the CACD staff should be authorized to release this data in the form shown below to any requesting party.

Name of Appl. for InterLATA CPCN	Appl. Date	Appl. No.	Assets	Liability	Equity	Decision No.	Application Approved (A)/ Denied (D)	PUC ID No.	Date First Tariff Filed	Date CPCN Withdrawn

EXHIBIT 2

PURPOSE: TO DETECT ANY CHANGE IN THE DEGREE OF CUSTOMER CHOICE AMONG SUBSTITUTABLE SERVICES

DATA SOURCE: The CACD staff recommends that all non-dominant interexchange carriers (NDIEC) be required to submit the information requested in Attachment 2.

CARRIERS REPORTED: The CACD staff recommends that the data submitted in Attachment 2 be reported in the following manner:

	PERCENT OF CERTIFIED NDIEC – OFFERING SERVICES BELOW							
LATA	Long Distance (L.D.)	WATS-Like	Directory Assistance	Credit Card	L.D. Operator	Analog Private Line	Digital Private Line	Virtual Private Line
LATA 1 '86-'87								
'87-'88								
LATA 2 '86-'87								
'87-'88								
LATA 3 '86-'87								
'87-'88								
LATA 4 '86-'87								
'87-'88								
LATA 5 '86-'87								
'87-'88								
LATA 6 '86-'87								
'87-'88								
LATA 7 '86-'87								
'87-'88								
LATA 8 '86-'87								
'87-'88								
LATA 9 '86-'87								
'87-'88								
LATA 10 '86-'87								
'87-'88								

ATTACHMENT 2

The CACD staff recommends that all certified non-dominant interexchange carriers be required to submit the information requested below, separately for each year beginning with 1985.

The CACD staff also recommends that, since this information is already available to the general public, it should be authorized to provide this data in the form below to any requesting party.

CARRIER NAME:_____ PUC ID. NO.: _____

Year _____

	LATA	Distance	Wats-like	Directory Assistance	Credit Card	L.D. Operator	Analog Private Line	Digital Private Line	Virtual Private Line
1									
2									
3									
4									
5									
6									
7									
8									
9									
10									

EXHIBIT 3

PURPOSED: To detect any change in competitive capacity to serve by percent change in intrastate circuit miles installed and planned.

DATA SOURCE: The CACD staff recommends that ATT-C, MCI, and U.S. Sprint be required to submit the information in Attachment 3.

CARRIERS REPORTED: CACD staff recommends that the information submitted in Attachment 3 be reported in the following manner:

Carrier	Percentage Change in Intrastate Circuit Miles Installed*	Percentage Change in Intrastate Circuit Miles Planned in the Next Two Years
ATT-C		
1986-87		
1887-88		
U.S. Sprint/ MCI Combined		
1986-87		
1987-88		

* When fully multiplexed.

The CACD staff recommends that ATT-C, MCI and U.S. Sprint be required to complete this form.

During the workshop, MCI and U.S. Sprint indicated that they may not be able to extract actual California-specific data from their voluminous data base where information is aggregated on a network-wide or national basis. If they are unable to provide the actual data, then they should make a reasonable effort to estimate the data. They should explain, however, how their estimates were derived and why they believe them to be reasonable.

The CACD staff believes that only the Commission staff should have access to this data in the form shown below.

INTEREXCHANGE CARRIER NAME: _____

Year	Intrastate Circuit Miles Installed*	Intrastate Circuit Miles Planned in the Next Two Years
1986		
1987		
1988		

* When fully multiplexed.

EXHIBIT 4

PURPOSE: To detect any change in competitive capacity to serve by percent change in switching capacity.

DATA SOURCE: The CACD staff recommends that ATT-C, MCI, and U.S. Sprint be required to furnish the data requested in Attachment 4 (shown here in a manner which protects the confidentiality of the data submitted) separately for each year beginning with 1986.

CARRIERS REPORTED: The CACD staff recommends that the data furnished by ATT-C, MCI and U.S. Sprint be reported in the manner shown below.

Carrier	Percent Change: Total Circuit Terms*	Percent Change: Additional Circuit Terms Planned in the Next 2 Years**
ATT-C		
1986-87		
1987-88		
MCI/US Sprint		
1986-87		
1987-88		

* Circuit terms is defined as the maximum number of calls that a switch can be equipped to have in progress at one time. Total circuit terms is therefore defined as the sum circuit terms for all switches combined.

** The current year plus 2 years.

ATTACHMENT 4

The CACD staff recommends that ATT-C, MCI and U.S. Sprint be required to furnish data requested below, separately for each year beginning with 1986. All three carriers have indicated that they are able to furnish this data.

The CACD staff believes that only the Commission's staff should have access to this data in the form shown below.

CARRIER NAME: _____ Year: _____

Switch Type/ Manufacturer	Quantity	Busy Hour Call Capacity/SW	Maximum Circuit Terms	Current Total Circuit Terms
Total				

ADDITIONAL CIRCUIT TERMS PLANNED IN THE NEXT TWO YEARS (Reported Year Plus 2)

Planned Method of Expansion	Maximum Circuit Terms
Acquisition of Additional Switches	
Other Methods of Expansion	
Total Additional Circuit Terms Planned in the Next 2 Years	

1. Busy Hour Call Capacity is the number of calls that can be switched during the busiest hour of use.

2. Maximum Circuit Terms/SW is the maximum number of calls that the switch can be equipped to have in progress at one time.

3. Current Total Circuit Terms is derived by multiplying column 2 and column 4.

EXHIBIT 5

PURPOSE: To detect any change in OCC size and growth potential by percent change in revenue by service category.

DATA SOURCE: The CACD staff recommends that all interexchange carriers be required to submit data requested in Attachment 5.

CARRIERS REPORTED: The CACD staff recommends that the data submitted by all interexchange carriers in response to the requirements in Attachment 5 be reported in the following manner:

Carrier	Percent Change from Previous Year	
	1987	1988
ATT-C		
- Private Line		
- Switched:		
- MTS		
- WATS		
- 800		
All OCCs		
- Private Line		
- Switched:		
- MTS		
- WATS		
- 800		

ATTACHMENT 5

The CACD staff recommends that all certified interexchange carriers be required to submit the data requested below separately for each year beginning with 1986.

The CACD staff believes that only the Commission's staff should have access to this data in the form shown below.

CARRIER NAME _____ Year _____

Service Categories	Revenue				
	First Qtr.	Second Qrt.	Third Qtr.	Fourth Qtr.	Total
- Total Private Line					
- Total Switched:*					
- MTS					
- WATS					
- 800					

* MTS, WATS and 800 service are subcategories of switched services.

EXHIBIT 6

PURPOSE: To detect any change in OCC size and growth potential by percent change in interstate and intrastate Minutes of Use (MOU).

DATA SOURCE: The CACD staff recommends that all Local Exchange Carriers be required to submit data requested in Attachment 6.

CARRIERS REPORTED: The CACD staff recommends that the data submitted in Attachment 5 be reported in the following manner:

Carrier	Percent Change in MOU 1985	1986	1987	1988
ATT-C				
Interstate MOU				
Intrastate MOU				
MCI				
Interstate MOU				
Intrastate MOU				
US Sprint				
Interstate MOU				
Intrastate MOU				
All Others				
Interstate MOU				
Intrastate MOU				

ATTACHMENT 6

The CACD staff recommends that all Local Exchange Carriers be required to submit the data requested below separately for each year beginning with 1984.

The CACD staff believes that only the Commission staff should have access to this data in the form shown below.

LOCAL EXCHANGE CARRIER REPORTING: _____

YEAR: _____

Interexchange Carrier	First Qtr.	Second Qtr.	Third Qtr.	Fourth Qtr.	Total
ATT-C					
Interstate MOU					
Intrastate MOU					
MCI					
Interstate MOU					
Intrastate MOU					
US Sprint					
Interstate MOU					
Intrastate MOU					
All Others					
Interstate MOU					
Intrastate MOU					
Total					
Interstate MOU					
Intrastate MOU					

EXHIBIT 7

PURPOSE: To detect any change in OCC market share by percent change in the share of total revenue by service category.

DATA SOURCE: The E&C staff recommends that all interchange carriers be required to submit data requested in Attachment 7.

CARRIERS REPORTED: The E&C staff recommends that the data submitted by all interchange carriers in Attachment 7 be reported in the following manner:

Carrier	Percent Change in Share of Total Revenue by Service Category	
	1987	1988
ATT-C		
- Private Line		
- Switched		
- MTS		
- WATS		
- 800		
All OCCs		
- Private Line		
- Switched		
- MTS		
- WATS		
- 800		

Please refer to Attachment 5.

EXHIBIT 8

PURPOSE: To detect any change in OCC market share by percent change in share of total interstate and intrastate access Minutes of Use (MOU).

DATA SOURCE: The E&C staff recommends that all Local Exchange Carriers be required to submit data requested in Attachment 8.

CARRIERS REPORTED: The E&C staff recommends that the data submitted in Attachment 8 be reported in the following manner:

Carrier	Percent Change in Total Share of MOU by MOU Categ.			
	1985	1986	1987	1988
AT&T-C				
Interstate MOU				
Intrastate MOU				
MCI				
Interstate MOU				
Intrastate MOU				
US Sprint				
Interstate MOU				
Intrastate MOU				
All Others				
Interstate MOU				
Intrastate MOU				

ATTACHMENT 8

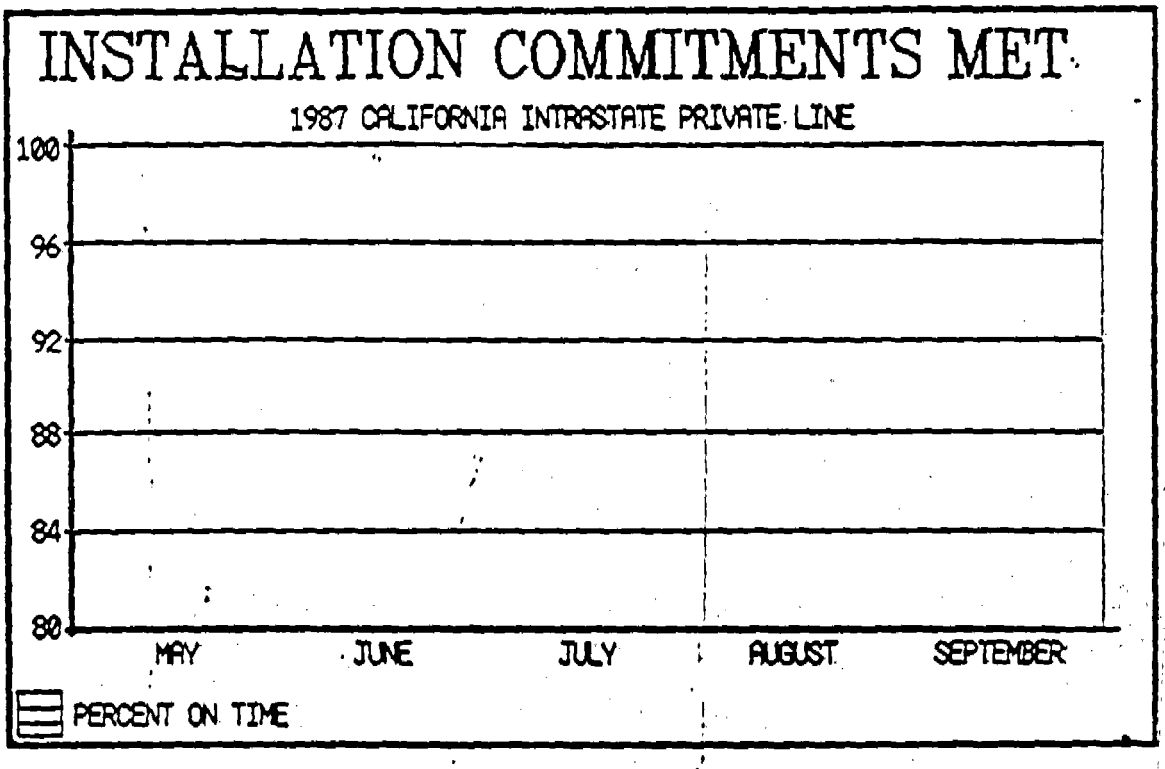
Please refer to Attachment 6.

MONITORING THE IMPACT ON CONSUMERS

Exhibits 9 through 19

(DRA Pilot Program)

EXHIBIT 9



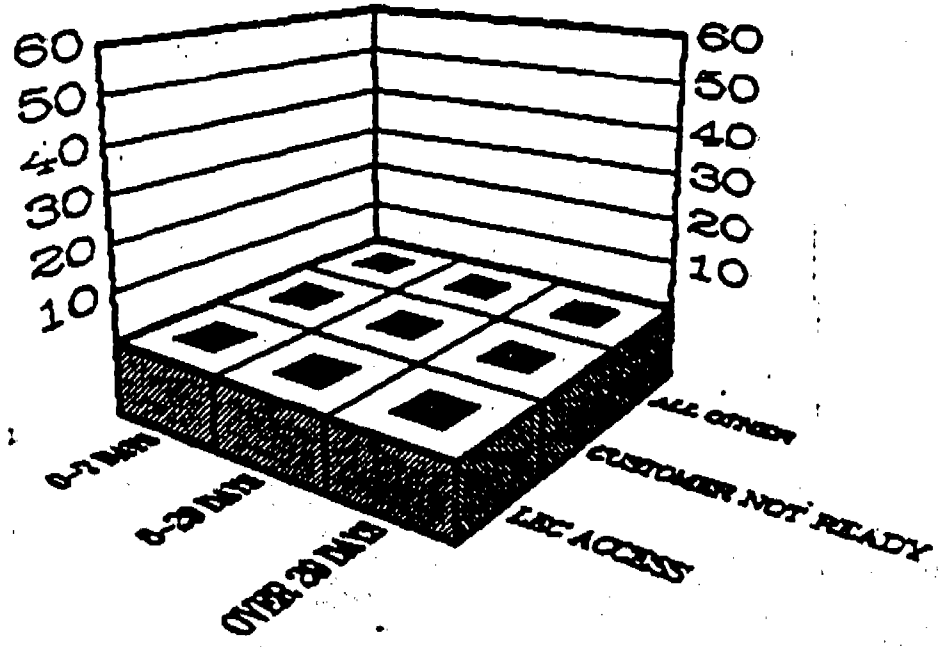
The installation commitments met shows what percent of customer due dates were met on or before the committed to date. Currently there are a number (3%-5%) of non-California orders included in the base since AT&T work centers located within California are also designated as the responsible reporting entity for circuits which do not physically appear in the state.

The system from which the data for the above graph was produced retains the raw data for only three months. Therefore, it is not possible to obtain earlier results.

EXHIBIT 10

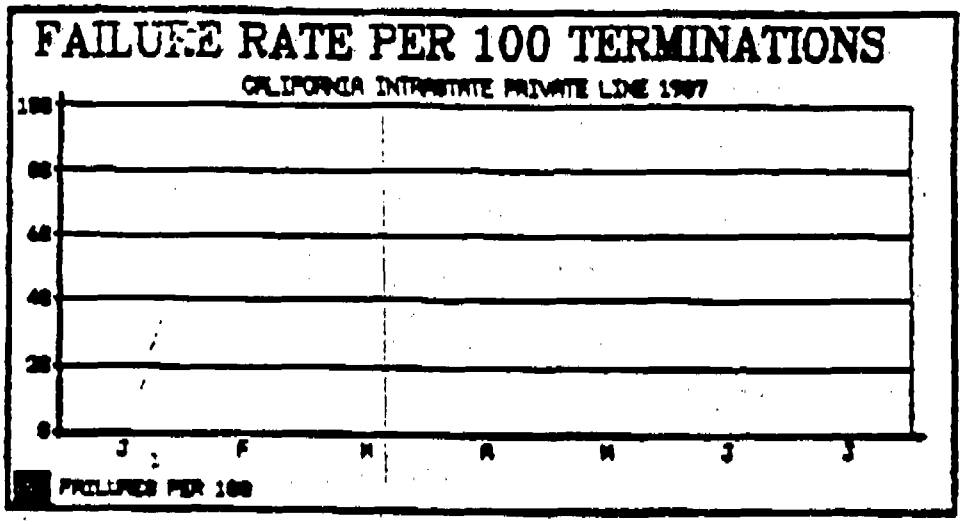
HELD ORDERS

CALIFORNIA PRIVATE LINE 1987



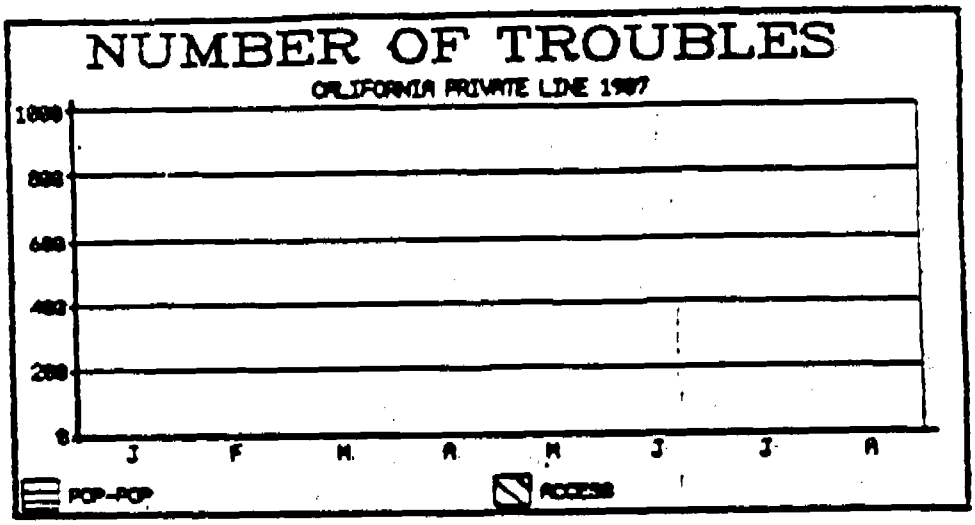
The Held Private Line Orders graph indicates the quantity of held orders by age and type. The Customer Not Ready (C.N.R.) row shows how many orders are held as a result of customer actions.

EXHIBIT 11



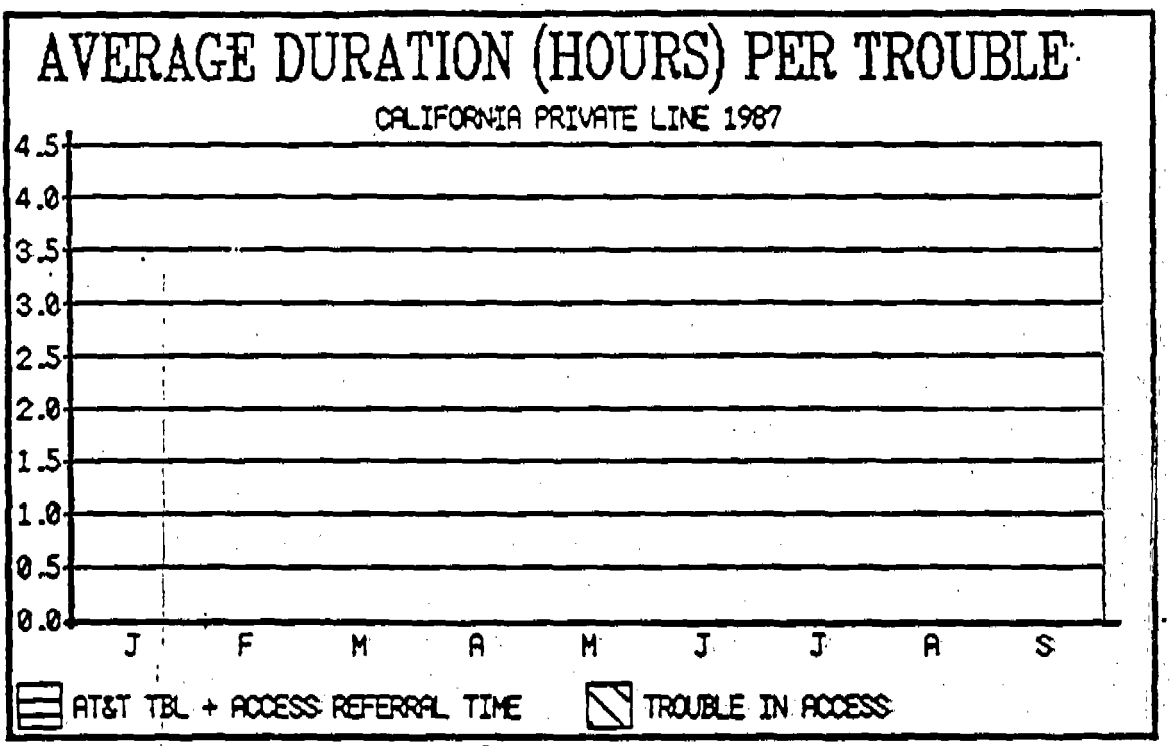
This graph depicts the number of failures per 100 private line circuit terminations. A circuit termination equates to a customer location or "virtual location" in the case of certain private switched services (open end of Foreign Exchange circuits and intermachine trunks on private switched networks).

EXHIBIT 12



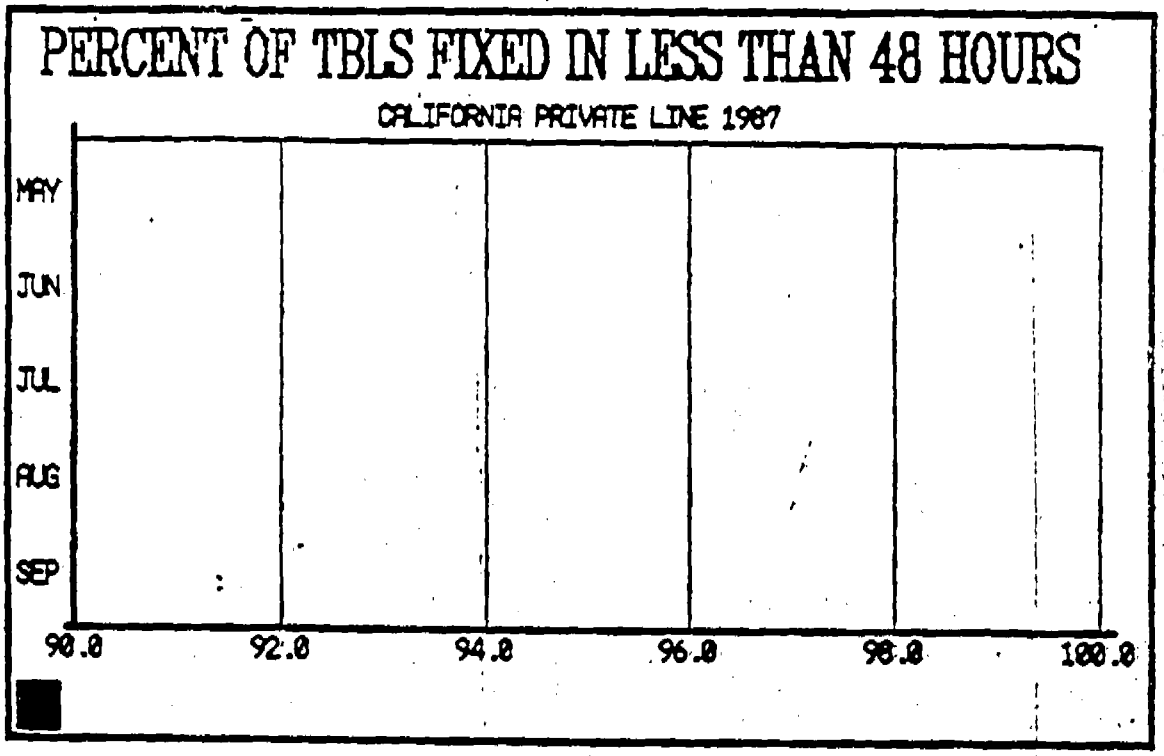
The number of troubles indicates the total quantity of customer troubles reported on California intrastate private line circuits. The POP-POP troubles are those found to be in AT&T facilities or equipment, and the ACCESS troubles are those which are located in LEC facilities or equipment.

EXHIBIT 13



The duration per trouble shows the average in hours that it takes to restore a failed private line circuit to normal operation after receiving a customer's report. In addition to the time required to isolate, repair and restore service faults in AT&T equipment or facilities, the "AT&T TBL" columns include the time taken by AT&T Technicians to sectionalize problems which are ultimately found to be in the LEC access. The "TROUBLE IN ACCESS" columns include only the time taken by the LEC to clear troubles within the access portion of a circuit and does not include the time expended by AT&T Technicians to determine that the trouble is located in the LEC access.

EXHIBIT 14



The percent of troubles fixed in less than 48 hours shows data for only six months since the database from which it was derived will not retain the data for a longer period of time. In addition, it is produced on a "demand" basis and is not a generally available report.

EXHIBIT 15

CUSTOMER SATISFACTION

SOURCE: CPUC CONSUMER AFFAIRS BUREAU MONTH: _____

DATA: _____

COMPANY	SERVICE	BILLING	RATE INCREASE PROTEST	OTHER	TOTAL
BENCHMARK _____					
1984					
1985					
1986					
AT&T					
MCI					
US SPRINT					
ALL OTHERS					

SERVICE

All problems with service work such as appointment not met, quality of work unsatisfactory, job incomplete, charge unacceptable, etc. All issues regarding the service provided by operator services such as attitude of operator, delays in completing calls, incorrect coding of call, etc.

BILLING

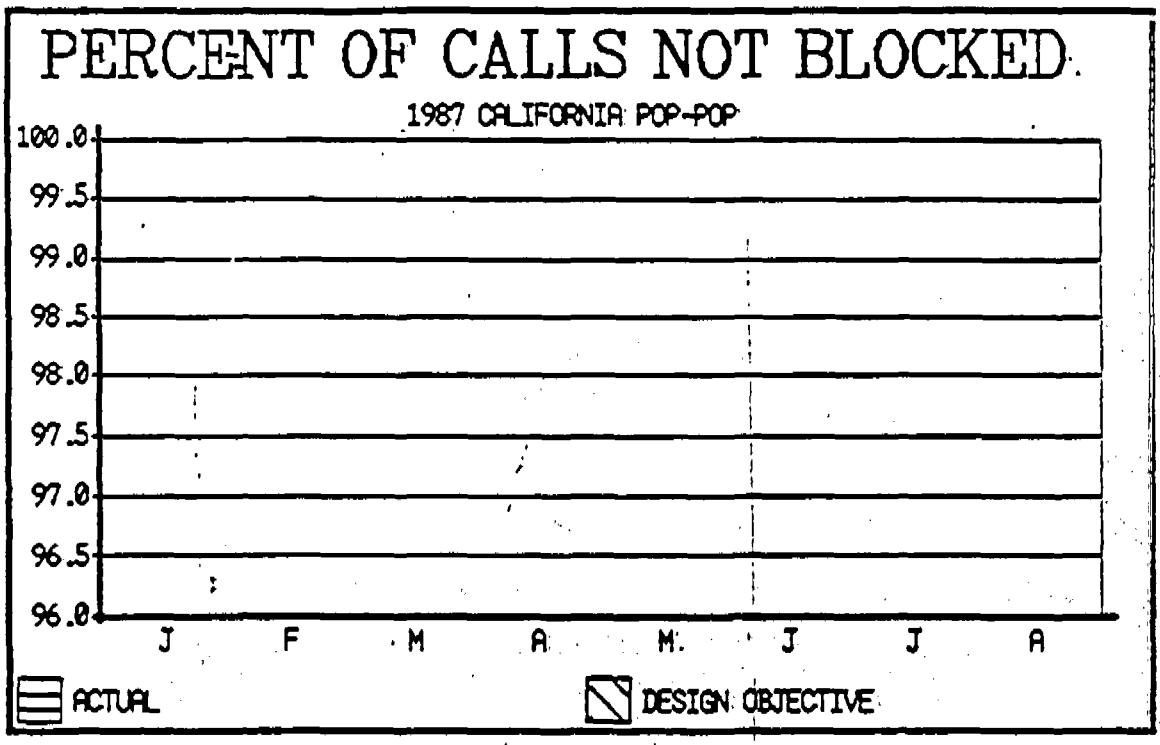
All problems regarding billing such as denies all knowledge of call/charge on bill (Collect, Direct Dial, Third Number Billing), charges differ from those quoted, adjustments or refunds not received, credit/terms/collection issues, Directory Assistant charges, etc.

RATE INCREASE PROTEST

All complaints regarding increases in long distance prices.

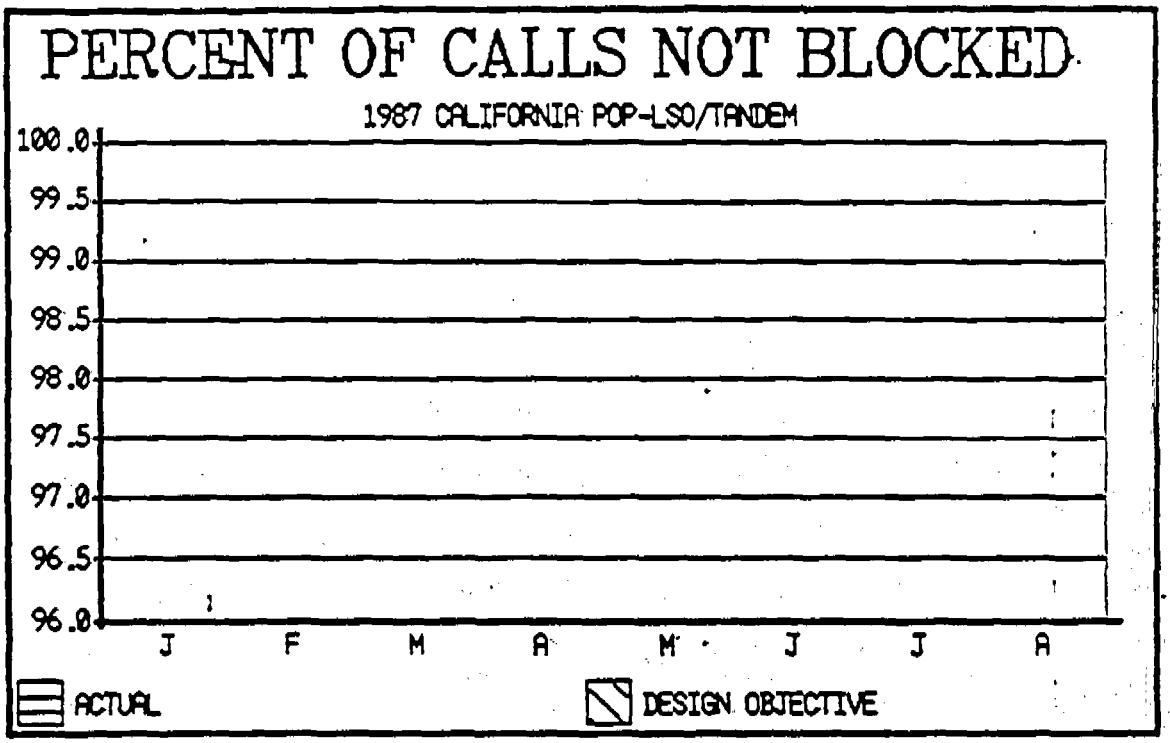
OTHER

All matters which do not fall in the other catagories



The percent of "POP-POP" calls not blocked is an indication of how well the ATT-C switch to switch network processes calls. The above graph is comprised of data from both interstate and intrastate service, and includes the impact of events outside of California. Factors which contribute to blockage in the network include:

1. Insufficient POP-POP trunking.
2. Transmission facility or switch failures.
3. Abnormal calling patterns to a particular location or community of interest.



The percent of "POP_LSO/TANDEN" Calls not blocked is an indication of how well the access network between AT&T switches and LEC local serving offices (LSO) or LEC access tandems processes calls. The above graph portrays both interstate and intrastate service, since the data cannot be directly broken down to "intraste only".

Factors which contribute to blockage in the Network include:

1. Inadequate access trunking.
2. LEC transmission facility and switch failures.
3. Abnormal calling patterns to a particular location/community of interest.
4. AT&T switch failures.

EXHIBIT 18

AVERAGE SPEED OF ANSWER

SOURCE: AT&T MONTH: _____ YEAR: _____

CENTER LOCATION	AVERAGE SPEED OF ANSWER (SECONDS)	#ACD CALLS
PRIMARY ACCOUNT SALES CENTER		
LAGUNA HILLS		
MONTEREY PARK		
PLEASANTON		
SANTA CLARA		
VAN NUYS		
AVERAGE: _____		
ACCOUNT INQUIRY CENTER		
LAGUNA HILLS		
MONTEREY PARK		
PLEASANTON		
SANTA CLARA		
VAN NUYS		
AVERAGE: _____		
CONSUMER MARKETING SALES CENTER		
PLEASANTON		
PHOENIX		
AVERAGE _____		

D R A-F-T

Dear Long Distance Telephone Company Customer:

The California Public Utilities Commission is monitoring the long distance telephone service provided by long distance telephone companies in California and would appreciate your taking a few moments to complete the attached survey. Since this evaluation is being sent to a small but representative sample of long distance telephone subscribers in your area, it is very important that you return the completed questionnaire promptly to ensure that the results reflect all viewpoints.

Please return the questionnaire in the enclosed postage-paid envelope by _____.

Thank you very much for your assistance. If you have any questions or would like to discuss this subject, please feel free to contact Dal Singh of my staff on (415) 557-2041.

Sincerely,

Public Staff Division

CALIFORNIA PUBLIC UTILITIES COMMISSION'S LONG DISTANCE TELEPHONE COMPANY SERVICE EVALUATION

Instructions:

CIRCLE ONLY ONE NUMBER PER QUESTION.
ANSWER FOR ONLY ONE PHONE IN YOUR HOME OR BUSINESS.

		YOUR RESPONSE
1.	What is the name of your Local Telephone Company?	_____
2.	What is the name of your Long Distance Company? (ALLNET, MCI, AT&T, SPRINT, etc.)	_____
3.	What is the area code and first 3 digits of your phone number?	
	YOUR TELEPHONE NUMBER (_ _ _) _ _ _ - x x x x (Area Code)	
4.	How long have you had service at this address?	
	Less than 6 months	1
	6 months to 2 years	2
	Over 2 years to 5 years	3
	Longer than 5 years	4
5.	What type of telephone service do you have?	
	Private Line Residential	1
	Business	2
6.	Do you or any of your relatives work for any telephone company?	
	YES ..... (If "YES", which company? _____)	1
	NO	2

7. Approximately how many LONG DISTANCE calls (those which require the dialing of an area code for completion) have you made from your phone in the last 30 days?

NONE (Skip to next page)	1
1 to 5	2
6 to 10	3
11 to 30	4
MORE THAN 30	5

On these LONG DISTANCE CALLS DURING THE LAST 30 DAYS, how often have you noticed:

		1-NEVER 2-RARELY		3-OCCASIONALLY 4-FREQUENTLY	
8.	Static or noise on the line	1	2	3	4
9.	Voices fading in and out	1	2	3	4
10.	Voices echoing	1	2	3	4
11.	Low volume	1	2	3	4
12.	You can't hear the other party	1	2	3	4
13.	The other party can't hear you	1	2	3	4
14.	Other voices on the line	1	2	3	4
15.	Getting disconnected while talking	1	2	3	4
16.	Receiving a busy signal or recording before you're finished dialing	1	2	3	4
17.	Receiving the recording, "All circuits are busy now ...", or a fast busy signal	1	2	3	4
18.	Having to redial the number because the call did not go through	1	2	3	4

Regarding contacts with your Long Distance service company's Office Personnel in the past 3 months:

19. Were the office personnel courteous while assisting you?

I HAVE NOT HAD CONTACT WITH THEM IN 3 MONTHS (Skip to Question #21) 1

YES 2

NO 3

20. Were you satisfied with the help you received from the office personnel?

YES 1

NO 2

(If "NO") Why not? _____

_____ 3

21. Were your most recent Long Distance Companay charges correct?

YES (If yes, then skip to Question #23) 1

NO 2

I DON'T KNOW (Skip to Question #23) 3

(If "NO", please explain the error) _____

_____

22. If your most recent Long Distance charges were NOT CORRECT, has the problem been resolved to your satisfaction?

YES 1

NO 2

About your Long Distance telephone service generally:

23. Considering your overall Long Distance telephone service DURING THE LAST 30 DAYS, would you call it:

EXCELLENT	1
GOOD	2
ADEQUATE	3
POOR	4
VERY POOR	5

24. In comparison to your overall Long Distance phone service 6 months ago, your Long Distance phone service DURING THE LAST 30 DAYS has been:

MUCH BETTER	1
SOMEWHAT BETTER	2
ABOUT THE SAME	3
SOMEWHAT WORSE	4
MUCH WORSE	5

25. Overall, are you satisfied or dissatisfied with the telephone service you are getting from your Long Distance Telephone Company?

VERY SATISFIED	1
SATISFIED	2
SOMEWHT SATISFIED	3
SOMEWHAT DISSATISFIED	4
VERY DISSATISFIED	5

WE WOULD APPRECIATE YOUR ANSWERING THE FOLLOWING QUESTIONS; THEY WILL BE USED FOR STATISTICAL PURPOSES ONLY.

26. Your sex is

MALE	1
FEMALE	2

27. Your age is

Under 36	1
36 to 50	2
over 50	3

28. The number of people in your household is

1 to 2	1
3 to 4	2
5 or more	3

29. Your family income is

LESS THAN $11,500	1
$11,500 to $25,000	2
$25,000 to $40,000	3
over $40,000	4

30. On average, how much do you pay for MONTHLY LONG DISTANCE SERVICE?

LESS THAN $5	1
$5 to $12	2
$12 to $20	3
OVER $20	4

THE FOLLOWING SPACE IS PROVIDED FOR ANY ADDITIONAL COMMENTS OR SUGGESTIONS YOU MAY HAVE REGARDING YOUR LONG DISTANCE TELEPHONE SERVICE.

31. _____

_____

_____

_____

_____

_____

32. TODAY'S DATE IS: ___/___/___.

THE COMMISSION SINCERELY THANKS YOU FOR TAKING THE TIME TO BE A PART OF THIS IMPORTANT SURVEY.

(END OF APPENDIX C)

service and asserts that no such submission or analysis is required in support of its proposal for limited regulatory flexibility.

7. Discussion

We agree with AT&T-C that it is time to put aside the issue of cost studies in this proceeding. The purpose of the Observation Approach was to avoid the burden of producing detailed cost studies. We believe that the compromise endorsed by the ALJ in her September 16, 1988 Ruling is a reasonable one. While both witnesses for MCI and US Sprint complained that they did not receive adequate cost data to challenge the proposed rate bands of AT&T-C, they in fact did manage to discuss the width of the rate band in their testimony and propose modifications to those bands.

To have excluded cost analysis completely would have been inappropriate, but likewise the level of detail sought by MCI and Sprint would not have allowed us to move forward expeditously with this proceeding and evolved AT&T-C's application into a process more appropriate if the Prediction Approach was being used.

The Observation Approach, by definition, will allow us to determine if flexibility granted to AT&T-C today benefits or harms its competitors and consumers. We believe the Observation Approach, taken as a whole, supports our finding that the rate bands we adopt today are just and reasonable without the provision of detailed cost studies. We will, however, consider the concerns of the parties based on cost data available to them, regarding the width of the rate band in the section to follow.

B. How Limited Should The Rate Bands Be Under The Observation Approach?

All parties to this proceeding rely on language in D.87-07-017 to support their diverse views on this subject. The question truly boils down to "how limited is limited" regulatory flexibility. Particularly because of the limited cost data that

rates where there is allegedly little or no competition. (Exhibit 3.) AT&T-C also proposes asymmetric rate band for MTS discount (evening and night/weekend). AT&T-C suggests that 5% of upward flexibility should be allowed, yet only 2% of downward flexibility is sought for evening discount and 4% for the night/weekend discount.

Likewise, AT&T-C's proposal requests asymmetric treatment for AT&T-C's WATS and 800 services. Increases for WATS are limited roughly to 5% while decreases of 15% are proposed. AT&T-C requests that for 800 service, increases are restricted to 5% while decreases of 10% are allowed for on-peak usage. AT&T-C proposes no decreases in the 800 band in off-peak time period usage. As another example of the reasonableness of its rate bands, AT&T-C points out that AT&T-C proposes no rate band for the per-message charges for WATS and 800 service. For private line service, AT&T-C proposes asymmetrical rate band of plus or minus 10%. AT&T-C maintains that no party to this proceeding has objected to such a rate band for private line services, except to the extent that a party generally opposes any upward flexibility.

AT&T-C objects to the attempt of several parties to transform its request for rate bands into a discussion of bands around costs. AT&T-C disagrees that it should be precluded from varying its rates more than its underlying costs may vary. AT&T-C argues that there are several assumptions of fact necessary to the contentions of the other parties. First, AT&T-C says it must be assumed that current rates exactly equal the sum of access cost, network cost, and billing cost. Second, it must be assumed that no rate element is currently set, or should be set, below cost. AT&T-C argues that neither of these assumptions is true.

The first assumption that current rates are set to equal the sum of access cost, network cost, and billing cost is not true because currently some rate elements provide a positive contribution above cost to the overall operation of the company

Finally, we will also require AT&T-C to send out a notice to its customers explaining the rate flexibility granted by this decision in the first practicable billing cycle. AT&T-C shall work with our Public Advisor's Office in developing the text of that notice.

VI. What Conditions Should Control AT&T-C's Offering of New Services?

A. What Should the Definition of New Services be and Where Should the Costing Methodology for New Services be Developed?

1. AT&T-C's Position

AT&T-C has returned to its original definition for "new services," found in its original application of October 1987. AT&T-C defines a new service as an offering which customers perceive as a new service and which has a combination of technology, access, features, or functions that distinguishes it from any existing services. In D.87-07-017 the Commission directed that for purposes of granting initial regulatory flexibility, repricing or repackaging of an existing service would not be considered a new service.

Thus, AT&T-C acknowledges that the definition does not classify an optional calling plan which discounts existing service

rates as a new service. Although AT&T-C has returned to its original definition, in its Statement of Position filed July 15, 1988 AT&T-C had proposed a definition which categorized optional calling plans as new services. Because of the opposition to this modified definition by DRA, MCI, Sprint, and TURN, AT&T-C at hearings returned to its original definition, in the rebuttal testimony of Mr. Parker.

AT&T-C argues that its proposed definition of new services is reasonable. AT&T-C acknowledges that it has committed not to introduce a new service through the advice letter procedure until the Commission adopts a standardized costing methodology. AT&T-C requests that the Commission adopt its definition of new service and address the issue of what standardized costing methodology to adopt in A.88-08-051, the PRO California proceeding. AT&T-C makes this recommendation despite the fact that its own witness Parker acknowledged that PRO California does not meet AT&T-C's recommended definition of a new service. PRO California is a discounted optional calling plan. AT&T-C's rationale for doing the costing methodology for new services in a proceeding that is not itself a new service is the fact that the costing methodology study must be done anyway both for the PRO California optional calling plan and for AT&T-C's MEGACOM 800 service (A.88-07-020). AT&T-C argues that since it will have to expend considerable resources on the presentation of its costing methodology in the PRO California proceeding, it is an efficient use of AT&T-C's resources to establish a costing methodology for all advice letter filings for new services that AT&T-C intends to make under the regulatory flexibility granted today.

2. CALTEL's Position

CALTEL urges the Commission to reject AT&T-C's proposal that its PRO California application be the forum for developing standardized costing and pricing methodologies for future new service applications. CALTEL points out that AT&T-C admits that

PRO California is not a new service as AT&T-C presently defines the term. Additionally, CALTEL does not believe that costing methodology developed in a proceeding such as PRO California, where the service being evaluated is simply a repricing of an existing service, will be of any use to the Commission in developing procedures for cost analysis of a true new service. CALTEL argues that the Commission must evaluate the cost methodology for a new service in a proceeding by which AT&T-C seeks to introduce a new service by its own definition.

CALTEL points to one final reason for requiring that the application by which costing methodologies are developed for new services be an actual new service application. CALTEL believes that the scope of the definition of new services itself will need additional work. CALTEL points out that AT&T-C has recognized that its proposed definition of new services has not been employed in any other regulatory proceeding. (Tr. Vol. 2, p. 234.) CALTEL further asserts that AT&T-C itself admits that this definition has been fraught with controversy since it was originally proposed and that the controversy has not disappeared. CALTEL believes it is inevitable that there will be controversy over whether the first "new service" proposed by AT&T-C actually falls within the definition which AT&T-C asks the Commission to adopt in this proceeding. CALTEL maintains that the definition will have to be refined and quite obviously that should be done in a proceeding where an actual new service is before the Commission for evaluation. Therefore, CALTEL believes that the Commission should address both the refining of the definition of new services and the costing methodology for new services in one application. CALTEL submits that PRO California is not the appropriate application.

3. US Sprint's Position

US Sprint argues that AT&T-C's new services definition is ill-defined. US Sprint claims that although AT&T-C says it has returned to its new services definition contained in its original

application, several new elements are added. US Sprint argues that it is not entirely clear why these elements are necessary or advisable and how they fit into the overall picture of new services.

US Sprint joins in the opposition to the PRO California application as the forum for development of uniform costing methodology for new services.

4. MCI's Position

MCI asserts that AT&T-C has only recently returned to its definition of new services that embodied the principles laid out in D.87-07-017. MCI supports this definition for new services that was contained in AT&T-C's application of October 30, 1987 and was readopted by AT&T-C in Mr. Parker's rebuttal testimony. At the same time, MCI vigorously opposes AT&T-C's proposal to use its pending PRO California application as the test case for cost methodology for all future new service filings. MCI points out, as did all other parties to the proceeding, that AT&T-C has acknowledged that PRO California is not a new service under AT&T-C's recommended definition. Witness Parker acknowledged that it is merely a pricing option. MCI maintains that AT&T-C has failed to provide any justification for why it should depart from its own definition and use PRO California, rather than a truly new service to develop a uniform cost methodology.

Further, MCI suggests that in light of the controversy over the definition of new services, it would make more sense for the costing methodology and the refinement of the definition to be done in an application that meets the new service definition as currently proposed. This would permit the Commission in MCI's view to refine and sharpen the definition so it would have some use in future proceedings. (Tr. Vol. 2, p. 235.) MCI argues that if the Commission were to use the PRO California application as the test case for new services, the Commission might be vulnerable to claims of denial of due process. MCI argues that a truly new service

should be the test case, wherein parties will be provided an opportunity to litigate fully the appropriate guidelines for new services and the appropriate costing methodology.

5. DRA's Position

DRA joins with all other active participants in this proceeding in opposing the use of the PRO California application as the test case for cost and pricing methodology for new services. DRA believes its concern is quite different from those of AT&T-C's competitors. DRA maintains that AT&T-C's competitors such as US Sprint and MCI wish to ensure that the price of AT&T-C's new services are not too low. DRA on the other hand, in addition to concerns regarding anticompetitive pricing, wants to ensure that prices are not too high. This is why, in its view, a costing and pricing standard must be developed in the first application for a new service under AT&T-C's proposed definition. DRA believes it is dangerous to attempt to develop a cost and pricing standard for a pricing option plan such as PRO California and hope that it also applies to new services. DRA urges that the Commission wait until AT&T-C files an application for a new service that meets its own proposed definition before a costing and pricing standard is developed. PRO California, in DRA's view is an inappropriate vehicle.

6. TURN's Position

TURN states that it is pleased that AT&T-C has returned to its original definition of a new service. However, TURN, like the other parties, is dismayed that AT&T-C proposes to use its application for PRO California as a forum for establishing a cost methodology for new services when PRO California is admittedly not a new service. TURN argues that this logical inconsistency is particularly troubling when one considers that AT&T-C's definition of new services will be making its maiden voyage in a subsequent application. If a cost methodology is already in place as an outcome of the PRO California application, when such a truly new

service is introduced, it may prove difficult to apply a costing methodology which did not have to consider the vagaries of costing a new service.

7. Discussion

We first turn to D.87-07-017 for guidance on the issue of new services.

> "We would want to be sure that the services under consideration are indeed new services and not merely variations of existing services disguised in an effort to escape traditional regulation. Explicit and clear definition of new services must be provided. The extent to which AT&T-C may automatically possess market power in the areas of new services, either because of its market power in other areas or for other reasons, must also be addressed." (Id., p. 64.)

We are relieved to see that AT&T-C has returned to its original definition that is consistent with the guidelines stated above. However, we share the dismay of the other parties in AT&T-C's recommendation that PRO California is an appropriate vehicle to determine the uniform costing methodology for new services, when AT&T-C has acknowledged that PRO California does not meet its definition of new services. Therefore, we agree with the position of CALTEL, US Sprint, MCI, DRA, and TURN on this issue. AT&T-C has made no compelling showing of why the costing methodology for new services should be handled in its PRO California application. In fact, the only reason AT&T-C puts forward is since it has to do costing methodology in PRO California, it therefore would like it to be applicable to all future filings. This is not an adequate reason. While we adopt AT&T-C's proposed definition of new services, we agree with CALTEL that, in fact, in the first application of a new service this definition will most probably be refined and improved. This is another reason why we believe it is imperative that costing methodology and a refinement of the definition be handled in an

application that AT&T-C itself believes fits its definition of new service.

Additionally, we note that the PRO California application is moving forward expeditiously. We are concerned about the ability of other parties to effectively participate in that proceeding. Since the costing methodology will guide future applications for new services, we believe it is important that the first new service application, not PRO California, proceed at a pace that allows all interested parties to participate in an effective manner. Therefore, we conclude that PRO California is not the appropriate vehicle for costing methodology to be resolved for new services. However, we do not intend to invalidate Ordering Paragraph 11 of D.88-11-053 where we designated PRO California as the proceeding for interested parties to address the reasonableness and propriety of AT&T-C's interim rates for MEGACOM and MEGACOM 800.

When AT&T-C desires to file an application for its first new service under regulatory flexibility it will be that application where all parties may participate in first, development of costing methodology for future new services and second, refinement of the new services definition.

B. How Should New Services be Introduced once Costing Methodology has been Resolved and How Quickly?

1. **AT&T-C's Position**

Once the issue of costing methodology is resolved, AT&T-C proposes to file requests for new services through the advice letter procedure, with some modifications. Currently, the advice letter process as laid out in GO 96-A allows for approval of new services on 40 calendar days' notice. In addition to the requirements of GO 96-A, AT&T-C proposes to provide standard costing data (using the uniform costing methodology) with all advice letter filings. However, AT&T-C seeks an amendment to

GO 96-A requesting that a new service or a revision to an existing service that has already been approved by the FCC be approved on only 20 days' notice. AT&T-C acknowledges that this would require a waiver of Sections IV and V of GO 96-A. (AT&T-C Exhibit 4, p. 13.) AT&T-C argues that a reduced notice period as requested is appropriate because "an initial opportunity to review the essential nature of the proposal would already have occurred during the review of the filing before the FCC." AT&T-C cites D.84-01-037 for the proposition that the Commission has already waived these sections for AT&T-C's competitors. AT&T-C argues that its major competitors compete on a national level with AT&T-C. Thus, AT&T-C claims that every filing before the FCC is scrutinized closely by its competitors. AT&T-C claims that the essential nature of any proposal that is part of a national program of AT&T-C would be revealed in AT&T-C's FCC filing. Therefore, AT&T-C concludes it would be appropriate for the California filing to be reviewed in less time.

For new services that are not part of an FCC review, AT&T-C acknowledges that the timeframe set out in GO 96-A is appropriate, i.e., 40-day review period.

2. CALTEL's Position

The issue of AT&T-C's introduction of new services is the issue of most concern to CALTEL in this proceeding. CALTEL believes that AT&T-C should be required to introduce new services by application rather than by advice letter. CALTEL argues that with the adoption of rate bands, AT&T-C would have been provided a significant level of rate flexibility and correspondingly, the Commission would have been provided with the challenge of observing and evaluating AT&T-C's conduct with that rate flexibility. CALTEL believes it is inappropriate for the Commission, consumers, and AT&T-C's competitors to be burdened with having to quickly respond to AT&T-C's filing of advice letters by which it seeks to introduce new services. CALTEL recognizes that AT&T-C has narrowed its

proposed definition of new services, but nonetheless believes that AT&T-C should bear the burden of proof that the approval of such a new service will be in the public interest.

CALTEL points out that as a practical matter, the burden placed on AT&T-C's competitors will be substantially greater if AT&T-C is permitted to introduce new services by advice letter rather than by application.

CALTEL points out that when an application is filed, the burden of proof falls squarely on AT&T-C, protests may be filed in a 30-day timeframe, and most importantly the relief requested can only be granted by an order of the Commission. By contrast, CALTEL points out that advice letters filed pursuant to GO 96-A take effect 30 days after filing unless suspended by the Commission, and must be protested within 20 days of filing. More importantly, the practical effect is that a party protesting an advice letter bears a burden of establishing that the advice letter should be suspended. This is unlike the application situation where the burden is on where it should be, on the applicant, or AT&T-C.

CALTEL argues that the advice letter procedure operates in practice to provide even less time for a protest than that set forth under the existing rules. In addition to the shortened time to protest an advice letter, parties may not have been advised of the existence of the proposed advice letter until several days after the filing itself. Unless a particular party has arranged to have all such advice letters served on it by the utility, the usual means of obtaining such notice is through the Commission's Daily calendar. For example, the Commission's Daily Calendar for a particular date contains notice of advice letter filings for several preceding days. Parties must also account for the time for the Daily Calendar to reach their office through the mail. Therefore, in reality, parties have as few as 10 days to prepare and file protests given these constraints. By contrast, a party considering protesting an application have 30 days from the date of

when the application first appears in the Commission's Daily Calendar.

Additionally, CALTEL points out that while the advice letter procedure places substantial burdens on the protestants, there is no corresponding public benefit by the reduced time period. Protests that are frivolous can be rejected under Rule 8.2 just as easily as they can under GO 96-A, according to CALTEL.

Finally, CALTEL notes that the new service proposals which AT&T-C wishes to introduce by advice letter, may well have been months or even years in preparation. Thus, while AT&T-C may take as long as it wants developing the operational details and the pricing and marketing strategies for a particular new product, interested parties are expected to formulate a response to that proposal somewhere between 10 and 20 days after first being apprised of it. CALTEL argues that this does not make sense.

CALTEL urges that by requiring applications, the protestants will have at least 30 days and the Commission may have as long as it needs to consider whether the new service should be authorized. This gives the Commission the option to choose in some cases to disregard any protest and approve the application expeditiously or in other cases set the matter for formal public hearings. CALTEL urges that the Commission not give up the broad array of options it possesses when the proposal is in the form of an application.

Finally, CALTEL proposes that AT&T-C be required to introduce new services by application for a 2-year period. CALTEL points out that controversy surrounding new services is likely to exist for some time until AT&T-C and other parties arrive at some understanding of the precise definition of new services. Therefore, CALTEL suggests that after a 2-year period by which all new services will be introduced by application, the Commission can determine whether the requirement should be continued or not.

In the event the Commission does not adopt CALTEL's proposal that all new services should be introduced through the application process, CALTEL particularly opposes AT&T-C's suggestion that the advice letter review time should be reduced to a mere 20 days when the FCC has already reviewed such a service. CALTEL points out that this proposal of AT&T-C's would leave its competitors with only a few days to prepare and file a protest to any such advice letter. The Commission and CACD would similarly be constrained in CALTEL's view from taking any action with respect to those proposals. CALTEL argues that we have not yet "observed" enough to permit AT&T-C this extreme level of flexibility.

Moreover, CALTEL points out that this Commission has in the past rejected state filings by AT&T-C which were "consistent with the national plan already approved by the FCC." CALTEL concludes that this Commission wishes to continue to conduct its separate review of such plans. CALTEL argues that it makes little sense to sharply reduce the opportunity of interested parties to offer comments to this Commission with respect to such plans.

3. US Sprint's Position

US Sprint does not oppose the use of the advice letter process under GO 96-A for AT&T-C's introduction of new services, if the services are truly new and after the costing methodology has been resolved in the first new service application. However, like all other parties to the proceeding, US Sprint takes strong exception to AT&T-C's proposal that the time to review services already approved by the FCC be shortened to a mere 20 days. US Sprint argues that AT&T-C is asking this Commission to defer its power, authority, and jurisdiction over certain of AT&T-C's services to the FCC. US Sprint argues that AT&T-C has not demonstrated any compelling reason for this Commission to accede authority to the FCC in this instance.

4. MCI's Position

MCI does not oppose the notion of advice letter filings for true new services once costing methodology has been resolved in the first application. However, MCI does oppose the 20-day review period for any new service that has already been introduced and approved by the FCC. MCI argues that this 20-day notice period conflicts with PU Code § 455. Section 455 provides that any revision which does not increase a rate: "Shall become effective on the expiration of 30 days from the time of filing thereof with the Commission or such lesser time as the Commission may grant...."

MCI believes that there would have to be a change in the underlying statutes before the Sections of GO 96-A which AT&T-C seeks to have waived, could be allowed.

Further, MCI asserts that AT&T-C has made no showing that prior approval of a service proposal by the FCC justifies a shorter than 40-day review period for advice letter filings. MCI witness Wand testified that AT&T-C's assumption that less review time is necessary for new or existing services already approved by the FCC is flawed. (Tr. Vol. 4. p. 421.) There is no basis to assume that any review which may have taken place at the interstate jurisdiction would be relevant to an intrastate filing. MCI points out that AT&T-C's intrastate offering would not have been reviewed before the FCC. Further, MCI maintains that the underlying cost data provided in connection with an FCC filing would be different than cost data developed for an intrastate service. MCI concludes that the different cost data provided at each jurisdiction would require a separate review at the intrastate level even if a prior review took place at the FCC. Therefore, MCI urges that the Commission not allow the 20-day shortened period for review.

5. DRA's Position

DRA urges that the time to review a new service filing should be at least 45 days. DRA maintains that several tasks must be accomplished in this timeframe. First, it must be determined if

the new service meets the definition of a new service. Second, it must be determined that the general costing and pricing methodology developed in the first new service application, is applicable for the new service in question. Third, that pricing and costing methodology must be applied. Fourth, the cost information provided by AT&T-C must be examined. Fifth, the parties must prepare and submit protests if necessary. Sixth, the Commission must review the findings and positions of the parties involved. DRA argues that the above scenario in their view would take at least 45 days. DRA acknowledges that the current Commission practice under GO 96-A allows for a 40-day period. However, DRA believes that the possibility that rates for substitute services could go up, a possibility that is generally prohibited in filing under GO 96-A, requires a small amount of additional time to determine the cost and benefits of a new service. DRA beleives its request for an additional 5 days is reasonable and will not harm AT&T-C.

DRA joins in opposition to AT&T-C's proposal that advice letters become effective within 20 days if that plan has received prior FCC approval. DRA argues that the Commission must not allow itself to relinquish its authority over intrastate telecommunication policy to the Federal Government. DRA urges the Commission to consider new service advice letter filings as to the cost and benefits that each service would bring to California. This review process necessarily takes time.

Finally, DRA points out that there are significant differences in cost between the intrastate and the interstate telecommunications market. For example, DRA states that access charges are different. DRA argues that there may be other costs or factors such as competition, technological differences, and legal restrictions that differ between the Federal and State jurisdictions. (DRA closing brief pp. 6-7.)

6. TURN's Position

TURN joins in the unanimous opposition to AT&T-C's request to have new services reviewed in the shorter than the current advice letter time frame. TURN points out that simply using an advice letter for the introduction of a new service is a major enhancement of AT&T-C's flexibility. TURN finds AT&T-C's distinction that several of these new services have previously been reviewed and challenged at the Federal level to be hardly comforting. The distinctions between the Federal and State requests for new services could be so fraught with problems that it would take more time to resolve than the additional 10 to 20 days sought by parties for Commission review of any new service. Therefore, TURN concludes that the Commission should give CACD and interested parties at least 30 to 40 days to review any new service proposal introduced by AT&T-C.

7. Discussion

We note that all parties except for CALTEL seem able to live with the introduction of new services by AT&T-C through the advice letter process. This of course assumes that standard costing methodology has been resolved in its first new service application as discussed in the prior section. CALTEL's concerns do have merit, and therefore even though we adopt the advice letter process for new services today we note that for any particular advice letter filing we retain the option to require AT&T-C to file an application instead if the protests so warrant. The Commission will make that determination on a case-by-case basis.

Likewise we are persuaded by the parties that AT&T-C's request to have a shortened time period for services approved by the FCC is without merit. AT&T-C's concern for speed must be balanced against the rights of other parties to be allowed effective participation in our process. That effective participation necessitates timing that makes participation meaningful.

Further, MCI and US Sprint are two of the very parties that would ordinarily participate in the FCC process. They, like all other participants in our proceeding, are adamantly opposed to a shortened review process. Several parties point out that there may be substantial differences between the intrastate and interstate filings for the same services. We agree that the review that the FCC does for a new service may be very different than the review done here at our Commission.

We do not find DRA's request for a 45-day period compelling. We will authorize advice letter filings for new services under the rules of GO 96-A, allowing a 40-day period before the new service is authorized. However, we caution AT&T-C that advice letters for new services fraught with controversy will be rejected and instead AT&T-C will be ordered to file an application. AT&T-C must not abuse the flexibility we grant them today in introducing new services. For clarification, this advice letter process that we today approve will not take effect until AT&T-C has presented its standard costing methodology for new services in an application for a new service as discussed above. Only after the Commission has approved that costing methodology may AT&T-C begin to present its new service requests through the advice letter process.

C. What Rate Bands Should be Adopted for New Services?

1. Parties' Positions

AT&T-C's proposes that any new service offering be allowed an upward flexibility no greater than 10% above its original price, and a downward flexibility set at or above the LRIC for the new service. This was not an issue of particular focus during the hearings or in the parties' briefs. It seems reasonable to assume that parties' positions regarding rate bands for new services are the same as their positions on rate bands for existing services unless otherwise stated.

US Sprint specifically argues that any new service introduced should be limited to the same 5% price band (upward and downward) proposed by US Sprint for AT&T-C's existing services. (Exh. 8, p. 22.)

MCI does not specifically address the appropriate size of rate bands for new services. We assume that MCI believes that the rate bands at least should cover costs on an element by element basis, and does not oppose some upward flexibility. In addition, MCI witness Wand testified that "The Commission should...use the application for the first new service that is consistent with this guideline as the test case for determining how truly new services should be regulated." (Exhibit 13, p. 7.) It could be inferred from this testimony, that MCI recommends that the issue of width of rate bands for new services be deferred until the first new services application.

Likewise, CALTEL does not specifically address the issue of rate band widths for new services. However, since CALTEL is quite adamant in its belief that all new services should be reviewed by the formal application process for at least the next two years, it is reasonable to assume that CALTEL does not endorse AT&T-C's proposal at this time.

Since both TURN and DRA oppose any upward flexibility for existing services, it is reasonable to infer a similar objection to upward flexibility for new services.

2. Discussion

None of the parties, including AT&T-C, spent much time developing the record on this issue. Logically, it makes sense to treat rate bands for new services in a manner consistent with what we have adopted today for existing services. We do not wish the parties to litigate, for example, the appropriateness of upward flexibility every time AT&T-C attempts to introduce a new service.

However, the first new service (not PRO-California) AT&T-C attempts to introduce will be through the formal application process with an extensive and thorough examination of AT&T-C's costing methodology. Likewise, we have ordered that the definition of new services may be refined in that first application. It is reasonable, therefore, to defer the approval of rate band widths until that first new services application.

Parties are cautioned that we do not expect them to relitigate the overall policy regarding rate bands adopted today.

VII. Should the Commission Adopt CACD's Proposed Monitoring Plan?

A. Background

In D.87-07-017, the Commission ordered CACD (then the Evaluation and Compliance Division) to conduct workshops and develop a monitoring plan which would enable the Commission to measure and assess the impact flexibility may have on AT&T-C's competitors and customers of interLATA services in California. (Id., Ordering Paragraph 2.) The Commission believed a monitoring plan was an important prerequisite to any grant of flexibility. CACD held the required workshops and filed its monitoring plan on November 18, 1987. CACD believes its proposal will help the Commission achieve the objectives outlined in D.87-07-017.

CACD held its first workshop on August 31, 1987. Prior to that date, CACD requested that AT&T-C distribute its draft application for regulatory flexibility to all workshop participants to help the development of a monitoring plan. The draft application (which eventually became A.87-10-039) outlined the flexibility AT&T-C intended to request from the Commission and recommended a monitoring plan which it believed would complement the flexibility it was seeking.

CACD reports that all participants emphasized that their involvement in the workshops should not be construed by the Commission as support for AT&T-C's regulatory flexibility. With

this understanding, CACD believes the participants talked constructively about the monitoring plan suggested by AT&T-C. At the conclusion of the session, AT&T-C was requested to revise the monitoring plan it proposed, taking into consideration the numerous suggestions made by the workshop participants. CACD directed AT&T-C to obtain comments from the workshop participants and submit a revised monitoring plan 10 days in advance of the second workshop.

CACD held the second workshop session on October 19, 1987. CACD reports that during this session, participants thoroughly discussed the revised monitoring plan and assessed the merits and shortcomings of each measurement presented in its various exhibits before they were adopted, rejected, or modified. No one requested further workshops.

The workshop participants agreed that only CACD's recommendations should be presented in the report to the Commission filed November 18, 1987. Comments on CACD's proposed monitoring plan were filed 20 days thereafter.

The ALJ determined in her September 16, 1988 ruling, that the monitoring plan would not be a subject for cross-examination at hearings, but that parties' suggestions regarding the monitoring plan as laid out in their position papers and briefs would be given consideration by the Commission. Thus, parties have been given several opportunities (as recently as October 25, 1988 in their reply briefs) to update their positions on CACD's proposed monitoring plan over the past year.

In its report, CACD emphasizes that its proposed monitoring plan "does not in any way suggest a method, scientific or otherwise, to isolate changes in specific measures which would enable the Commission to draw causal relationships between such changes and the flexibility exercised by AT&T-C." (CACD Report, pp. 4-5.) CACD believes the Commission recognized this problem in D.87-07-017 noting "that the observation of the results of

regulatory flexibility may present difficulties similar to those we encountered in trying to set criteria for the measurement of current market power." (Id., p. 4.) CACD believes the proposed monitoring plan presents several helpful indicators which, collectively, can aid the Commission in assessing how well the interLATA market is working. CACD believes it should be up to the Commission to decide whether and how the monitoring program results can be used in later decisions to either reduce, maintain, or increase the amount of flexibility granted AT&T-C.

CACD recommends that the Commission require CACD to publish an annual report presenting the results of the monitoring program 60 days after receipt of the first year's monitoring results.

The attachments to CACD's monitoring plan report are included in this decision as Appendix C. These attachments would form the basis of CACD's annual report under its monitoring plan.

The exhibits are designed to show data as they would appear in the annual report. The attachments to the exhibits clearly specify the actual (raw) data to be submitted, much of which is confidential; it also recommends to the Commission which carriers should be ordered to supply the data requested.

CACD believes interested parties should be given an opportunity to comment on that annual report. CACD proposes that the annual report should thoroughly aggregate or otherwise arrange the data submitted by various parties to guard against inadvertent release of any confidential information.

CACD believes the proposed monitoring plan, based largely on workshop discussions, is consistent with the flexibility AT&T-C is seeking in A.87-10-039. (CACD Report, p. 6.)

CACD's proposed monitoring plan has two major components. The first suggests indicators which would help the Commission detect changes in the status of AT&T-C's competitors, after limited flexibility is granted to AT&T-C. The second component suggests

indicators which would help the Commission detect important changes in the degree of customer service and satisfaction.

In D.87-07-017, the Commission recognized that it is necessary to monitor the impact regulatory flexibility may have on AT&T-C's competitors. CACD recommends in its report that the Commission adopt the following exhibits (and their associated attachments) to help meet this objective:

EXHIBIT 1 - Ease of Market Entry and Exit

EXHIBIT 2 - Customer Choice Among Substitutable Services

EXHIBIT 3 - Competitive Capacity to Serve (Intrastate Circuit Miles Installed and Planned)

EXHIBIT 4 - Competitive Capacity to Serve (Switching Capacity)

EXHIBIT 5 - OCC Size and Growth Potential (Revenue by Service Category)

EXHIBIT 6 - OCC Size and Growth Potential (Interstate and Intrastate Minutes of Use)

EXHIBIT 7 - OCC Market Share (Revenue by Service Category)

EXHIBIT 8 - OCC Market Share (Interstate and Intrastate Minutes of Use)

CACD believes these exhibits, viewed collectively, should help inform the Commission about significant changes in the status of interLATA competition after AT&T-C is granted some flexibility. CACD emphasizes that it will be very difficult to analyze whether changes in the indicators being monitored directly result from the flexibility exercised by AT&T-C.

CACD believes the information requested for these exhibits will not be unreasonably burdensome or onerous to the various parties who would be required to provide them.

Furthermore, CACD notes that the data shown in these exhibits is presented in a manner which ensures that confidential information is not disclosed on a company-specific basis.

The Commission recognized that it is necessary to monitor the impact regulatory flexibility may have on California consumers (D.87-07-017.) CACD therefore devoted a significant amount of workshop time exploring which variables should be included in the monitoring plan to achieve this objective. CACD believes the following exhibits may be helpful in this regard:

EXHIBIT 9 - Private Line Installation Commitments Met

EXHIBIT 10 - Private Line Held Orders

EXHIBIT 11 - Failure Rate Per 100 Private Line Circuit Terminations

EXHIBIT 12 - Number of Troubles Reported on Intrastate Private Line Circuits

EXHIBIT 13 - Average Duration (Hours) Per Trouble (Private Line)

EXHIBIT 14 - Percent of Troubles Fixed in Less than 48 Hours (Private Line)

EXHIBIT 15 - Customer Satisfaction (Commission Complaints)

EXHIBIT 16 - Percent of Calls Not Blocked (POP-POP)

EXHIBIT 17 - Percent of Calls Not Blocked (POP-LSO/Tandem)

EXHIBIT 18 - Average Speed of Answer

EXHIBIT 19 - Customer Satisfaction Survey

However, CACD points out in its report, only AT&T-C has committed to providing the information needed for these exhibits. CACD states it is doubtful from the workshop proceedings whether Other Common Carriers (OCCs) will be able to readily and easily

furnish the same information. Before imposing a potentially burdensome and onerous requirement on the OCCs, CACD recommends that the Commission adopt a Pilot Program suggested by DRA. Under this Pilot Program, DRA would work with AT&T-C over the course of six months to "test" the overall viability of Exhibits 9 through 19.

CACD recommends that if the Commission adopts this Pilot Program, DRA should be required to submit a report to all workshop participants within 60 days after the end of the 6-month test period. This report should discuss:

1. Whether it was burdensome to obtain the data required in Exhibit 9 through 19.
2. Whether the data collected provided meaningful results.
3. Whether OCCs should be required to furnish the same data.
4. Whether other measures are necessary.
5. Other matters regarding the Pilot Program that DRA believes are important.

CACD recommends that all parties be allowed to comment on DRA's report. CACD proposes that comments be submitted to CACD and served on all parties within 20 days. CACD proposes that the Commission should then issue a Resolution adopting a set of exhibits and attachments to be used to help the Commission detect changes in the overall degree of customer service and satisfaction after AT&T-C is granted limited flexibility.

Acknowledging the directive in D.87-07-017 to consider the effect of regulatory flexibility on universal service, CACD believes there is no likely measurable link between the two. CACD maintains it is difficult to link customers' decisions to abandon, retain, or subscribe to local exchange telephone service with changing conditions in the interLATA market which may be attributed to the actions of AT&T-C. Therefore, CACD recommends that specific

universal service indicators should not be included in the monitoring plan.

Finally, CACD believes that, because of limited resources, the Commission should seriously consider utilizing its data processing capabilities to ensure the monitoring program is implemented efficiently and effectively. In its report, CACD offered to work with the Commission's Data Processing staff, and the various carriers which would be required to submit data, to develop the procedures necessary to achieve this objective.

B. AT&T-C's Position

AT&T-C endorses CACD's monitoring plan as being fully consistent with the Observation Approach and, along with other reports regularly submitted by AT&T-C, will permit the Commission to sufficiently monitor the marketplace and detect impacts on customers and competition.

AT&T-C acknowledges that the Commission relinquishes no regulatory authority if it were to grant the pricing flexibility proposed by AT&T-C. AT&T-C concedes that the Commission can modify the flexibility granted at any time, quoting that the Commission "...would not hesitate to rescind the flexibility granted earlier if it appears that the ratepayers are being harmed by the granted regulatory changes. The ultimate result may be a completely deregulated AT&T-C, the status quo, or some partial but continuing regulation." (D.87-07-017, p. 4.)

AT&T-C maintains that it was clear from the workshop discussions that DRA's pilot program concept was intended to be a part of the evolving monitoring plan and not a prerequisite to granting AT&T-C flexibility. Furthermore, AT&T-C argues that the six-month "report and comment" procedure after the pilot program recommended by CACD should relate only to the issue of whether OCCs should be required to provide the same consumer data as AT&T-C. AT&T-C contends that while it may be useful for DRA to assess the first six months' results for trends or impacts, DRA's analysis

should not be part of CACD's proposed six-month "report and comment" procedure, the only appropriate issue being whether the OCCs must also supply data. AT&T-C supports CACD's proposal that there will be an opportunity at the end of one year's accumulation and evaluation of results to modify and/or enhance the measurement tools to ensure their validity, relevance and appropriateness as a measure of the interexchange telecommunications market.

AT&T-C opposes US Sprint's suggestions for additions to the monitoring plan (US Sprint's proposal is discussed below) to identify AT&T-C's ability to impact individual customer groups with price changes thereby cross-subsidizing competitive services with revenues from non-competitive services. AT&T-C describes US Sprint's proposal as "an elaborate plan that attempts to monitor price changes for thirty-eight customer groups." (AT&T-C Opening Brief, p. 41.) AT&T-C argues that this plan would require an enormous amount of data through an extensive sampling process. AT&T-C claims accumulation of the data would be "extremely burdensome at best," and argues it does not possess the required data to identify the customer groups chosen by US Sprint. (Id., pp. 41-42.) AT&T-C claims that US Sprint acknowledges that even if the data were collectible, it would not be clear whether the changes are a result of competitive forces, changes in cost, or exercise of monopoly power.

C. US Sprint's Position

US Sprint argues that CACD's proposed monitoring plan contains serious flaws, and does not accurately reflect the discussions in the workshops as it relates to collection and reporting of market share indicators.

US Sprint filed comments regarding the deficiencies of the monitoring plan on December 8, 1987. US Sprint alleges the exhibits developed by the CACD fail to collect and report absolute market share information as well as information regarding change in market share. US Sprint contends information regarding absolute

market share is critical to a complete evaluation of the response of the market to any flexibility granted AT&T-C. Further, according to US Sprint, the Exhibits developed by CACD fail to collect and report market share information by product segment. US Sprint argues the Commission, in D.87-07-017, explicitly recognized the need to collect measures of market power by customer segment. US Sprint presented in its December 1987 comments modified exhibits which reflect its recommended changes to correct the deficiencies relating to collection of market share information of the monitoring plan as presented in the CACD's Report.

Additionally, US Sprint proposed an additional set of measures for the monitoring plan in a letter dated November 23, 1987 to AT&T-C which would monitor the effects of AT&T-C pricing flexibility on distinct customer groupings. US Sprint circulated the proposed set of price indices to all parties participating in the workshops. Because of the very real possibility of cross-subsidy which arises from the Observation Approach, US Sprint argues the inclusion of these indices in the monitoring plan is essential to a thorough evaluation of market performance following the introduction of limited pricing flexibility.

US Sprint developed its price indices to evaluate the impact of AT&T-C's pricing flexibility on different customer groups. US Sprint's proposal would require that AT&T-C's customers be divided into various groups based on their location, the amount of calling, and whether they are residential or business users. US Sprint's plan then calls for a sample of customer billing information to be drawn for each group of customers. Included in this information, under US Sprint's recommendation, would be all calls placed by each sample customer. US Sprint proposes that whenever AT&T-C changes rates, these calls of customers would be rerated using the new AT&T-C rates to supposedly determine the price impact on different customer groups. US Sprint believes this procedure would create a price index for AT&T-C for each identified

customer group as well as an overall weighted index of AT&T-C's prices for service provided to all customers. US Sprint maintains that these indices can then be compared to determine both the overall price level for AT&T-C services, and the effect of price changes on the relative prices paid by various customer groups.

US Sprint proposes that the samples of customer billing information used to calculate the average prices or price index values would not be redrawn for each calculation of the price levels. US Sprint believes the sample bills should be drawn only once just prior to the granting of flexibility and the same bills and calling patterns would be used for subsequent calculations of the index values. US Sprint argues that this approach keeps the quantity weights used to combine individual prices to generate the overall index constant for the duration of the monitoring program. In US Sprint's view, this process would allow any changes in the index to be a clear result of changes in AT&T-C's rates. (Exhibit 8, Appendix 8.)

Finally, US Sprint believes CACD's monitoring plan is unclear about the mechanisms that will be in place for either the Commission, AT&T-C or interest parties to act upon the information collected. US Sprint maintains that the Commission should include clear procedures and an expeditious timetable following release of the monitoring plan results for the Commission to consider the effects of pricing flexibility and whether or not the flexibility should be increased, restricted, or otherwise modified.

D. MCI's Position

MCI believes that the monitoring plan recommended by CACD is consistent with the requirements of D.87-07-017, subject to certain qualifications. MCI consistently has maintained that the monitoring plan should not increase the regulatory burden on other interexchange carriers. MCI argues that as a consequence of granting relief to AT&T-C from current regulatory procedures, other

interexchange carriers should not be subjected to increased regulation.

MCI urges the Commission to review carefully the information requested by CACD to ensure that it is necessary in monitoring any flexibility granted to AT&T-C, not as a means of simply obtaining more information about the other interexchange carriers or their customers. Specifically, MCI believes that it should not be required to file the information contained in Exhibits 9 through 18 of the Monitoring Plan. (See Appendix C to this decision.) In MCI's view, these exhibits are designed to provide information about the impact of regulatory flexibility on AT&T-C's customers, and should not be used to elicit information about customers of MCI and US Sprint. Moreover, the Commission does not need to review information regarding the quality of service of the other interexchange carriers, according to MCI. MCI argues this exercise would increase the regulatory burden on the other interexchange carriers; at the same time, it would reveal no useful information on whether granting rate flexibility to AT&T-C has resulted in a degradation of service to its customers. For these same reasons, MCI also requests that its customers not be included in the survey proposed in Exhibit 19 of the monitoring plan. With these qualifications, MCI supports the adoption of CACD's monitoring plan.

E. DRA's Position

DRA expresses concern regarding the adequacy of CACD's proposed monitoring plan. DRA stresses that the monitoring plan should be considered supplementary to existing Commission staff access to the books and records of AT&T-C. DRA recommends that the adopted monitoring plan include language clearly affirming the Commission's right to continue to monitor AT&T-C through verification audits.

Likewise DRA urges that it be made clear that the monitoring plan does not exempt AT&T-C from any current reporting

requirements. (i.e., those reports currently required by General Orders, Statutes, Commission Decisions, etc.) For example, the recent AT&T-C general rate case decision (D.88-06-036) imposed several specific reporting requirements on AT&T-C. DRA believes the monitoring plan should be in addition to all current requirements, unless so specifically stated.

DRA believes the six-month Pilot Program it will conduct with AT&T-C should cover all the exhibits, not just Exhibits 9-19 dealing with the impact of flexibility on California consumers. Additionally, DRA suggests that all service and financial data should be collected from AT&T-C on a monthly basis and submitted to the Commission on a quarterly basis within 30 days after the end of each calendar quarter. DRA points out that some of the exhibits in the CACD report call for reporting time frames of as much as a year. DRA believes it would severely limit the six-month Pilot Program.

DRA agrees with US Sprint that some additional exhibits are needed for the monitoring plan. DRA believes CACD's proposed monitoring plan fails to include a way of monitoring the strategic behavior of AT&T-C directly.

DRA would carry US Sprint's proposal a step further and request that the data necessary to develop price indices for AT&T-C, should also be provided by the OCCs. However, DRA gives little detail regarding what these additional exhibits to the monitoring plan should be. DRA offers to work with the OCCs to "work out the details of collection and compilation of this data. In addition, the format for these exhibits as they are reported to the Commission can be worked out between DRA and the affected companies." (DRA Response to CACD's Report, filed December 8, 1987, pp. 9-10.)

Finally, DRA recommends that the monitoring plan should allow the Commission to add or delete information that it needs to adapt to changing market conditions. (DRA Opening Brief, p. 10.)

F. TURN's Position

TURN refers to "much needed changes" to CACD's monitoring plan in its brief. (TURN's Opening Brief, p. 1.) TURN filed comments on December 8, 1987, stating its views on CACD's proposal and addressed the monitoring plan in its opposition to AT&T-C's Application for Rate Flexibility, dated August 30, 1988.

TURN points out that the Commission conceded that monitoring presents the same difficulties as those encountered in attempting to measure market power as envisioned under the Prediction Approach. (D.87-07-017, p. 4.) TURN believes that not only will it be difficult to assess the competitive environment, the Commission will also have a difficult time trying to measure the impacts on ratepayers. TURN argues that for states already experiencing rate flexibility, the results have been difficult to decipher. (TURN Opposition, Attachment C, pp. 1-3.)

TURN maintains that following the "Observe and Monitor" approach also presents the Commission with the unlikely task of "unringing the bell." While the Commission has stated that it will not hesitate to rescind the flexibility granted TURN believes it is not likely to happen. TURN claims that DRA, CACD, and other parties would be hard pressed to derive enough intelligible data from the proposed monitoring plan to be able to convince this Commission to turn back the clock. To TURN's knowledge, no other state has stepped backwards from the initial flexibility granted AT&T-C.

One of the obvious problems in TURN's view, with monitoring an upward/downward flexibility plan is the inability to link the upward and downward movements in any meaningful fashion. TURN poses the following questions which it believes the proposed monitoring plan cannot answer. If AT&T-C lowers its WATS rates and subsequently raises some of its MTS rates, was that a response to competition or a perceived change in costs? If it was a response to a change in costs, which costs have changed? If it was based on

a variety of considerations (i.e., a likely scenario), what is CACD to make of the results? Even more puzzling, how is CACD to assess all of the dozens of likely AT&T-C rate designs which are likely to unfold between review periods?

TURN acknowledges that on the customer service side, the proposed monitoring plan is seemingly capable of measuring the current level of customer satisfaction, although TURN believes there is little effort made to differentiate between customer classes. Just because customers on the whole might be pleased, TURN argues the data provided may camouflage some customer classes which are not satisfied with the level of service provided by AT&T-C.

TURN endorses US Sprint's proposed additions to the monitoring plan. Further, TURN suggests that the Commission consider requiring both MCI and US Sprint to provide similar data at some point in the future. TURN realizes that providing this level of detail may be burdensome for the OCCs, but TURN believes a true assessment of AT&T-C's competitive response cannot be accurately made without a view of what the competition is doing.

Finally, TURN argues that the monitoring plan will not detect potential future impacts on service levels because it cannot analyze those investments which are not made which should be made in order to maintain the same level of service, 5-10 years down the road. For instance, TURN suggests that it AT&T-C lowers the rates of its most competitive services below cost, it may attempt to recover those expenses by foregoing needed capital investment on the MTS side of the house. TURN points out that the current monitoring plan makes no attempt to follow AT&T-C's investment levels or plans.

G. Discussion

First, we commend CACD for its efforts in developing its proposed monitoring plan. We note that the ALJ's rejection of US Sprint's original proposed addition to the plan to monitor the

effects of pricing flexibility on thirty eight customer groups has prompted US Sprint to modify its proposal in its comments on her proposed decision. US Sprint now proposes customer sampling of either 4 or 8 groups. While we agree with the Proposed Decision that US Sprint's original proposal was too burdensome, we find merit in the compromise put forth by US Sprint in its comments.

AT&T-C correctly points out in its reply comments that it would be inappropriate for us today to adopt US Sprint's new proposal raised for the first time in comments on the proposed decision. However, AT&T-C does express a willingness to meet with CACD and US Sprint to consider the feasibility of adding to the monitoring plan along the lines raised by US Sprint in its comments.

We believe the much more limited proposal made by US Sprint in its comments has merit. Therefore, we will direct CACD to conduct meetings or workshops within 45 of the effective date of this order, inviting all parties, to develop an additional report for the monitoring plan based on the four customer subgroups (MTS residential, MTS business, WATS, and 800) suggested by US Sprint in its comments. We authorize CACD to collect information from AT&T-C for an additional report in its monitoring plan at the same time it begins data collection for the rest of the report. We strongly encourage the parties to cooperate in developing a mutually acceptable addition to the monitoring plan along the lines laid out in US Sprint's comments.

We adopt today CACD's monitoring plan in full. Therefore, the exhibits and attachments in Appendix C will form the basis for CACD's annual report pursuant to its proposal, with whatever additions developed pursuant to the above discussion.

We note that parties' fears that our regulatory oversight and authority over AT&T-C is being weakened by this monitoring plan, are unfounded. We relinquish no regulatory authority over AT&T-C today. The monitoring plan, in conjunction with all

regulatory oversight we currently enjoy, will allow us to determine if the road toward rate flexibility is indeed the best one for California to take. Today's order gives AT&T-C a tremendous opportunity to break from the traditional form of regulation it has dealt with in California. In this new era of rate flexibility, we expect AT&T-C to be more cooperative, not less, in supplying the Commission staff, both DRA and CACD, with requested information. Likewise, unless specifically in conflict with an element of the authority we grant today, AT&T-C shall continue to meet all of its existing reporting requirements in effect here at the Commission.

We endorse the proposal to have a six-month Pilot Program for Exhibits 9-19, overseen by DRA. We disagree with AT&T-C that the only determination to be made at the conclusion of that Pilot Program is whether OCCs should also submit data. Refinements and changes to those exhibits can also be made at the end of the Pilot Program pursuant to the comment and resolution process CACD proposes. Thus, MCI and US Sprint need not supply information at this time as part of the monitoring plan. The issue remains open, whether they and other OCCs will have to do so at a future date.

We agree with CACD that its proposed monitoring plan will present us with several helpful indicators which collectively can aid us in assessing how well the interLATA market is doing. If after obtaining results we find that more information is needed, we can change the monitoring plan.

We recognize that even with today's adoption of CACD's monitoring plan with the addition already discussed, certain details will have to be worked out among the parties as to how data is actually going to be gathered and processed. CACD has recommended that our data processing capabilities be used to assist CACD in gathering data under the plan. We delegate to CACD the implementation of its proposed plan and instruct CACD to work with our Data Processing Staff and the parties to determine how the data should be submitted.

The results of the monitoring plan will be recorded data, which may be up to a year old. Thus, the results will be after the fact. It is not appropriate to withhold rate flexibility pending the implementation of the monitoring plan, particularly the Pilot Program which will be in effect for six months. We believe the limited flexibility granted today will result in relatively small changes occurring over an extended period of time.

VIII. Adoption of Non-Contested Issues

AT&T-C offered several additional commitments as conditions on its regulatory flexibility granted today. Since these commitments are not disputed by the other parties[5] and we believe they are in the public interest, we adopt them today. Therefore, as conditions of the authority we grant today, AT&T-C shall:

1. maintain statewide average rates;
2. introduce all new services on a statewide basis;
3. make a maximum of four revisions within approved rate bands per service per year;
4. not impose restrictions on the resale and sharing of its services;
5. not abandon any service except by formal application to the Commission;
6. not seek to withdraw any service from a community on a geographically discriminatory basis;
7. use the formal application process for any new service submission or for the revision

5 CALTEL objects to condition 3 requesting only two revisions per year. However, we find its objection without merit.

of existing service where that submission or revision departs from the approved standard costing methodology;

8. use the formal application process for any service submission that utilizes a combination of existing tariff services discounted in order to provide a competitive response to a specific customer.

Findings of Fact

1. No party has objected to the admission of late filed Exhibit 17 into evidence.

2. Upward pricing flexibility is consistent with the Observation Approach the Commission created in D.87-07-017.

3. At no time in D.87-07-017, did the Commission suggest that only downward pricing flexibility would be appropriate under the Observation Approach.

4. AT&T-C has adequately rebutted the arguments of TURN and DRA regarding the alleged illegality of upward pricing flexibility.

5. Because of concerns regarding the potential adverse impacts if AT&T-C uses rate flexibility to wield market power, it is reasonable to grant relatively limited rate flexibility.

6. The purpose of the Observation Approach is to monitor AT&T-C's behavior once flexibility is granted.

7. Public witness hearings are not necessary prior to granting AT&T-C some limited upward flexibility.

8. It is the Commission's intention to carefully monitor the effects of rate flexibility, both upward and downward, granted today.

9. The Commission stated in D.87-07-017 that it would not hesitate to rescind the flexibility granted to AT&T-C if it appears that ratepayers are being harmed by the granted regulatory changes.

10. One of the purposes of the Observation Approach was to avoid the production of detailed cost studies by AT&T-C.

11. The ALJ made a reasonable resolution of the parties discovery disputes over the level of detail of cost data that was required by AT&T-C, in ordering production of Long Run Incremental Cost Studies on a service-by-service basis.

12. The cost data provided was adequate for parties to argue for changes to the width of AT&T-C's rate bands.

13. The Commission intended that only limited regulatory flexibility be granted AT&T-C under the Observation Approach.

14. Assymetrical rate bands are consistent with the Observation Approach.

15. In order to alleviate the concerns of other parties and comply with the directive that the rate bands be limited, it is reasonable to alter AT&T-C's proposed rate bands in some instances.

16. There is merit in the suggestion of several parties that the rate bands should be tied to percentage points of increase and decrease.

17. AT&T-C's argument that it must establish its rate bands in at least penny increments is reasonable because of its current billing structure.

18. Many of AT&T-C's proposed rate bands are in the 5-10% range.

19. Some of AT&T-C's proposed rate bands indicate a substantially higher percentage change in one or both directions.

20. The parties' suggestion that the all rate bands be limited to 5-10% change is too limited.

21. It is reasonable for AT&T-C to adjust its bands so that no rate band changes more than 15% in either direction, except when necessary to round to the nearest penny.

22. It is not reasonable to give AT&T-C permission to adjust all its rate bands to ±15%.

23. AT&T-C's proposed reference rates will be changed by other decisions granted today.

24. It is reasonable to require AT&T-C to file an advice letter reflecting the new reference rates and rate bands consistent with this order, showing both percentage and cent bands.

25. It is not reasonable to incorporate whatever refund mechanism that is finally adopted in the rehearing on D.88-06-036 into the reference rates for AT&T-C's authorized rate bands.

26. It is reasonable to allow the rate bands to remain the same absolute size in cents as they are on January 1, 1989, after the January 1, 1990, SPF to SLU adjustment.

27. AT&T-C's request to make changes within its approved rate bands on five days' notice through advice letter filings is reasonable so long as such advice letters are served by any party requesting it by overnight mail.

28. It is reasonable to require AT&T-C to send out a customer notice, developed with the Public Advisor's Office, regarding the flexibility granted today during the first practicable billing cycle.

29. AT&T-C has not made a convincing showing that the lower ends of its rate bands should be approved through the advice letter process.

30. It is reasonable to require AT&T-C to make adjustments to the upper or lower end of its rate bands by formal application.

31. AT&T-C's definition of a new service as an offering which customers perceive as a new service and which has a combination of technology, access, features, or functions that distinguishes it from any existing services, meets the guidelines stated in D.87-07-017.

32. By its own admission, AT&T-C's PRO California application pending before the Commission is not a new service.

33. AT&T-C has made no compelling showing why uniform costing methodology for new services should be developed in the PRO California application.

34. It is reasonable to assume that the definition of new services adopted today will be refined in the first new service application that will also determine costing methodology.

35. It is important to allow all interested parties to effectively participate in the first new service application where costing methodology for future filings will be determined.

36. Once uniform costing methodology is established in the first new service application, approval of future new services via advice letter filings is reasonable, allowing the effective date of the new services 40 days after filing unless otherwise authorized by the Commission.

37. If the protests to these advice letter filings so indicate, the Commission may require the filing of an application instead.

38. AT&T-C's proposal to shorten the review time to twenty days for new services already approved by the FCC is without merit because this Commission has a strong interest in maintaining its independent review for intrastate services.

39. The appropriate width of rate bands for new services is appropriately deferred to the first new services application since the record is minimal on this issue.

40. CACD's proposed monitoring plan adequately addresses our guidelines expressed in D.87-07-017, except for the area discussed in Finding of Fact No. 44.

41. The Commission is not relinquishing any regulatory authority over AT&T-C by its grant of limited regulatory flexibility today.

42. It is reasonable to conduct a six-month Pilot Program for Exhibits 9-19 of CACD's monitoring plan, overseen by DRA.

43. US Sprint's original suggested additions to the monitoring plan impose too great a burden on AT&T-C and CACD relative to the useful information that could be obtained.

44. US Sprint's modified proposal to add to the monitoring plan, first presented in its comments on the proposed decision, has merit.

45. It is reasonable to require CACD to conduct meetings or workshops to develop an additional report for the monitoring plan based on the four customer subgroups (MTS residential, MTS business, WATS, and 800) suggested by US Sprint in its comments.

46. It is necessary for CACD to work out the final details of implementing the monitoring plan, in consultation with our Data Processing staff and interested parties.

Conclusions of Law

1. Since no party objected to the receipt of late filed Exhibit 17 into evidence, it should be received.

2. Upward pricing flexibility, consistent with this decision is just and reasonable and should be adopted by the Commission.

3. The Commission should rescind or alter the flexibility granted today if it appears ratepayers are being harmed.

4. Under the Observation Approach, the Commission should not require detailed cost studies.

5. AT&T-C's proposed rate bands should be limited in keeping with the directives of D.87-07-017.

6. AT&T-C should establish its rate bands both in penny increments and percentage points.

7. AT&T-C should adjust its proposed rate bands so that no rate band changes more than 15% in either direction, except when necessary to round to the nearest penny for billing purposes.

8. AT&T-C's rate bands that change less than 15% in either direction should be adopted as proposed.

9. The 15% cap/floor should not preclude assymetrical rates.

10. Since AT&T-C's reference rates will change due to other pending Commission matters, a compliance filing should be ordered.

11. Whatever refund mechanism adopted in the rehearing on D.88-06-036 should not be incorporated into AT&T-C's reference rates.

12. The January 1, 1990 SPF to SLU adjustments should not change the range of flexibility as expressed in dollars and cents granted today.

13. AT&T-C's proposal to make changes within rate bands effective on five days' notice through advice letter filings should be adopted provided that AT&T-C serves its advice letters on any party so requesting by overnight mail.

14. Sections IV and V of GO 96-A should be waived in accordance with the preceding conclusion of law.

15. AT&T-C should provide customer notice through a bill insert developed with the Public Advisor's Office regarding the flexibility granted today during the first practicable billing cycle.

16. AT&T-C should be ordered to make changes to the rate bands adopted today through the formal application process.

17. AT&T-C's definition of new services as described in Finding of Fact 29 should be adopted.

18. AT&T-C's request that PRO California be the application where uniform costing methodology for new services is established should be denied.

19. The first new services application that meets our adopted definition should establish uniform costing methodology, refine the new service definition and allow all parties to effectively participate.

20. Once uniform costing methodology is established in AT&T-C's first new service application, future new service filings should be handled through the advice letter process with the effective date of the tariffs 40 days after filing.

21. The Commission should order the filing of an application instead of an advice letter for new services if warranted by the protests.

22. The Commission should not adopt AT&T-C's proposal to introduce new services approved by the FCC on twenty days' notice in California.

23. The appropriate width of rate bands for new services should be deferred until the first new service application is filed by AT&T-C.

24. The Commission should adopt AT&T-C's monitoring plan in full, including additions referenced in Conclusion of Law No. 27, including the six-month Pilot Program to be overseen by DRA.

25. AT&T-C should continue to meet all reporting requirements currently in effect by Commission decision, statute or rule.

26. US Sprint's original proposed additions to CACD's monitoring plan should not be adopted.

27. CACD should hold meetings or workshops to consider what additions should be made to the monitoring plan as raised in US Sprint's comments on the proposed decision.

28. CACD should work out the final details of implementing the monitoring plan in consultation with our Data Processing staff and interested parties.

O R D E R

IT IS ORDERED that:

1. Late filed Exhibit 17 shall be received in evidence.

2. AT&T-C is granted limited regulatory flexibility consistent with this decision and subject to the following conditions:

   a. AT&T-C shall adjust its proposed rate bands so that no rate band changes more than 15% in either direction from the reference rate, except when necessary to round to the nearest penny.

b. AT&T-C shall adjust its reference rates discussed in section (a) above pursuant to other year-end Commission actions. Whatever refund mechanism adopted in rehearing on D.88-06-036 shall not be incorporated into AT&T-C's reference rates. The January 1, 1990, SPF to SLU adjustment shall not affect the range of flexibility as expressed in dollars and cents granted today.

c. Sections IV and V of GO 96-A shall be waived to allow AT&T-C to make changes within its approved rate bands effective on five days' notice through advice letter filings, provided AT&T-C serves such advice letter filings on any requesting party by overnight mail. AT&T-C shall notify its customers of the flexibility granted today through a bill insert developed with the Public Advisor's Office during the first practicable billing cycle.

d. AT&T-C shall be required to use the formal application process to make any changes to the rate bands authorized today.

e. AT&T-C shall not use its PRO California application to develop a uniform costing methodology for future new service filings.

f. The advice letter process approved today for new services shall not take effect until AT&T-C has filed a new service application where uniform costing methodology shall be established, the new services definition shall be refined and all parties shall be allowed to effectively participate.

g. After uniform costing methodology is established in the first new service application, future new service filings shall be handles through the advice letter process under General Order 96-A.

h. AT&T-C shall maintain statewide average rates;

i. AT&T-C shall introduce all new services on a statewide basis;

j. AT&T-C shall make a maximum of four revisions within approved rate bands per service per year;

k. AT&T-C shall not impose restrictions on the resale and sharing of its services;

l. AT&T-C shall not abandon any service except by formal application to the Commission;

m. AT&T-C shall not seek to withdraw any service from a community on a geographically discriminatory basis;

n. AT&T-C shall use the formal application process for any new service submission or for the revision of existing service where that submission or revision departs from the approved standard costing methodology;

o. AT&T-C shall use the formal application process for any service submission that utilizes a combination of existing tariff services discounted in order to provide a competitive response to a specific customer.

3. CACD shall implement its proposed monitoring plan in full. CACD shall hold workshops within 45 days of the effective date of this order to determine what additions should be made to the monitoring plan, limited to the proposal made by US Sprint in its comments to the proposed decision. In addition, CACD shall inform all parties by letter of the final details of implementing the monitoring plan and the date for commencement of data collection for the monitoring plan.

4. AT&T-C shall continue to meet all Commission reporting requirements currently in effect.

5. Within ten days of the effective date of this order, AT&T-C shall file an advice letter tariff sheets reflecting all the conditions discussed in this order. For administrative

convenience, AT&T-C shall consolidate the rate changes in the Phase I opinion on the rehearing of D.88-06-036 and Advice Letter 113 with changes in this decision to preclude a set of consolidated tariff sheets. These tariffs sheets shall be effective on January 1, 1989.

This order is effective today.

Dated DEC 19 1988, at San Francisco, California.

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

On September 16, 1988 the ALJ issued a ruling resolving both discovery motions and determining which issues would be addressed in hearings. While still asserting that cost data was irrelevant under the Observation Approach, AT&T-C offered to provide cost data restricted to long run incremental costs (LRIC) on a service-by-service basis in the spirit of compromise. The ALJ adopted AT&T-C's suggested compromise regarding the motions to compel.

Based on evaluation of the position papers filed by the parties, the ALJ ruled that three issues would be addressed in hearings and were the proper subject for rebuttal testimony. Those issues were: (1) should upward flexibility be allowed in the rate bands? (2) what is the appropriate width of the rate bands? and (3) what conditions should control AT&T-C's offering of new services? Other issues regarding AT&T-C's proposal, were believed by the ALJ to be adequately addressed by the parties' position papers. However, parties were allowed to file additional comments on these issues in their final briefs in this proceeding.

Hearings commenced on October 3, 1988 and concluded on October 6, 1988. This matter was submitted upon the filing of concurrent opening briefs on October 18, 1988 and concurrent reply briefs on October 25, 1988. The parties filing briefs in this proceeding included AT&T-C, US Sprint, MCI, DRA, CALTEL, and TURN. Finally, in compliance with the ALJ's order, AT&T-C submitted late-filed Exhibit 17. No party has objected to the admission of Exhibit 17 into evidence. Mr. Sidney Webb, while participating in the hearings, did not file either opening or reply briefs.

III. Summary of AT&T-C's Current Proposal

In order to understand better the sections to follow we will now briefly describe AT&T-C's current proposal. Our summary of AT&T-C's proposal here is not an endorsement of the entire

package. Our endorsement or rejection of each of the elements of AT&T-C's proposal will be discussed in later sections of this decision.

Fundamentally, AT&T-C seeks approval of rate bands around the rates adopted by the Commission in AT&T-C's current rate case (A.85-11-029), and the ability to change rates and introduce new services through established advice letter filing procedures. AT&T-C maintains that this would afford it some relaxation of present regulatory restraints while still providing sufficient protection to AT&T-C's California customers and competitors.

The first component of AT&T-C's proposal are rate bands for each rate element of its Message Toll Service (MTS), Wide Area Telephone Service (WATS), 800 service, and Private Line Service, including a limited band for new services. AT&T-C's proposed rate bands for its MTS, WATS, and 800 service are set forth in Appendix B to this decision. AT&T-C proposes a rate band of plus or minus 10% for all private line service elements. Additionally, AT&T-C proposes that any new service offering will have an upward flexibility no greater than 10% above its original price, and a downward flexibility set at or above the LRIC for the new service.

The second basic element of AT&T-C's proposal is the flexibility to introduce new services, in a manner which AT&T-C believes is more consistent with the streamlined procedure currently allowed all of AT&T-C's interexchange competitors. AT&T-C has returned to the definition of new services of its original application, meaning an offering which customers perceive as a new service and which has a combination of technology, access, features, or functions that distinguishes it from any existing service.

The third basic element of AT&T-C's proposal is the adoption by the Commission of a standardized costing methodology which AT&T-C will use in support of future advice letter filings. Following the adoption of this standardized methodology, AT&T-C

while others do not. AT&T-C contends that an adjustment to rate bands for access costs fails to recognize the contribution above cost built into various rate elements and thus overstates the rate band width relative to cost when access costs are excluded.

The second assumption implicit in the parties' analysis is that no rate element is currently set below cost. AT&T-C remarks that this is obviously untrue. AT&T-C maintains that the Commission has long refused to allow AT&T-C to raise certain rates to a level which recovers cost in consideration of various social goals. The proposed access cost adjustment in such a case is pure fantasy in AT&T-C's view. For example, AT&T-C points out that MTS directory assistance is currently priced below its access cost. An adjustment to limit the proposed rate band to a percent of nonaccess cost would make no sense in AT&T-C's view because such a band would never permit these rates to recover all costs.

7. **Discussion**

We agree with the parties that the dispute over the width of the rate bands centers on what we meant when we used the term "limited" rate flexibility in D.87-07-017. We are sympathetic to the arguments of the parties that the rate bands are too broad in some instances. On the other hand, we wish to give AT&T-C enough flexibility today to fulfill its desire to respond more quickly in its markets and have something for our monitoring plan to monitor.

We agree with AT&T-C that asymmetrical rate bands are consistent with the Observation Approach. We do not take the term midpoint as literally as some parties propose. We find AT&T-C's development of the term "reference rate" as reasonable and consistent with D.87-07-017. We note that the asymmetrical rate bands are the result of AT&T-C's attempts to accommodate other parties' concerns. Therefore, we will adopt AT&T-C's rate bands as proposed with certain limitations. We believe the limitations we are imposing should alleviate the concerns of the other parties.

First, we find merit in tying the rate bands to percentage points of increase and decrease as suggested by several parties. However, we believe AT&T-C's desire to establish rate bands in penny increments is reasonable given its current billing structure. Even though AT&T-C has presented its proposed rate bands in cents instead of percentages (see Appendix B), we can determine that many of the proposed bands are in the 5-10% range. However, as pointed out by DRA and TURN, other rate bands present a much higher percentage change. We will order AT&T-C to adjust its rate bands so that no rate band is greater than ± 15%. We do not give AT&T-C permission to increase or decrease any rate band which is currently at a lower level in either or both directions up to that 15% level. The ± 15% cap/floor will only apply to rate bands that are currently larger than that. Likewise, we are not requiring symmetrical rate bands in all instances. The 15% cap/floor can be applied in one direction only.

In keeping with AT&T-C's need to bill by penny increments we will allow AT&T-C to increase this ± 15% band only if it is necessary to round to the nearest penny.

We realize this degree of flexibility is greater than that advocated by most parties and less, in certain instances, then that requested by AT&T-C. We are convinced that our compromise is a reasonable one. Given the evidence, we believe our approach will produce just and reasonable rates.

We have not attached our adopted rate bands as an Appendix to this decision because other proceedings we will decide this year will impact the reference rates that form the basis for the rate bands.

The Phase I opinion on the rehearing of D.88-06-036 also being issued today will impact those reference rates. Likewise, the year-end SPF to SLU and access flow through cost adjustments will alter the reference rates.

We therefore will order AT&T-C to file an advice letter within ten days of the effective date of this order with tariff sheets reflecting reference rates which incorporate the changes discussed above. In addition, AT&T-C's tariff sheets shall include tables of rate bands both in cents and percentages for each of its rate elements consistent with the limitations discussed above.

Finally, whatever refund mechanism is adopted in the rehearing of D.88-06-036, shall not be incorporated into the reference rates for AT&T-C's rate bands.

C. How Should Changes Within and Below The Adopted Rate Bands Be Implemented?

1. AT&T-C's Position

AT&T-C requests that it be allowed to change rates within an approved rate band on five days' notice through advice letter filings. AT&T-C acknowledges that this would require a waiver of Sections IV, V, and VI of General Order (GO) 96-A. AT&T-C points out that this waiver has already been granted to AT&T-C's competitors. AT&T-C refers to D.84-01-037 stating that "The provisions of GO 96-A are waived only to the extent of Section IV, relating to filed and effective dates; Section V, procedure in filing tariff sheets which do not increase rates or charges; and Section VI, procedure in filing increased rates. In all other respects, tariffs shall be filed in accordance with GO 96-A. Tariff filings will be effective five days after filing" (Id., p. 7). For changes within its rate bands approved by this decision, AT&T-C is seeking only what its competitors already have, five-day effective dates for tariff changes.

AT&T-C seeks 20 days' notice for a reduction in existing rates below the approved rate bands. AT&T-C maintains that currently under GO 96-A they would be entitled to reduce rates using the 40-day notice period.

2. US Sprint's Position

US Sprint proposes that if its rate bands (5% upward and downward) are adopted by the Commission, then US Sprint would agree that rate changes within their proposed bands could be approved upon five-day notice. (Exhibit 8, p. 20.) However, if greater flexibility than US Sprint has recommended is approved, US Sprint urges the full review period currently provided under GO 96-A should be required to allow the Commission staff and interested parties adequate time to verify that AT&T-C's price change would not result in rates set below cost.

US Sprint is adamantly opposed to allowing rate bands to be lowered by the advice letter process. US Sprint poses the question of why should the Commission bother setting bands if the lower limit has no meaning? US Sprint points out that the testimony in this proceeding has focused on the relationship between the flexibility requested in one service and the flexibility requested in another service. In particular, US Sprint claims that concerns have been raised regarding the possibility of predatory pricing and cross-subsidization. US Sprint argues that the limited banding concept of the Observation Approach will be destroyed if AT&T-C is not required to justify changes be they downward or upward in the rate bands through the application process.

3. MCI's Position

MCI likewise is concerned about AT&T-C's proposal to change the lower bound of rate bands approved by this decision via the advice letter process. MCI argues that the first time AT&T-C proposed such a plan regarding lowering the rate bands was in its rebuttal testimony. MCI disagrees with AT&T-C's attempt to characterize this recommendation as a clarification of AT&T-C's proposal for revision to existing services. Further, MCI believes this proposal is inconsistent with the Observation Approach and should be rejected.

MCI agrees that under the Observation Approach, AT&T-C can request limited pricing flexibility, including relaxation of certain procedures currently in place. However, MCI believes that AT&T-C's proposal goes far beyond that and in fact makes the lower end of any approved rate band illusory. MCI witness Wand testified "I don't understand the purpose of a lower band if [AT&T-C is] lowering the rates below that band." (Tr. Vol. 4, p. 421.)

MCI agrees with Sprint witness Purkey who testified that allowing the lower end of the rate bands to be lowered by advice letter violates the concept of the Observation Approach. This is particularly true if the purpose of the Observation Approach to monitor the results of the granted price bands. If AT&T-C is allowed to price outside of those bands, whether it is upward or downward pricing flexibility, then the monitoring plan will have little effect. MCI urges that any change in the rate bands approved by this decision today only be allowed through the application process where the full impact of those proposed new rate bands can be determined, and any changes that may be necessary to the monitoring plan can be deliberated.

4. CALTEL's Position

CALTEL disagrees with AT&T-C's proposal that changes within preapproved rate bands be effective on 5-days notice. CALTEL believes that the effective date should be no less than 14 days after the date of filing. CALTEL argues that even in an era of "limited regulatory flexibility", the nation's dominant long distance carrier should not be permitted to change rates without some opportunity for review by affected consumers and competitors. CALTEL asserts that a 14-day effective date would permit those entities an adequate period of time to review the tariff changes and raise issues of concern with CACD should they be warranted. By contrast, with the 5-day effective date, CALTEL argues that any party wishing to express concerns with regard to such a tariff filing would have to do so practically on the date of receiving the

tariff filing through the US Mail. (CALTEL's Statement of Position, dated August 26, 1988, pp. 2-3.)

CALTEL also disagrees with AT&T-C's proposal to reduce the lower end of its approved price rate bands by advice letter. CALTEL suggests that the Commission should evaluate AT&T-C's proposal in light of all of the requests set forth in AT&T-C's application. CALTEL draws a distinction between a company like AT&T-C seeking limited rate flexibility in the form of rate bands and a company like Southern California Gas Company still subject to rate base, rate of return regulation and who may not alter its rates without a formal order of the Commission. CALTEL suggests that AT&T-C is seeking to have the best of both worlds, i.e., to escape the rate base, rate of return regulation applicable to monopoly utilities while at the same time enjoying the benefits of filing procedures designed for rate reductions by monopoly utilities. CALTEL argues that while an abbreviated procedure for rate reduction (below authorized rates) may be appropriate for an entity that solely provides monopoly services, it is hardly appropriate for an entity such as AT&T-C which provides services in many markets and enjoys quasi-monopoly status in some.

CALTEL suggests that AT&T-C's request is inconsistent with the notion of limited rate flexibility. CALTEL believes that the Commission should have some time to "observe" AT&T-C's conduct in setting rates within the rate bands for existing services before it permits AT&T-C to introduce pricing plans and rate reductions below the lower end of the rate band by advice letter. CALTEL proposes that a 2-year period of observation be adopted and that AT&T-C be required to file application for new pricing plans for that same period.

5. TURN's Position

As discussed previously in an earlier section, TURN believes that the proposed rate bands should continue in effect unchanged until at least 12 months of monitoring data has been

gathered by CACD. In addition, TURN believes that the Commission staff should be satisfied that all of the necessary data has been provided by AT&T-C. TURN suggests that no less than 90 days following this determination, AT&T-C may file an advice letter proposing additional flexibility.

6. DRA's Position

DRA has no objection to allowing changes within the approved rate bands on 5-days notice through tariff filing. However, DRA believes it is imperative that changes to those rate bands, including reductions, be done through our application process. DRA argues that the intent of establishing rate bands was to allow AT&T-C to have flexibility within certain constraints. DRA points out that the Commission made it clear that any widening of existing rate bands would be predicated on the result of the Observation Approach. (D.87-07-017, p. 14.) DRA urges that any widening, either upward or downward, of the rate band be accomplished through an application so that the Commission can reflect on the outcome of the flexibility already granted, before approving any greater flexibility.

7. Discussion

We find it reasonable for AT&T-C to be allowed to make changes within rate bands approved by today's decision on short notice through advice letter filings.

While we are sympathetic to CALTEL's argument that 5 days allows for virtually no checking by other parties of AT&T-C's submission, we are hopeful that only requests that fall within the rate bands approved today will be sought. Therefore, we order that changes within the rate bands may be made on 5 days' notice and will waive GO 96-A accordingly. We note that if the 5-day notice provision is changed for the non dominant interexchange carriers pursuant to our Rulemaking (R.) 85-08-042, it should likewise change for AT&T-C. AT&T-C shall serve such advice letters by express mail on any party who so requests. We are concerned with

the problems raised by other parties with AT&T-C's proposal to lower the rate bands through the advice letter process. We believe it is necessary for us and the parties to obtain data through the monitoring plan of AT&T-C's behavior before increased flexibility is allowed. Therefore, we agree with the parties who recommended that during this initial stage of limited rate flexibility, the flexibility is limited to what is approved today. AT&T-C must use the formal application process if it wishes to make adjustments to the lower end or the upper end of its rate bands. As AT&T-C's reference rates are altered over time by other Commission actions, the proportional size of the rate bands, around those reference rates must remain consistent with today's decision.

VI. What Conditions Should Control AT&T-C's Offering of New Services?

A. What Should the Definition of New Services be and Where Should the Costing Methodology for New Services be Developed?

1. AT&T-C's Position

AT&T-C has returned to its original definition for "new services," found in its original application of October 1987. AT&T-C defines a new service as an offering which customers perceive as a new service and which has a combination of technology, access, features, or functions that distinguishes it from any existing services. In D.87-07-017 the Commission directed that for purposes of granting initial regulatory flexibility, repricing or repackaging of an existing service would not be considered a new service.

Thus, AT&T-C acknowledges that the definition does not classify an optional calling plan which discounts existing service rates as a new service. Although AT&T-C has returned to its original definition, in its Statement of Position filed July 15,

1988 AT&T-C had proposed a definition which categorized optional calling plans as new services. Because of the opposition to this modified definition by DRA, MCI, Sprint, and TURN, AT&T-C at hearings returned to its original definition, in the rebuttal testimony of Mr. Parker.

AT&T-C argues that its proposed definition of new services is reasonable. AT&T-C acknowledges that it has committed not to introduce a new service through the advice letter procedure until the Commission adopts a standardized costing methodology. AT&T-C requests that the Commission adopt its definition of new service and address the issue of what standardized costing methodology to adopt in A.88-08-051, the PRO California proceeding. AT&T-C makes this recommendation despite the fact that its own witness Parker acknowledged that PRO California does not meet AT&T-C's recommended definition of a new service. PRO California is a discounted optional calling plan. AT&T-C's rationale for doing the costing methodology for new services in a proceeding that is not itself a new service is the fact that the costing methodology study must be done anyway both for the PRO California optional calling plan and for AT&T-C's MEGACOM 800 service (A.88-07-020). AT&T-C argues that since it will have to expend considerable resources on the presentation of its costing methodology in the PRO California proceeding, it is an efficient use of AT&T-C's resources to establish a costing methodology for all advice letter filings for new services that AT&T-C intends to make under the regulatory flexibility granted today.

2. CALTEL's Position

CALTEL urges the Commission to reject AT&T-C's proposal that its PRO California application be the forum for developing standardized costing and pricing methodologies for future new service applications. CALTEL points out that AT&T-C admits that PRO California is not a new service as AT&T-C presently defines the term. Additionally, CALTEL does not believe that costing

methodology developed in a proceeding such as PRO California, where the service being evaluated is simply a repricing of an existing service, will be of any use to the Commission in developing procedures for cost analysis of a true new service. CALTEL argues that the Commission must evaluate the cost methodology for a new service in a proceeding by which AT&T-C seeks to introduce a new service by its own definition.

CALTEL points to one final reason for requiring that the application by which costing methodologies are developed for new services be an actual new service application. CALTEL believes that the scope of the definition of new services itself will need additional work. CALTEL points out that AT&T-C has recognized that its proposed definition of new services has not been employed in any other regulatory proceeding. (Tr. Vol. 2, p. 234.) CALTEL further asserts that AT&T-C itself admits that this definition has been fraught with controversy since it was originally proposed and that the controversy has not disappeared. CALTEL believes it is inevitable that there will be controversy over whether the first "new service" proposed by AT&T-C actually falls within the definition which AT&T-C asks the Commission to adopt in this proceeding. CALTEL maintains that the definition will have to be refined and quite obviously that should be done in a proceeding where an actual new service is before the Commission for evaluation. Therefore, CALTEL believes that the Commission should address both the refining of the definition of new services and the costing methodology for new services in one application. CALTEL submits that PRO California is not the appropriate application.

3. US Sprint's Position

US Sprint argues that AT&T-C's new services definition is ill-defined. US Sprint claims that although AT&T-C says it has returned to its new services definition contained in its original application, several new elements are added. US Sprint argues that it is not entirely clear why these elements are necessary or

advisable and how they fit into the overall picture of new services.

US Sprint joins in the opposition to the PRO California application as the forum for development of uniform costing methodology for new services.

4. MCI's Position

MCI asserts that AT&T-C has only recently returned to its definition of new services that embodied the principles laid out in D.87-07-017. MCI supports this definition for new services that was contained in AT&T-C's application of October 30, 1987 and was readopted by AT&T-C in Mr. Parker's rebuttal testimony. At the same time, MCI vigorously opposes AT&T-C's proposal to use its pending PRO California application as the test case for cost methodology for all future new service filings. MCI points out, as did all other parties to the proceeding, that AT&T-C has acknowledged that PRO California is not a new service under AT&T-C's recommended definition. Witness Parker acknowledged that it is merely a pricing option. MCI maintains that AT&T-C has failed to provide any justification for why it should depart from its own definition and use PRO California, rather than a truly new service to develop a uniform cost methodology.

Further, MCI suggests that in light of the controversy over the definition of new services, it would make more sense for the costing methodology and the refinement of the definition to be done in an application that meets the new service definition as currently proposed. This would permit the Commission in MCI's view to refine and sharpen the definition so it would have some use in future proceedings. (Tr. Vol. 2, p. 235.) MCI argues that if the Commission were to use the PRO California application as the test case for new services, the Commission might be vulnerable to claims of denial of due process. MCI argues that a truly new service should be the test case, wherein parties will be provided an

opportunity to litigate fully the appropriate guidelines for new services and the appropriate costing methodology.

5. DRA's Position

DRA joins with all other active participants in this proceeding in opposing the use of the PRO California application as the test case for cost and pricing methodology for new services. DRA believes its concern is quite different from those of AT&T-C's competitors. DRA maintains that AT&T-C's competitors such as US Sprint and MCI wish to ensure that the price of AT&T-C's new services are not too low. DRA on the other hand, in addition to concerns regarding anticompetitive pricing, wants to ensure that prices are not too high. This is why, in its view, a costing and pricing standard must be developed in the first application for a new service under AT&T-C's proposed definition. DRA believes it is dangerous to attempt to develop a cost and pricing standard for a pricing option plan such as PRO California and hope that it also applies to new services. DRA urges that the Commission wait until AT&T-C files an application for a new service that meets its own proposed definition before a costing and pricing standard is developed. PRO California, in DRA's view is an inappropriate vehicle.

6. TURN's Position

TURN states that it is pleased that AT&T-C has returned to its original definition of a new service. However, TURN, like the other parties, is dismayed that AT&T-C proposes to use its application for PRO California as a forum for establishing a cost methodology for new services when PRO California is admittedly not a new service. TURN argues that this logical inconsistency is particularly troubling when one considers that AT&T-C's definition of new services will be making its maiden voyage in a subsequent application. If a cost methodology is already in place as an outcome of the PRO California application, when such a truly new service is introduced, it may prove difficult to apply a costing

methodology which did not have to consider the vagaries of costing a new service.

7. Discussion

We first turn to D.87-07-017 for guidance on the issue of new services.

> "We would want to be sure that the services under consideration are indeed new services and not merely variations of existing services disguised in an effort to escape traditional regulation. Explicit and clear definition of new services must be provided. The extent to which AT&T-C may automatically possess market power in the areas of new services, either because of its market power in other areas or for other reasons, must also be addressed." (Id., p. 64.)

We are relieved to see that AT&T-C has returned to its original definition that is consistent with the guidelines stated above. However, we share the dismay of the other parties in AT&T-C's recommendation that PRO California is an appropriate vehicle to determine the uniform costing methodology for new services, when AT&T-C has acknowledged that PRO California does not meet its definition of new services. Therefore, we agree with the position of CALTEL, US Sprint, MCI, DRA, and TURN on this issue. AT&T-C has made no compelling showing of why the costing methodology for new services should be handled in its PRO California application. In fact, the only reason AT&T-C puts forward is since it has to do costing methodology in PRO California, it therefore would like it to be applicable to all future filings. This is not an adequate reason. While we adopt AT&T-C's proposed definition of new services, we agree with CALTEL that, in fact, in the first application of a new service this definition will most probably be refined and improved. This is another reason why we believe it is imperative that costing methodology and a refinement of the definition be handled in an

application that AT&T-C itself believes fits its definition of new service.

Additionally, we note that the PRO California application is moving forward expeditiously. We are concerned about the ability of other parties to effectively participate in that proceeding. Since the costing methodology will guide future applications for new services, we believe it is important that the first new service application, not PRO California, proceed at a pace that allows all interested parties to participate in an effective manner. Therefore, we conclude that PRO California is not the appropriate vehicle for costing methodology to be resolved for new services. When AT&T-C desires to file an application for its first new service under regulatory flexibility it will be that application where all parties may participate in first, development of costing methodology for future new services and second, refinement of the new services definition.

B. How Should New Services be Introduced once Costing Methodology has been Resolved and How Quickly?

1. **AT&T-C's Position**

Once the issue of costing methodology is resolved, AT&T-C proposes to file requests for new services through the advice letter procedure, with some modifications. Currently, the advice letter process as laid out in GO 96-A allows for approval of new services on 40 calendar days' notice. In addition to the requirements of GO 96-A, AT&T-C proposes to provide standard costing data (using the uniform costing methodology) with all advice letter filings. However, AT&T-C seeks an amendment to GO 96-A requesting that a new service or a revision to an existing service that has already been approved by the FCC be approved on only 20 days' notice. AT&T-C acknowledges that this would require a waiver of Sections IV and V of GO 96-A. (AT&T-C Exhibit 4, p. 13.) AT&T-C argues that a reduced notice period as requested is

appropriate because "an initial opportunity to review the essential nature of the proposal would already have occurred during the review of the filing before the FCC." AT&T-C cites D.84-01-037 for the proposition that the Commission has already waived these sections for AT&T-C's competitors. AT&T-C argues that its major competitors compete on a national level with AT&T-C. Thus, AT&T-C claims that every filing before the FCC is scrutinized closely by its competitors. AT&T-C claims that the essential nature of any proposal that is part of a national program of AT&T-C would be revealed in AT&T-C's FCC filing. Therefore, AT&T-C concludes it would be appropriate for the California filing to be reviewed in less time.

For new services that are not part of an FCC review, AT&T-C acknowledges that the timeframe set out in GO 96-A is appropriate, i.e., 40-day review period.

2. CALTEL's Position

The issue of AT&T-C's introduction of new services is the issue of most concern to CALTEL in this proceeding. CALTEL believes that AT&T-C should be required to introduce new services by application rather than by advice letter. CALTEL argues that with the adoption of rate bands, AT&T-C would have been provided a significant level of rate flexibility and correspondingly, the Commission would have been provided with the challenge of observing and evaluating AT&T-C's conduct with that rate flexibility. CALTEL believes it is inappropriate for the Commission, consumers, and AT&T-C's competitors to be burdened with having to quickly respond to AT&T-C's filing of advice letters by which it seeks to introduce new services. CALTEL recognizes that AT&T-C has narrowed its proposed definition of new services, but nonetheless believes that AT&T-C should bear the burden of proof that the approval of such a new service will be in the public interest.

CALTEL points out that as a practical matter, the burden placed on AT&T-C's competitors will be substantially greater if

AT&T-C is permitted to introduce new services by advice letter rather than by application.

CALTEL points out that when an application is filed, the burden of proof falls squarely on AT&T-C, protests may be filed in a 30-day timeframe, and most importantly the relief requested can only be granted by an order of the Commission. By contrast, CALTEL points out that advice letters filed pursuant to GO 96-A take effect 30 days after filing unless suspended by the Commission, and must be protested within 20 days of filing. More importantly, the practical effect is that a party protesting an advice letter bears a burden of establishing that the advice letter should be suspended. This is unlike the application situation where the burden is on where it should be, on the applicant, or AT&T-C.

CALTEL argues that the advice letter procedure operates in practice to provide even less time for a protest than that set forth under the existing rules. In addition to the shortened time to protest an advice letter, parties may not have been advised of the existence of the proposed advice letter until several days after the filing itself. Unless a particular party has arranged to have all such advice letters served on it by the utility, the usual means of obtaining such notice is through the Commission's Daily calendar. For example, the Commission's Daily Calendar for a particular date contains notice of advice letter filings for several preceding days. Parties must also account for the time for the Daily Calendar to reach their office through the mail. Therefore, in reality, parties have as few as 10 days to prepare and file protests given these constraints. By contrast, a party considering protesting an application have 30 days from the date of when the application first appears in the Commission's Daily Calendar.

Additionally, CALTEL points out that while the advice letter procedure places substantial burdens on the protestants, there is no corresponding public benefit by the reduced time

period. Protests that are frivolous can be rejected under Rule 8.2 just as easily as they can under GO 96-A, according to CALTEL.

Finally, CALTEL notes that the new service proposals which AT&T-C wishes to introduce by advice letter, may well have been months or even years in preparation. Thus, while AT&T-C may take as long as it wants developing the operational details and the pricing and marketing strategies for a particular new product, interested parties are expected to formulate a response to that proposal somewhere between 10 and 20 days after first being apprised of it. CALTEL argues that this does not make sense.

CALTEL urges that by requiring applications, the protestants will have at least 30 days and the Commission may have as long as it needs to consider whether the new service should be authorized. This gives the Commission the option to choose in some cases to disregard any protest and approve the application expeditiously or in other cases set the matter for formal public hearings. CALTEL urges that the Commission not give up the broad array of options it possesses when the proposal is in the form of an application.

Finally, CALTEL proposes that AT&T-C be required to introduce new services by application for a 2-year period. CALTEL points out that controversy surrounding new services is likely to exist for some time until AT&T-C and other parties arrive at some understanding of the precise definition of new services. Therefore, CALTEL suggests that after a 2-year period by which all new services will be introduced by application, the Commission can determine whether the requirement should be continued or not.

In the event the Commission does not adopt CALTEL's proposal that all new services should be introduced through the application process, CALTEL particularly opposes AT&T-C's suggestion that the advice letter review time should be reduced to a mere 20 days when the FCC has already reviewed such a service. CALTEL points out that this proposal of AT&T-C's would leave its

competitors with only a few days to prepare and file a protest to any such advice letter. The Commission and CACD would similarly be constrained in CALTEL's view from taking any action with respect to those proposals. CALTEL argues that we have not yet "observed" enough to permit AT&T-C this extreme level of flexibility.

Moreover, CALTEL points out that this Commission has in the past rejected state filings by AT&T-C which were "consistent with the national plan already approved by the FCC." CALTEL concludes that this Commission wishes to continue to conduct its separate review of such plans. CALTEL argues that it makes little sense to sharply reduce the opportunity of interested parties to offer comments to this Commission with respect to such plans.

3. US Sprint's Position

US Sprint does not oppose the use of the advice letter process under GO 96-A for AT&T-C's introduction of new services, if the services are truly new and after the costing methodology has been resolved in the first new service application. However, like all other parties to the proceeding, US Sprint takes strong exception to AT&T-C's proposal that the time to review services already approved by the FCC be shortened to a mere 20 days. US Sprint argues that AT&T-C is asking this Commission to defer its power, authority, and jurisdiction over certain of AT&T-C's services to the FCC. US Sprint has not demonstrated any compelling reason for this Commission to accede authority to the FCC in this instance.

4. MCI's Position

MCI does not oppose the notion of advice letter filings for true new services once costing methodology has been resolved in the first application. However, MCI does oppose the 20-day review period for any new service that has already been introduced and approved by the FCC. MCI argues that this 20-day notice period conflicts with PU Code § 455. Section 455 provides that any revision which does not increase a rate: "Shall become effective on

the expiration of 30 days from the time of filing thereof with the Commission or such lesser time as the Commission may grant...."

MCI believes that there would have to be a change in the underlying statutes before the Sections of GO 96-A which AT&T-C seeks to have waived, could be allowed.

Further, MCI asserts that AT&T-C has made no showing that prior approval of a service proposal by the FCC justifies a shorter than 40-day review period for advice letter filings. MCI witness Wand testified that AT&T-C's assumption that less review time is necessary for new or existing services already approved by the FCC is flawed. (Tr. Vol. 4. p. 421.) There is no basis to assume that any review which may have taken place at the interstate jurisdiction would be relevant to an intrastate filing. MCI points out that AT&T-C's intrastate offering would not have been reviewed before the FCC. Further, MCI maintains that the underlying cost data provided in connection with an FCC filing would be different than cost data developed for an intrastate service. MCI concludes that the different cost data provided at each jurisdiction would require a separate review at the intrastate level even if a prior review took place at the FCC. Therefore, MCI urges that the Commission not allow the 20-day shortened period for review.

5. DRA's Position

DRA urges that the time to review a new service filing should be at least 45 days. DRA maintains that several tasks must be accomplished in this timeframe. First, it must be determined if the new service meets the definition of a new service. Second, it must be determined that the general costing and pricing methodology developed in the first new service application, is applicable for the new service in question. Third, that pricing and costing methodology must be applied. Fourth, the cost information provided by AT&T-C must be examined. Fifth, the parties must prepare and submit protests if necessary. Sixth, the Commission must review the findings and positions of the parties involved. DRA argues

that the above scenario in their view would take at least 45 days. DRA acknowledges that the current Commission practice under GO 96-A allows for a 40-day period. However, DRA believes that the possibility that rates for substitute services could go up, a possibility that is generally prohibited in filing under GO 96-A, requires a small amount of additional time to determine the cost and benefits of a new service. DRA beleives its request for an additional 5 days is reasonable and will not harm AT&T-C.

DRA joins in opposition to AT&T-C's proposal that advice letters become effective within 20 days if that plan has received prior FCC approval. DRA argues that the Commission must not allow itself to relinquish its authority over intrastate telecommunication policy to the Federal Government. DRA urges the Commission to consider new service advice letter filings as to the cost and benefits that each service would bring to California. This review process necessarily takes time.

Finally, DRA points out that there are significant differences in cost between the intrastate and the interstate telecommunications market. For example, DRA states that access charges are different. DRA argues that there may be other costs or factors such as competition, technological differences, and legal restrictions that differ between the Federal and State jurisdictions. (DRA closing brief pp. 6-7.)

6. TURN's Position

TURN joins in the unanimous opposition to AT&T-C's request to have new services reviewed in the shorter than the current advice letter time frame. TURN points out that simply using an advice letter for the introduction of a new service is a major enhancement of AT&T-C's flexibility. TURN finds AT&T-C's distinction that several of these new services have previously been reviewed and challenged at the Federal level to be hardly comforting. The distinctions between the Federal and State requests for new services could be so fraught with problems that it

would take more time to resolve than the additional 10 to 20 days sought by parties for Commission review of any new service. Therefore, TURN concludes that the Commission should give CACD and interested parties at least 30 to 40 days to review any new service proposal introduced by AT&T-C.

7. Discussion

We note that all parties except for CALTEL seem able to live with the introduction of new services by AT&T-C through the advice letter process. This of course assumes that standard costing methodology has been resolved in its first new service application as discussed in the prior section. CALTEL's concerns do have merit, and therefore even though we adopt the advice letter process for new services today we note that for any particular advice letter filing we retain the option to require AT&T-C to file an application instead if the protests so warrant. The Commission will make that determination on a case-by-case basis.

Likewise we are persuaded by the parties that AT&T-C's request to have a shortened time period for services approved by the FCC is without merit. AT&T-C's concern for speed must be balanced against the rights of other parties to be allowed effective participation in our process. That effective participation necessitates timing that makes participation meaningful.

Further, MCI and US Sprint are two of the very parties that would ordinarily participate in the FCC process. They, like all other participants in our proceeding, are adamantly opposed to a shortened review process. Several parties point out that there may be substantial differences between the intrastate and interstate filings for the same services. We agree that the review that the FCC does for a new service may be very different than the review done here at our Commission.

We do not find DRA's request for a 45-day period compelling. We will authorize advice letter filings for new

services under the rules of GO 96-A, allowing a 40-day period before the new service is authorized. However, we caution AT&T-C that advice letters for new services fraught with controversy will be rejected and instead AT&T-C will be ordered to file an application. AT&T-C must not abuse the flexibility we grant them today in introducing new services. For clarification, this advice letter process that we today approve will not take effect until AT&T-C has presented its standard costing methodology for new services in an application for a new service as discussed above. Only after the Commission has approved that costing methodology may AT&T-C begin to present its new service requests through the advice letter process.

C. What Rate Bands Should be Adopted for New Services?

1. Parties' Positions

AT&T-C's proposes that any new service offering be allowed an upward flexibility no greater than 10% above its original price, and a downward flexibility set at or above the LRIC for the new service. This was not an issue of particular focus during the hearings or in the parties' briefs. It seems reasonable to assume that parties' positions regarding rate bands for new services are the same as their positions on rate bands for existing services unless otherwise stated.

US Sprint specifically argues that any new service introduced should be limited to the same 5% price band (upward and downward) proposed by US Sprint for AT&T-C's existing services. (Exh. 8, p. 22.)

MCI does not specifically address the appropriate size of rate bands for new services. We assume that MCI believes that the rate bands at least should cover costs on an element by element basis, and does not oppose some upward flexibility. In addition, MCI witness Wand testified that "The Commission should...use the application for the first new service that is consistent with this

guideline as the test case for determining how truly new services should be regulated." (Exhibit 13, p. 7.) It could be inferred from this testimony, that MCI recommends that the issue of width of rate bands for new services be deferred until the first new services application.

Likewise, CALTEL does not specifically address the issue of rate band widths for new services. However, since CALTEL is quite adamant in its belief that all new services should be reviewed by the formal application process for at least the next two years, it is reasonable to assume that CALTEL does not endorse AT&T-C's proposal at this time.

Since both TURN and DRA oppose any upward flexibility for existing services, it is reasonable to infer a similar objection to upward flexibility for new services.

2. Discussion

None of the parties, including AT&T-C, spent much time developing the record on this issue. Logically, it makes sense to treat rate bands for new services in a manner consistent with what we have adopted today for existing services. We do not wish the parties to litigate, for example, the appropriateness of upward flexibility every time AT&T-C attempts to introduce a new service.

However, the first new service (not PRO-California) AT&T-C attempts to introduce will be through the formal application process with an extensive and thorough examination of AT&T-C's costing methodology. Likewise, we have ordered that the definition of new services may be refined in that first application. It is reasonable, therefore, to defer the approval of rate band widths until that first new services application.

Parties are cautioned that we do not expect them to relitigate the overall policy regarding rate bands adopted today.

VII. Should the Commission Adopt CACD's Proposed Monitoring Plan?

A. Background

In D.87-07-017, the Commission ordered CACD (then the Evaluation and Compliance Division) to conduct workshops and develop a monitoring plan which would enable the Commission to measure and assess the impact flexibility may have on AT&T-C's competitors and customers of interLATA services in California. (Id., Ordering Paragraph 2.) The Commission believed a monitoring plan was an important prerequisite to any grant of flexibility. CACD held the required workshops and filed its monitoring plan on November 18, 1987. CACD believes its proposal will help the Commission achieve the objectives outlined in D.87-07-017.

CACD held its first workshop on August 31, 1987. Prior to that date, CACD requested that AT&T-C distribute its draft application for regulatory flexibility to all workshop participants to help the development of a monitoring plan. The draft application (which eventually became A.87-10-039) outlined the flexibility AT&T-C intended to request from the Commission and recommended a monitoring plan which it believed would complement the flexibility it was seeking.

CACD reports that all participants emphasized that their involvement in the workshops should not be construed by the Commission as support for AT&T-C's regulatory flexibility. With this understanding, CACD believes the participants talked constructively about the monitoring plan suggested by AT&T-C. At the conclusion of the session, AT&T-C was requested to revise the monitoring plan it proposed, taking into consideration the numerous suggestions made by the workshop participants. CACD directed AT&T-C to obtain comments from the workshop participants and submit a revised monitoring plan 10 days in advance of the second workshop.

CACD held the second workshop session on October 19, 1987. CACD reports that during this session, participants thoroughly discussed the revised monitoring plan and assessed the merits and shortcomings of each measurement presented in its various exhibits before they were adopted, rejected, or modified. No one requested further workshops.

The workshop participants agreed that only CACD's recommendations should be presented in the report to the Commission filed November 18, 1987. Comments on CACD's proposed monitoring plan were filed 20 days thereafter.

The ALJ determined in her September 16, 1988 ruling, that the monitoring plan would not be a subject for cross-examination at hearings, but that parties' suggestions regarding the monitoring plan as laid out in their position papers and briefs would be given consideration by the Commission. Thus, parties have been given several opportunities (as recently as October 25, 1988 in their reply briefs) to update their positions on CACD's proposed monitoring plan over the past year.

In its report, CACD emphasizes that its proposed monitoring plan "does not in any way suggest a method, scientific or otherwise, to isolate changes in specific measures which would enable the Commission to draw causal relationships between such changes and the flexibility exercised by AT&T-C." (CACD Report, pp. 4-5.) CACD believes the Commission recognized this problem in D.87-07-017 noting "that the observation of the results of regulatory flexibility may present difficulties similar to those we encountered in trying to set criteria for the measurement of current market power." (Id., p. 4.) CACD believes the proposed monitoring plan presents several helpful indicators which, collectively, can aid the Commission in assessing how well the interLATA market is working. CACD believes it should be up to the Commission to decide whether and how the monitoring program results

can be used in later decisions to either reduce, maintain, or increase the amount of flexibility granted AT&T-C.

CACD recommends that the Commission require CACD to publish an annual report presenting the results of the monitoring program 60 days after receipt of the first year's monitoring results.

The attachments to CACD's monitoring plan report are included in this decision as Appendix C. These attachments would form the basis of CACD's annual report under its monitoring plan.

The exhibits are designed to show data as they would appear in the annual report. The attachments to the exhibits clearly specify the actual (raw) data to be submitted, much of which is confidential; it also recommends to the Commission which carriers should be ordered to supply the data requested.

CACD believes interested parties should be given an opportunity to comment on that annual report. CACD proposes that the annual report should thoroughly aggregate or otherwise arrange the data submitted by various parties to guard against inadvertent release of any confidential information.

CACD believes the proposed monitoring plan, based largely on workshop discussions, is consistent with the flexibility AT&T-C is seeking in A.87-10-039. (CACD Report, p. 6.)

CACD's proposed monitoring plan has two major components. The first suggests indicators which would help the Commission detect changes in the status of AT&T-C's competitors, after limited flexibility is granted to AT&T-C. The second component suggests indicators which would help the Commission detect important changes in the degree of customer service and satisfaction.

In D.87-07-017, the Commission recognized that it is necessary to monitor the impact regulatory flexibility may have on AT&T-C's competitors. CACD recommends in its report that the Commission adopt the following exhibits (and their associated attachments) to help meet this objective:

EXHIBIT 1 - Ease of Market Entry and Exit

EXHIBIT 2 - Customer Choice Among Substitutable Services

EXHIBIT 3 - Competitive Capacity to Serve (Intrastate Circuit Miles Installed and Planned)

EXHIBIT 4 - Competitive Capacity to Serve (Switching Capacity)

EXHIBIT 5 - OCC Size and Growth Potential (Revenue by Service Category)

EXHIBIT 6 - OCC Size and Growth Potential (Interstate and Intrastate Minutes of Use)

EXHIBIT 7 - OCC Market Share (Revenue by Service Category)

EXHIBIT 8 - OCC Market Share (Interstate and Intrastate Minutes of Use)

CACD believes these exhibits, viewed collectively, should help inform the Commission about significant changes in the status of interLATA competition after AT&T-C is granted some flexibility. CACD emphasizes that it will be very difficult to analyze whether changes in the indicators being monitored directly result from the flexibility exercised by AT&T-C.

CACD believes the information requested for these exhibits will not be unreasonably burdensome or onerous to the various parties who would be required to provide them. Furthermore, CACD notes that the data shown in these exhibits is presented in a manner which ensures that confidential information is not disclosed on a company-specific basis.

The Commission recognized that it is necessary to monitor the impact regulatory flexibility may have on California consumers (D.87-07-017.) CACD therefore devoted a significant amount of workshop time exploring which variables should be included in the

monitoring plan to achieve this objective. CACD believes the following exhibits may be helpful in this regard:

EXHIBIT 9 - Private Line Installation Commitments Met

EXHIBIT 10 - Private Line Held Orders

EXHIBIT 11 - Failure Rate Per 100 Private Line Circuit Terminations

EXHIBIT 12 - Number of Troubles Reported on Intrastate Private Line Circuits

EXHIBIT 13 - Average Duration (Hours) Per Trouble (Private Line)

EXHIBIT 14 - Percent of Troubles Fixed in Less than 48 Hours (Private Line)

EXHIBIT 15 - Customer Satisfaction (Commission Complaints)

EXHIBIT 16 - Percent of Calls Not Blocked (POP-POP)

EXHIBIT 17 - Percent of Calls Not Blocked (POP-LSO/Tandem)

EXHIBIT 18 - Average Speed of Answer

EXHIBIT 19 - Customer Satisfaction Survey

However, CACD points out in its report, only AT&T-C has committed to providing the information needed for these exhibits. CACD states it is doubtful from the workshop proceedings whether Other Common Carriers (OCCs) will be able to readily and easily furnish the same information. Before imposing a potentially burdensome and onerous requirement on the OCCs, CACD recommends that the Commission adopt a Pilot Program suggested by DRA. Under this Pilot Program, DRA would work with AT&T-C over the course of six months to "test" the overall viability of Exhibits 9 through 19.

CACD recommends that if the Commission adopts this Pilot Program, DRA should be required to submit a report to all workshop participants within 60 days after the end of the 6-month test period. This report should discuss:

1. Whether it was burdensome to obtain the data required in Exhibit 9 through 19.
2. Whether the data collected provided meaningful results.
3. Whether OCCs should be required to furnish the same data.
4. Whether other measures are necessary.
5. Other matters regarding the Pilot Program that DRA believes are important.

CACD recommends that all parties be allowed to comment on DRA's report. CACD proposes that comments be submitted to CACD and served on all parties within 20 days. CACD proposes that the Commission should then issue a Resolution adopting a set of exhibits and attachments to be used to help the Commission detect changes in the overall degree of customer service and satisfaction after AT&T-C is granted limited flexibility.

Acknowledging the directive in D.87-07-017 to consider the effect of regulatory flexibility on universal service, CACD believes there is no likely measurable link between the two. CACD maintains it is difficult to link customers' decisions to abandon, retain, or subscribe to local exchange telephone service with changing conditions in the interLATA market which may be attributed to the actions of AT&T-C. Therefore, CACD recommends that specific universal service indicators should not be included in the monitoring plan.

Finally, CACD believes that, because of limited resources, the Commission should seriously consider utilizing its data processing capabilities to ensure the monitoring program is implemented efficiently and effectively. In its report, CACD

offered to work with the Commission's Data Processing staff, and the various carriers which would be required to submit data, to develop the procedures necessary to achieve this objective.

B. AT&T-C's Position

AT&T-C endorses CACD's monitoring plan as being fully consistent with the Observation Approach and, along with other reports regularly submitted by AT&T-C, will permit the Commission to sufficiently monitor the marketplace and detect impacts on customers and competition.

AT&T-C acknowledges that the Commission relinquishes no regulatory authority if it were to grant the pricing flexibility proposed by AT&T-C. AT&T-C concedes that the Commission can modify the flexibility granted at any time, quoting that the Commission "...would not hesitate to rescind the flexibility granted earlier if it appears that the ratepayers are being harmed by the granted regulatory changes. The ultimate result may be a completely deregulated AT&T-C, the status quo, or some partial but continuing regulation." (D.87-07-017, p. 4.)

AT&T-C maintains that it was clear from the workshop discussions that DRA's pilot program concept was intended to be a part of the evolving monitoring plan and not a prerequisite to granting AT&T-C flexibility. Furthermore, AT&T-C argues that the six-month "report and comment" procedure after the pilot program recommended by CACD should relate only to the issue of whether OCCs should be required to provide the same consumer data as AT&T-C. AT&T-C contends that while it may be useful for DRA to assess the first six months' results for trends or impacts, DRA's analysis should not be part of CACD's proposed six-month "report and comment" procedure, the only appropriate issue being whether the OCCs must also supply data. AT&T-C supports CACD's proposal that there will be an opportunity at the end of one year's accumulation and evaluation of results to modify and/or enhance the measurement

tools to ensure their validity, relevance and appropriateness as a measure of the interexchange telecommunications market.

AT&T-C opposes US Sprint's suggestions for additions to the monitoring plan (US Sprint's proposal is discussed below) to identify AT&T-C's ability to impact individual customer groups with price changes thereby cross-subsidizing competitive services with revenues from non-competitive services. AT&T-C describes US Sprint's proposal as "an elaborate plan that attempts to monitor price changes for thirty-eight customer groups." (AT&T-C Opening Brief, p. 41.) AT&T-C argues that this plan would require an enormous amount of data through an extensive sampling process. AT&T-C claims accumulation of the data would be "extremely burdensome at best," and argues it does not possess the required data to identify the customer groups chosen by US Sprint. (Id., pp. 41-42.) AT&T-C claims that US Sprint acknowledges that even if the data were collectible, it would not be clear whether the changes are a result of competitive forces, changes in cost, or exercise of monopoly power.

C. US Sprint's Position

US Sprint argues that CACD's proposed monitoring plan contains serious flaws, and does not accurately reflect the discussions in the workshops as it relates to collection and reporting of market share indicators.

US Sprint filed comments regarding the deficiencies of the monitoring plan on December 8, 1987. US Sprint alleges the exhibits developed by the CACD fail to collect and report absolute market share information as well as information regarding change in market share. US Sprint contends information regarding absolute market share is critical to a complete evaluation of the response of the market to any flexibility granted AT&T-C. Further, according to US Sprint, the Exhibits developed by CACD fail to collect and report market share information by product segment. US Sprint argues the Commission, in D.87-07-017, explicitly recognized

the need to collect measures of market power by customer segment. US Sprint presented in its December 1987 comments modified exhibits which reflect its recommended changes to correct the deficiencies relating to collection of market share information of the monitoring plan as presented in the CACD's Report.

Additionally, US Sprint proposed an additional set of measures for the monitoring plan in a letter dated November 23, 1987 to AT&T-C which would monitor the effects of AT&T-C pricing flexibility on distinct customer groupings. US Sprint circulated the proposed set of price indices to all parties participating in the workshops. Because of the very real possibility of cross-subsidy which arises from the Observation Approach, US Sprint argues the inclusion of these indices in the monitoring plan is essential to a thorough evaluation of market performance following the introduction of limited pricing flexibility.

US Sprint developed its price indices to evaluate the impact of AT&T-C's pricing flexibility on different customer groups. US Sprint's proposal would require that AT&T-C's customers be divided into various groups based on their location, the amount of calling, and whether they are residential or business users. US Sprint's plan then calls for a sample of customer billing information to be drawn for each group of customers. Included in this information, under US Sprint's recommendation, would be all calls placed by each sample customer. US Sprint proposes that whenever AT&T-C changes rates, these calls of customers would be rerated using the new AT&T-C rates to supposedly determine the price impact on different customer groups. US Sprint believes this procedure would create a price index for AT&T-C for each identified customer group as well as an overall weighted index of AT&T-C's prices for service provided to all customers. US Sprint maintains that these indices can then be compared to determine both the overall price level for AT&T-C services, and the effect of price changes on the relative prices paid by various customer groups.

US Sprint proposes that the samples of customer billing information used to calculate the average prices or price index values would not be redrawn for each calculation of the price levels. US Sprint believes the sample bills should be drawn only once just prior to the granting of flexibility and the same bills and calling patterns would be used for subsequent calculations of the index values. US Sprint argues that this approach keeps the quantity weights used to combine individual prices to generate the overall index constant for the duration of the monitoring program. In US Sprint's view, this process would allow any changes in the index to be a clear result of changes in AT&T-C's rates. (Exhibit 8, Appendix 8.)

Finally, US Sprint believes CACD's monitoring plan is unclear about the mechanisms that will be in place for either the Commission, AT&T-C or interest parties to act upon the information collected. US Sprint maintains that the Commission should include clear procedures and an expeditious timetable following release of the monitoring plan results for the Commission to consider the effects of pricing flexibility and whether or not the flexibility should be increased, restricted, or otherwise modified.

D. MCI's Position

MCI believes that the monitoring plan recommended by CACD is consistent with the requirements of D.87-07-017, subject to certain qualifications. MCI consistently has maintained that the monitoring plan should not increase the regulatory burden on other interexchange carriers. MCI argues that as a consequence of granting relief to AT&T-C from current regulatory procedures, other interexchange carriers should not be subjected to increased regulation.

MCI urges the Commission to review carefully the information requested by CACD to ensure that it is necessary in monitoring any flexibility granted to AT&T-C, not as a means of simply obtaining more information about the other interexchange

carriers or their customers. Specifically, MCI believes that it should not be required to file the information contained in Exhibits 9 through 18 of the Monitoring Plan. (See Appendix C to this decision.) In MCI's view, these exhibits are designed to provide information about the impact of regulatory flexibility on AT&T-C's customers, and should not be used to elicit information about customers of MCI and US Sprint. Moreover, the Commission does not need to review information regarding the quality of service of the other interexchange carriers, according to MCI. MCI argues this exercise would increase the regulatory burden on the other interexchange carriers; at the same time, it would reveal no useful information on whether granting rate flexibility to AT&T-C has resulted in a degradation of service to its customers. For these same reasons, MCI also requests that its customers not be included in the survey proposed in Exhibit 19 of the monitoring plan. With these qualifications, MCI supports the adoption of CACD's monitoring plan.

E. DRA's Position

DRA expresses concern regarding the adequacy of CACD's proposed monitoring plan. DRA stresses that the monitoring plan should be considered supplementary to existing Commission staff access to the books and records of AT&T-C. DRA recommends that the adopted monitoring plan include language clearly affirming the Commission's right to continue to monitor AT&T-C through verification audits.

Likewise DRA urges that it be made clear that the monitoring plan does not exempt AT&T-C from any current reporting requirements. (i.e., those reports currently required by General Orders, Statutes, Commission Decisions, etc.) For example, the recent AT&T-C general rate case decision (D.88-06-036) imposed several specific reporting requirements on AT&T-C. DRA believes the monitoring plan should be in addition to all current requirements, unless so specifically stated.

DRA believes the six-month Pilot Program it will conduct with AT&T-C should cover all the exhibits, not just Exhibits 9-19 dealing with the impact of flexibility on California consumers. Additionally, DRA suggests that all service and financial data should be collected from AT&T-C on a monthly basis and submitted to the Commission on a quarterly basis within 30 days after the end of each calendar quarter. DRA points out that some of the exhibits in the CACD report call for reporting time frames of as much as a year. DRA believes it would severely limit the six-month Pilot Program.

DRA agrees with US Sprint that some additional exhibits are needed for the monitoring plan. DRA believes CACD's proposed monitoring plan fails to include a way of monitoring the strategic behavior of AT&T-C directly.

DRA would carry US Sprint's proposal a step further and request that the data necessary to develop price indices for AT&T-C, should also be provided by the OCCs. However, DRA gives little detail regarding what these additional exhibits to the monitoring plan should be. DRA offers to work with the OCCs to "work out the details of collection and compilation of this data. In addition, the format for these exhibits as they are reported to the Commission can be worked out between DRA and the affected companies." (DRA Response to CACD's Report, filed December 8, 1987, pp. 9-10.)

Finally, DRA recommends that the monitoring plan should allow the Commission to add or delete information that it needs to adapt to changing market conditions. (DRA Opening Brief, p. 10.)

F. TURN's Position

TURN refers to "much needed changes" to CACD's monitoring plan in its brief. (TURN's Opening Brief, p. 1.) TURN filed comments on December 8, 1987, stating its views on CACD's proposal and addressed the monitoring plan in its opposition to AT&T-C's Application for Rate Flexibility, dated August 30, 1988.

TURN points out that the Commission conceded that monitoring presents the same difficulties as those encountered in attempting to measure market power as envisioned under the Prediction Approach. (D.87-07-017, p. 4.) TURN believes that not only will it be difficult to assess the competitive environment, the Commission will also have a difficult time trying to measure the impacts on ratepayers. TURN argues that for states already experiencing rate flexibility, the results have been difficult to decipher. (TURN Opposition, Attachment C, pp. 1-3.)

TURN maintains that following the "Observe and Monitor" approach also presents the Commission with the unlikely task of "unringing the bell." While the Commission has stated that it will not hesitate to rescind the flexibility granted TURN believes it is not likely to happen. TURN claims that DRA, CACD, and other parties would be hard pressed to derive enough intelligible data from the proposed monitoring plan to be able to convince this Commission to turn back the clock. To TURN's knowledge, no other state has stepped backwards from the initial flexibility granted AT&T-C.

One of the obvious problems in TURN's view, with monitoring an upward/downward flexibility plan is the inability to link the upward and downward movements in any meaningful fashion. TURN poses the following questions which it believes the proposed monitoring plan cannot answer. If AT&T-C lowers its WATS rates and subsequently raises some of its MTS rates, was that a response to competition or a perceived change in costs? If it was a response to a change in costs, which costs have changed? If it was based on a variety of considerations (i.e., a likely scenario), what is CACD to make of the results? Even more puzzling, how is CACD to assess all of the dozens of likely AT&T-C rate designs which are likely to unfold between review periods?

TURN acknowledges that on the customer service side, the proposed monitoring plan is seemingly capable of measuring the

current level of customer satisfaction, although TURN believes there is little effort made to differentiate between customer classes. Just because customers on the whole might be pleased, TURN argues the data provided may camouflage some customer classes which are not satisfied with the level of service provided by AT&T-C.

TURN endorses US Sprint's proposed additions to the monitoring plan. Further, TURN suggests that the Commission consider requiring both MCI and US Sprint to provide similar data at some point in the future. TURN realizes that providing this level of detail may be burdensome for the OCCs, but TURN believes a true assessment of AT&T-C's competitive response cannot be accurately made without a view of what the competition is doing.

Finally, TURN argues that the monitoring plan will not detect potential future impacts on service levels because it cannot analyze those investments which are not made which should be made in order to maintain the same level of service, 5-10 years down the road. For instance, TURN suggests that it AT&T-C lowers the rates of its most competitive services below cost, it may attempt to recover those expenses by foregoing needed capital investment on the MTS side of the house. TURN points out that the current monitoring plan makes no attempt to follow AT&T-C's investment levels or plans.

G. **Discussion**

We commend CACD for its efforts in developing its proposed monitoring plan. We do not find the parties' arguments for additions or changes to CACD's proposal compelling at this time. We adopt today CACD's monitoring plan in full. Therefore, the exhibits and attachments in Appendix C will form the basis for CACD's annual report pursuant to its proposal.

We note that parties' fears that our regulatory oversight and authority over AT&T-C is being weakened by this monitoring plan, are unfounded. We relinquish no regulatory authority over

AT&T-C today. The monitoring plan, in conjunction with all regulatory oversight we currently enjoy, will allow us to determine if the road toward rate flexibility is indeed the best one for California to take. Today's order gives AT&T-C a tremendous opportunity to break from the traditional form of regulation it has dealt with in California. In this new era of rate flexibility, we expect AT&T-C to be more cooperative, not less, in supplying the Commission staff, both DRA and CACD, with requested information. Likewise, unless specifically in conflict with an element of the authority we grant today, AT&T-C shall continue to meet all of its existing reporting requirements in effect here at the Commission.

We endorse the proposal to have a six-month Pilot Program for Exhibits 9-19, overseen by DRA. We disagree with AT&T-C that the only determination to be made at the conclusion of that Pilot Program is whether OCCs should also submit data. Refinements and changes to those exhibits can also be made at the end of the Pilot Program pursuant to the comment and resolution process CACD proposes. Thus, MCI and US Sprint need not supply information at this time as part of the monitoring plan. The issue remains open, whether they and other OCCs will have to do so at a future date.

The suggested additions to the monitoring plan by US Sprint and endorsed in some fashion by DRA and TURN, impose too great a burden on AT&T-C and CACD when balanced against the "useful" information that could be derived. We agree with CACD that its proposed monitoring plan will present us with several helpful indicators which collectively can aid us in assessing how well the interLATA market is doing. If after obtaining results we find that more information is needed, we can change the monitoring plan.

We recognize that even with today's adoption of CACD's monitoring plan, certain details will have to be worked out among the parties as to how data is actually going to be gathered and processed. CACD has recommended that our data processing

capabilities be used to assist CACD in gathering data under the plan. We delegate to CACD the implementation of its proposed plan and instruct CACD to work with our Data Processing Staff and the parties to determine how the data should be submitted.

The results of the monitoring plan will be recorded data, which may be up to a year old. Thus, the results will be after the fact. It is not appropriate to withhold rate flexibility pending the implementation of the monitoring plan, particularly the Pilot Program which will be in effect for six months. We believe the limited flexibility granted today will not result in any sudden collapse of the interexchange marketplace, but rather, if changes do occur, they will be relatively small and occur over an extended period of time.

VIII. Adoption of Non-Contested Issues

AT&T-C offered several additional commitments as conditions on its regulatory flexibility granted today. Since these commitments are not disputed by the other parties[5] and we believe they are in the public interest, we adopt them today. Therefore, as conditions of the authority we grant today, AT&T-C shall:

1. maintain statewide average rates;
2. introduce all new services on a statewide basis;
3. make a maximum of four revisions within approved rate bands per service per year;
4. not impose restrictions on the resale and sharing of its services;

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5 CALTEL objects to condition 3 requesting only two revisions per year. However, we find its objection without merit.

5. not abandon any service except by formal application to the Commission;

6. not seek to withdraw any service from a community on a geographically discriminatory basis;

7. use the formal application process for any new service submission or for the revision of existing service where that submission or revision departs from the approved standard costing methodology;

8. use the formal application process for any service submission that utilizes a combination of existing tariff services discounted in order to provide a competitive response to a specific customer.

Findings of Fact

1. No party has objected to the admission of late filed Exhibit 17 into evidence.

2. Upward pricing flexibility is consistent with the Observation Approach the Commission created in D.87-07-017.

3. At no time in D.87-07-017, did the Commission suggest that only downward pricing flexibility would be appropriate under the Observation Approach.

4. AT&T-C has adequately rebutted the arguments of TURN and DRA regarding the alleged illegality of upward pricing flexibility.

5. Because of concerns regarding the potential adverse impacts if AT&T-C uses rate flexibility to wield market power, it is reasonable to grant relatively limited rate flexibility.

6. The purpose of the Observation Approach is to monitor AT&T-C's behavior once flexibility is granted.

7. Public witness hearings are not necessary prior to granting AT&T-C some limited upward flexibility.

8. It is the Commission's intention to carefully monitor the effects of rate flexibility, both upward and downward, granted today.

9. The Commission stated in D.87-07-017 that it would not hesitate to rescind the flexibility granted to AT&T-C if it appears that ratepayers are being harmed by the granted regulatory changes.

10. One of the purposes of the Observation Approach was to avoid the production of detailed cost studies by AT&T-C.

11. The ALJ made a reasonable resolution of the parties discovery disputes over the level of detail of cost data that was required by AT&T-C, in ordering production of Long Run Incremental Cost Studies on a service-by-service basis.

12. The cost data provided was adequate for parties to argue for changes to the width of AT&T-C's rate bands.

13. The Commission intended that only limited regulatory flexibility be granted AT&T-C under the Observation Approach.

14. Assymetrical rate bands are consistent with the Observation Approach.

15. In order to alleviate the concerns of other parties and comply with the directive that the rate bands be limited, it is reasonable to alter AT&T-C's proposed rate bands in some instances.

16. There is merit in the suggestion of several parties that the rate bands should be tied to percentage points of increase and decrease.

17. AT&T-C's argument that it must establish its rate bands in at least penny increments is reasonable because of its current billing structure.

18. Many of AT&T-C's proposed rate bands are in the 5-10% range.

19. Some of AT&T-C's proposed rate bands indicate a substantially higher percentage change in one or both directions.

20. The parties' suggestion that the all rate bands be limited to 5-10% change is too limited.

21. It is reasonable for AT&T-C to adjust its bands so that no rate band changes more than 15% in either direction, except when necesary to round to the nearest penny.

22. It is not reasonable to give AT&T-C permission to adjust all its rate bands to ±15%.

23. AT&T-C's proposed reference rates will be changed by other decisions granted today.

24. It is reasonable to require AT&T-C to file an advice letter reflecting the new reference rates and rate bands consistent with this order, showing both percentage and cent bands.

25. It is not reasonable to incorporate whatever refund mechanism that is finally adopted in the rehearing on D.88-06-036 into the reference rates for AT&T-C's authorized rate bands.

26. AT&T-C's request to make changes within its approved rate bands on five days' notice through advice letter filings is reasonable so long as such advice letters are served by any party requesting it by overnight mail.

27. AT&T-C has not made a convincing showing that the lower ends of its rate bands should be approved through the advice letter process.

28. It is reasonable to require AT&T-C to make adjustments to the upper or lower end of its rate bands by formal application.

29. AT&T-C's definition of a new service as an offering which customers perceive as a new service and which has a combination of technology, access, features, or functions that distinguishes it from any existing services, meets the guidelines stated in D.87-07-017.

30. By its own admission, AT&T-C's PRO California application pending before the Commission is not a new service.

31. AT&T-C has made no compelling showing why uniform costing methodology for new services should be developed in the PRO California application.

32. It is reasonable to assume that the definition of new services adopted today will be refined in the first new service application that will also determine costing methodology.

33. It is important to allow all interested parties to effectively participate in the first new service application where costing methodology for future filings will be determined.

34. Once uniform costing methodology is established in the first new service application, approval of future new services via advice letter filings is reasonable, allowing the effective date of the new services 40 days after filing unless otherwise authorized by the Commission.

35. If the protests to these advice letter filings so indicate, the Commission may require the filing of an application instead.

36. AT&T-C's proposal to shorten the review time to twenty days for new services already approved by the FCC is without merit because this Commission has a strong interest in maintaining its independent review for intrastate services.

37. The appropriate width of rate bands for new services is appropriately deferred to the first new services application since the record is minimal on this issue.

38. CACD's proposed monitoring plan adequately addresses our guidelines expressed in D.87-07-017.

39. The Commission is not relinquishing any regulatory authority over AT&T-C by its grant of limited regulatory flexibility today.

40. It is reasonable to conduct a six-month Pilot Program for Exhibits 9-19 of CACD's monitoring plan, overseen by DRA.

41. US Sprint's suggested additions to the monitoring plan impose too great a burden on AT&T-C and CACD relative to the useful information that could be obtained.

42. It is necessary for CACD to work out the final details of implementing the monitoring plan, in consultation with our Data Processing staff and interested parties.

Conclusions of Law

1. Since no party objected to the receipt of late filed Exhibit 17 into evidence, it should be received.

2. Upward pricing flexibility, consistent with this decision is just and reasonable and should be adopted by the Commission.

3. The Commission should rescind or alter the flexibility granted today if it appears ratepayers are being harmed.

4. Under the Observation Approach, the Commission should not require detailed cost studies.

5. AT&T-C's proposed rate bands should be limited in keeping with the directives of D.87-07-017.

6. AT&T-C should establish its rate bands both in penny increments and percentage points.

7. AT&T-C should adjust its proposed rate bands so that no rate band changes more than 15% in either direction, except when necessary to round to the nearest penny for billing purposes.

8. AT&T-C's rate bands that change less than 15% in either direction should be adopted as proposed.

9. The 15% cap/floor should not preclude assymetrical rates.

10. Since AT&T-C's reference rates will change due to other pending Commission matters, a compliance filing should be ordered.

11. Whatever refund mechanism adopted in the rehearing on D.88-06-036 should not be incorporated into AT&T-C's reference rates.

12. AT&T-C's proposal to make changes within rate bands effective on five days' notice through advice letter filings should be adopted provided that AT&T-C serves its advice letters on any party so requesting by overnight mail.

13. Sections IV and V of GO 96-A should be waived in accordance with the preceding conclusion of law.

14. AT&T-C should be ordered to make changes to the rate bands adopted today through the formal application process.

15. AT&T-C's definition of new services as described in Finding of Fact 29 should be adopted.

16. AT&T-C's request that PRO California be the application where uniform costing methodology for new services is established should be denied.

17. The first new services application that meets our adopted definition should establish uniform costing methodology, refine the new service definition and allow all parties to effectively participate.

18. Once uniform costing methodology is established in AT&T-C's first new service application, future new service filings should be handled through the advice letter process with the effective date of the tariffs 40 days after filing.

19. The Commission should order the filing of an application instead of an advice letter for new services if warranted by the protests.

20. The Commission should not adopt AT&T-C's proposal to introduce new services approved by the FCC on twenty days' notice in California.

21. The appropriate width of rate bands for new services should be deferred until the first new service application is filed by AT&T-C.

22. The Commission should adopt AT&T-C's monitoring plan in full, including the six-month Pilot Program to be overseen by DRA.

23. AT&T-C should continue to meet all reporting requirements currently in effect by Commission decision, statute or rule.

24. US Sprint's proposed additions to CACD's monitoring plan should not be adopted.

25. CACD should work out the final details of implementing the monitoring plan in consultation with our Data Processing staff and interested parties.

O R D E R

IT IS ORDERED that:

1. Late filed Exhibit 17 shall be received in evidence.

2. AT&T-C is granted limited regulatory flexibility consistent with this decision and subject to the following conditions:

   a. AT&T-C shall adjust its proposed rate bands so that no rate band changes more than 15% in either direction from the reference rate, except when necessary to round to the nearest penny.

   b. AT&T-C shall adjust its reference rates discussed in section (a) above pursuant to other year-end Commission actions. Whatever refund mechanism adopted in rehearing on D.88-06-036 shall not be incorporated into AT&T-C's reference rates.

   c. Sections IV and V of GO 96-A shall be waived to allow AT&T-C to make changes within its approved rate bands effective on five days' notice through advice letter filings, provided AT&T-C serves such advice letter filings on any requesting party by overnight mail.

   d. AT&T-C shall be required to use the formal application process to make any changes to the rate bands authorized today.

   e. AT&T-C shall not use its PRO California application to develop a uniform costing methodology for future new service filings.

   f. The advice letter process approved today for new services shall not take effect until AT&T-C has filed a new service application where uniform costing methodology shall be established, the new services definition shall be refined and all parties shall be allowed to effectively participate.

g. After uniform costing methodology is established in the first new service application, future new service filings shall be handles through the advice letter process under General Order 96-A.

h. AT&T-C shall maintain statewide average rates;

i. AT&T-C shall introduce all new services on a statewide basis;

j. AT&T-C shall make a maximum of four revisions within approved rate bands per service per year;

k. AT&T-C shall not impose restrictions on the resale and sharing of its services;

l. AT&T-C shall not abandon any service except by formal application to the Commission;

m. AT&T-C shall not seek to withdraw any service from a community on a geographically discriminatory basis;

n. AT&T-C shall use the formal application process for any new service submission or for the revision of existing service where that submission or revision departs from the approved standard costing methodology;

o. AT&T-C shall use the formal application process for any service submission that utilizes a combination of existing tariff services discounted in order to provide a competitive response to a specific customer.

3. CACD shall implement its proposed monitoring plan in full. CACD shall inform all parties by letter of the final details of implementing the monitoring plan and the date for commencement of data collection for the monitoring plan.

4. AT&T-C shall continue to meet all Commission reporting requirements currently in effect.

5. Within ten days of the effective date of this order, AT&T-C shall file an advice letter tariff sheets reflecting all the conditions discussed in this order. These tariffs sheets shall be effective on January 1, 1989.

This order is effective today.

Dated _____, at San Francisco, California.

APPENDIX B

TABLE 1 - MTS Mileage Steps

MILEAGE STEP	DIAL STATION INITIAL MINUTE Reference Rate	DIAL STATION INITIAL MINUTE Rate Band	COIN DIAL INITIAL 3 MINUTES Reference Rate	COIN DIAL INITIAL 3 MINUTES Rate Band	EACH ADDITIONAL MINUTE FOR ALL CLASSES OF MTS SERVICE Reference Rate	EACH ADDITIONAL MINUTE FOR ALL CLASSES OF MTS SERVICE Rate Band
0-20	$.20	.19-.20	$ .55	.50- .60	$.10	.09-.11
21-40	.28	.27-.28	.75	.70- .80	.17	.16-.18
41-70	.30	.29-.30	.85	.80- .90	.18	.17-.19
71-100	.34	.32-.35	.90	.80- .95	.20	.18-.22
101-150	.36	.33-.37	1.00	.90-1.05	.21	.18-.23
151-330	.38	.35-.39	1.10	1.00-1.15	.24	.21-.26
OVER 300	.39	.36-.40	1.15	1.05-1.20	.24	.21-.26

TABLE 2 - MTS Discounts

	Current Discount	Rate Band
Evening	20%	18% - 25%
Night/Weekend	40%	16% - 45%

TABLE 3 - MTS Operator Services

	Reference Rate	Rate Band
Calling Card	$ .50	.40 - .53
Station	1.00	.90 - 1.05
Person	3.00	2.80 - 3.15
Verify	1.00	.85 - 1.15
Interrupt	1.50	1.30 - 1.70
Dir. Asst.	.35	.25 - .45

TABLE 4 - WATS (zero rate band around per-message charge)

Hours of Usage	HALF STATE Reference Rate	HALF STATE Rate Band	FULL STATE Reference Rate	FULL STATE Rate Band
0 - 15	$9.66	8.21 - 10.14	$10.48	8.91 - 11.00
15 - 40	8.36	7.11 - 8.78	9.85	8.37 - 10.34
40 - 80	7.61	6.47 - 7.99	8.75	7.44 - 9.19
OVER 80	7.01	5.96 - 7.36	7.65	6.50 - 8.03

TABLE 5 - 800 Service (zero rate band around per-message charge)

Hours of Usage	HALF STATE Reference Rate	HALF STATE Rate Band	FULL STATE Reference Rate	FULL STATE Rate Band
M-F, 9a-9p	$11.55	10.40 - 12.13	$14.26	12.83 -14.97
ALL OTHER	5.20	5.20 - 5.46	6.55	6.55 - 6.88

(END OF APPENDIX B)

I N D E X