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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of Alternative Regulatory Frameworks for Local Exchange Carriers.	I.87-11-033 (Filed November 25, 1987)
In the Matter of the Application of Pacific Bell (U 1001 C), a corporation, for authority to increase intrastate rates and charges applicable to telephone services furnished within the State of California.	Application 85-01-034 (Filed January 22, 1985; amended June 17, 1985 and May 19, 1986)
Application of General Telephone Company of California (U 1002 C), a California corporation, for authority to increase and/or restructure certain intrastate rates and charges for telephone services.	Application 87-01-002 (Filed January 5, 1987)
And Related Matters.	I.85-03-078 (Filed March 20, 1985) OII 84 (Filed December 2, 1980) C.86-11-028 (Filed November 17, 1986) I.87-02-025 (Filed February 11, 1987) C.87-07-024 (Filed July 16, 1987) A.88-07-020 (Filed July 15, 1988)

(See Appendix A in Decision 88-08-024, Attachment D in Decision 89-10-031, and Appendix A in Decision 90-04-023 for appearances.)

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INTERIM OPINION ON PHASE III OF I.87-11-033

I. Summary of Decision

In this decision in Phase III of Investigation (I.) 87-11-033, we continue our investigation of local telephone regulation, looking today at whether competition should be expanded for intraLATA telecommunications services and whether various rate design changes and increased pricing flexibility should be allowed for local telephone companies (also called local exchange carriers) so that they can compete more fairly in the increasingly competitive intraLATA market.

We are examining competition within LATAs[1] in the context of the new regulatory framework for local exchange carriers ordered in Phase II. Today's decision applies the rules and principles adopted in Decision (D.) 89-10-031 (the Phase II decision) and adds clarity or detail to some aspects of the new regulatory framework.

This decision finds that the LATAs should be opened to competition for most services (notable exceptions being local and ZUM calling) following a rate rebalancing that will set rates for local telephone company services closer to their costs and create a more competitive rate structure. This approach will encourage fair and economically efficient competition while protecting basic ratepayers regardless of how broadly competitive the intraLATA market actually becomes. We are confident that consumers will be well served by this regulatory strategy and will reap benefits due to more competitive pricing of existing services as well as from more service choices.

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1 The attached glossary contains descriptions of LATAs and other telecommunications terms.

This decision changes no rates. We will hold hearings in the followup implementation phase of this investigation to restructure and rebalance local exchange carriers' rates consistent with policies adopted today.

One of the most important outcomes of today's decision will be allowance of competition for intraLATA switched toll (long distance) services, including basic Message Toll Service (MTS), Wide Area Telephone Service (WATS), toll-free "800" services, and transmission of information "900" services, accompanied by rate reductions to bring local telephone companies' rates for these services closer to costs.

These toll rates are currently far above cost because they contribute significant revenues to cover costs of the local exchange network, more than interLATA service providers contribute through the "access charges" they pay for access to the local network. With competition, we determine that access charges should be the same for both intraLATA and interLATA calls and further that access charges and local telephone company switched toll rates should be modified so that they contribute equally to local exchange costs.

We anticipate that access charges and/or basic rates will need to be raised in order to permit intraLATA switched toll rates to be brought closer to costs. In the implementation phase we will balance toll rates, access charges, basic rates, and other rates to best achieve our regulatory goals including maintenance of universal service, affordable local exchange rates, and encouragement of technological innovation in the new competitive environment.

To allow local exchange carriers to compete more fairly, we also provide that they may propose discounted toll services aimed at high volume users who have a range of alternatives including private networks as well as competitors' discounted toll

services, e.g., AT&T's MEGACOM, MEGACOM 800, and 800 READYLINE services.

We do not at this time require that local exchange carriers implement network changes which would be needed to allow customers to preselect, or "presubscribe" to competitive carriers for provision of switched toll services. Instead, all intraLATA toll calls which are preceded by "1" will continue to be carried automatically by the local exchange carrier. To reach competitive intraLATA carriers, customers will have to prefix the dialed number by a "10XXX" company-specific code, as is currently required for "casual" interLATA and interstate calling.

Because we believe that local and Zone Usage Measurement (ZUM) calling and residence exchange services should continue to receive special pricing treatment to ensure affordable local rates, we do not allow competition or local carrier pricing flexibility for these services. We defer certain parties' proposals that competitors be allowed to colocate their facilities within local carriers' end offices and to connect directly to the local network.

We likewise defer determination of whether competition should be allowed for low speed private line services until their costs can be examined in the implementation phase. Since the pricing structure adopted for services for which competition is permitted grants local exchange carriers flexibility to set rates between direct embedded and fully allocated costs, we wish to examine those costs to ensure that rates within that range would not result in unacceptably large and sudden price increases for low speed private line customers. It is our clear intention, if such a cost scenario materializes, to phase in rate increases for these services as quickly as is reasonable so that these services cover their costs, in order that other rates can be lowered commensurately and competition can develop, if viable, for these services.

Full competition (beyond that already allowed) will be permitted for operator services and pay telephone services as soon as new rate designs are adopted in the implementation phase.

To protect ratepayers, particularly customers of higher cost, predominantly rural companies, we affirm that the current practice of statewide average toll rates should be continued. To ensure that this policy remains viable after intraLATA competition is expanded, we impose a new requirement that access charges also be set on a statewide average basis.

Finally, we determine that the current framework whereby costs of the higher cost independent telephone companies are pooled should be reconsidered. While we present a specific proposal in today's decision, we require that parties submit additional testimony later this year on this topic.

We ask for parties' input on how to best inform and educate customers regarding the new competitive telecommunications market structure. While parties may recommend other steps, we ask for comments on a proposal that local carriers be required to provide detailed descriptions in their white pages directories of 10XXX calling along with the 10XXX company codes for interexchange carriers which meet certain requirements.

To ensure our ability to monitor the effectiveness of the adopted regulatory changes, we also instruct the Commission's Advisory and Compliance Division (CACD) to hold workshops on whether and how the existing interLATA monitoring program and the intraLATA monitoring program being developed in compliance with the Phase II decision might need enhancement. We plan to monitor the adopted regulatory framework closely, so that changes can be made if warranted.

II. Procedural Matters

A. Background

Through I.83-06-01 initiated on June 29, 1983 to consider the effects of an antitrust consent decree between the U.S. Department of Justice and American Telephone and Telegraph Company (the Modified Final Judgment), this Commission authorized intrastate interLATA competition. However, in D.84-06-113 the Commission declined to authorize intraLATA competition, taking a cautious approach in light of transitional conditions and uncertainties in the telecommunications industry at the time that threatened universal service through upward pressures on basic exchange rates.

Because the passage of time has brought rapid technological change and increasing erosion of the intraLATA competition ban, we instituted I.87-11-033 on November 25, 1987 following an en banc hearing to once again reconsider the intraLATA regulatory framework. In the Order Instituting Investigation, the Commission laid out an intended road map for comprehensive reconsideration of ratemaking and pricing flexibility for local exchange carriers and of possible expansion of intraLATA competition, with three phases and a closely coordinated supplemental rate design proceeding for Pacific Bell (Pacific). Parties are referred to D.89-10-031 for a description of how the investigation unfolded through Phase II.

In the Phase II decision, we adopted an incentive-based regulatory framework for Pacific and GTE California Incorporated (GTEC) centered around a price cap indexing mechanism with sharing of excess earnings above a benchmark rate of return, and adopted several rate design changes. For pricing purposes, local exchange carrier services were divided into three categories: Category I services whose rates can be changed only with Commission approval (basic monopoly services); Category II with pricing flexibility

between Commission-approved rate ceilings and floors (discretionary or partially competitive services); and Category III services which have the maximum pricing flexibility allowed by law (services which are fully competitive or for which Commission rate regulation has been preempted).

To ensure that local exchange carriers do not favor their own competitive services, the Phase II decision also adopted basic principles of unbundling and nondiscriminatory access to monopoly utility services, imputation of the tariffed rates for any function deemed to be a monopoly building block in the local exchange carrier's rates for any bundled tariffed service which includes that monopoly function, and rate setting based on underlying cost structures.

Pacific and GTEC were required to make compliance filings, workshops were held, and D.89-12-048 adopted new rates for Pacific and GTEC effective January 1, 1990 consistent with the new regulatory framework.

In D.90-04-031 we modified D.89-10-031 to extend the imputation requirement to contract services and granted limited rehearing on certain issues regarding the sharing mechanism.

In the meantime, a November 22, 1989 Assigned Commissioner's Ruling laid out a three-part structure for Phase III of I.87-11-033. First, a rulemaking procedure provided for submittal of prepared opening and reply testimony on specified policy issues regarding increased intraLATA competition for services that are now local exchange carrier monopolies and related local exchange carrier rate design issues. The ruling stated that this mechanism would allow the Commission to determine policy matters on subjects where a hearing is not required as a matter of law or to provide additional clarity for the record and that hearings would be scheduled if needed after the reply testimony was received.

Second, CACD was instructed to convene workshops to discuss modifications or reforms to the pooling and settlements process and to produce a workshop report to be filed and served on all parties in I.87-11-033. Finally, the ruling provided for limited hearings to implement certain rate design policies adopted in Phase II. Following interim decisions on these issues, the ruling contemplated a combined implementation and supplemental rate design phase of this proceeding.

Today's interim Phase III decision addresses intraLATA competition, related rate design, and settlements issues. As contemplated, hearings have not been held on these policy issues; the decision relies instead on the opening and reply testimony submitted on competition and related rate design issues (identified by an Administrative Law Judge's Ruling as Exhibits B-1 through B-63) and on CACD's report on the settlements workshops.

An implementation phase will follow Phase III, in which policies adopted today will be implemented. Supplemental rate design issues identified earlier will be included in this implementation phase of I.87-11-033. Separate hearings will be held on pooling and settlements issues identified as a result of the settlements workshop.

The proposed decision of Administrative Law Judge (ALJ) Ford-TerKeurst was filed with the Commission and served on all parties on July 27, 1990. Parties filed comments on the proposed decision on August 16, 1990 and reply comments on August 21, 1990.

We have considered carefully the ALJ's proposed decision and each and every comment and reply comment filed by the parties and have made certain modifications to the ALJ's proposed decision where appropriate. We have deferred competition for switched virtual private network services until after the implementation phase of this proceeding, and have not authorized facilities-based competition with the local loop until bypass potential of such a step can be assessed in the implementation phase. We allow local

exchange carriers to introduce incremental cost studies in the implementation phase and to propose that rate floors for flexibly priced services and the local transport element of access charges be based on incremental costs rather than direct embedded costs. While agreeing with the ALJ that intraLATA presubscription should not be adopted at this time, we find maintenance of an overall balance in the competitive regulatory framework to be a more compelling justification than unresolved technical constraints. Various other minor substantive and procedural changes as well as clarifications and typographical corrections are made as needed.

B. The Need for Hearings

The policy matters decided today are based on the widely recognized increase in competitive conditions in the intraLATA market (discussed in Section IV.A) that has occurred since intraLATA competition was last considered in D.84-06-113. As discussed herein, the long run viability of economic competition within telecommunications markets is not a material disputed issue of fact for which hearings would be required, particularly in light of highly complex and largely unquantifiable factors. Nor do we see that hearings would have developed facts which would have aided us in reaching the policy determination that the public interest is best served by a regulatory structure that will allow economically efficient competition to develop where feasible while protecting ratepayers regardless of the extent to which competition actually develops for particular services.

Today's decision adopts certain broad rate design policies, with wide latitude reserved in refining and finalizing these policies in the planned implementation phase in which actual rate impacts of a range of scenarios will be considered through full evidentiary and public participation hearings. For other important aspects of the regulatory framework, either factual disputes arose or more information is needed about potential rate impacts of parties' proposals. In these areas, we either defer

reaching conclusions until hearings are held or reach tentative conclusions with an opportunity for parties to comment and make alternative proposals in the implementation hearings.

In summary, we find that evidentiary hearings were not required to reach our findings on matters decided today, that issues requiring hearings have properly been deferred, and that wide latitude has been reserved within the adopted policies to ensure that specific rates and charges set following evidentiary hearings will be in the public interest. On this basis, we conclude that today's interim Phase III decision fully preserves parties' due process rights and is consistent with Public Utilities (PU) Code § 729.

In their comments a number of parties contend that hearings must be held to resolve certain factual disputes before we can decide some of the policy issues resolved today. We are not convinced by these arguments; however, we remain committed to holding hearings to resolve underlying material disputed issues of fact, if there are any. Accordingly, prior to holding hearings in the implementation phase, we will afford all parties an opportunity to file pretrial opening and reply briefs to specifically identify any material disputed issues of fact relevant to the adoption of these policies. Parties requesting hearings will be required to explain why hearings are required and the specific facts they wish to establish. After reviewing the parties' filings, we will determine if there are any material disputed issues of fact which need to be pursued. If so, we will hear these specific factual issues in conjunction with our implementation phase hearings.

III. Parties' Phase III Proposals

In this section, we provide an overview of the proposals before us. Parties' proposals are discussed in more detail in later sections of this decision.

Most parties' proposals contain both a recommendation that intraLATA competition be expanded in some form, coupled with various rate design changes to enable local exchange carriers to respond more readily to the increased competition. Differences arise in the extent of intraLATA competition recommended, the amount of pricing flexibility which would be afforded the local exchange carriers, and the timing of rate redesign relative to expanded competitive entry.

A. Pacific

Pacific proposes that intraLATA competition be phased in, with switched toll competition authorized only after a fairly extensive rate rebalancing program is largely implemented.

Pacific contemplates that the Commission would through the implementation and supplemental rate design proceeding begin an extensive rate rebalancing program including the following elements:

a. Price increases resulting from future SPF-to-SLU shifts would be applied only to below-cost business services.

b. The toll settlements payments from Pacific to GTEC would be phased out over three years, after which Pacific and GTEC would pay access charges to recover the costs of intercompany calls.

c. All the existing billing surcredits except the portion needed to implement the expanded local calling area and elimination of Touch Tone charges adopted in D.89-10-031 would be applied to reduce intraLATA toll rates. Pacific would also be allowed to target toll discount plans to high-volume users.

d. All below-cost services except residential exchange rates would be raised at least to cost, with the additional revenue used for further toll reductions.

e. A further subsidy reduction transition plan like SPF-to-SLU would be adopted to begin

in 1993, which would decrease toll prices further with offsetting price increases in business and residence exchange services priced below cost.

Under Pacific's plan, competitive entry would be allowed for intraLATA 800 services, operator services, and low speed private line services after a decision is issued in the implementation proceeding. Instead of the limited intraLATA operator services competition proposed in a settlement pending in I.88-04-029 at the time Phase III testimony was submitted,[2] Pacific proposes that full operator services competition, with certain exceptions, be permitted with the caveat that intraLATA calls must be routed over Pacific's toll network until full MTS competition is permitted. Pacific would receive pricing flexibility for these services concurrently with competitive entry.

Full intraLATA switched toll (MTS, WATS, and 900) competition, including resale of these services, would begin in 1993, along with concurrent pricing flexibility for these services. Pacific would prohibit intraLATA presubscription ("equal access"), allowing intraLATA competition only on a 10XXX basis. Competition would not be allowed for basic exchange services, local and ZUM calling, 411, intraLATA foreign Number Plan Area (NPA) 555-1212 directory assistance, or non-revenue producing 0- calls.

B. GTEC

GTEC supports opening the LATAs to MTS competition on a 10XXX basis after certain conditions are met. GTEC also believes the Commission should grant permanent operating authority for interexchange services such as AT&T's MEGACOM services, Software Defined Network, and Switch 56 services, and should remove the

2 The Commission approved a modified version of the referenced settlement in D.90-06-018 issued June 6, 1990, as discussed in Section VI.C.

existing "holding out" restrictions which have prevented interexchange carriers from promoting these services' intraLATA capabilities after its conditions are met.

GTEC strongly opposes opening the LATAs to 1+ toll competition or to additional competition for any other intraLATA services, including low speed private line services. It asserts that permanent authority to carry intraLATA traffic should not be granted for READYLINE-like services nor should further expansion of competition into the intraLATA 800 market be allowed unless interexchange carriers participate in local exchange carriers' 800 data bases.

GTEC also puts forward several prerequisites which it asserts must be satisfied before any expansion of intraLATA competition is permitted:

1. Completion of the current SPF-to-SLU cost reallocation programs;

2. Replacement of the current toll pooling arrangements between Pacific and GTEC over an appropriate transition period with an access charge-based settlements arrangement;

3. Reduction of intraLATA toll rates to levels more in line with costs; and

4. Rate rebalancing to offset the toll rate reductions and phase-out of revenue flows from settlements.

To allow true benefits of competition to occur, GTEC proposes that local exchange carriers be afforded the same pricing flexibility as their nondominant interexchange competitors.

C. Other Local Exchange Carriers

The other local exchange carriers are generally supportive of expanded competition for intraLATA toll services, but maintain that local exchange services should remain as monopoly Category I services. They are united in their concern that any

expansion of competition be implemented so as to maintain reasonable rates and universal service in their predominantly rural, high cost territories, particularly since in their view their customers are likely to receive fewer benefits from competition than will urban customers. The smaller companies also unanimously support maintenance of statewide average toll rates.

Contel of California, Inc. (Contel) proposes gradual expansion of intraLATA competition, with the first phase encompassing WATS, 800, private line, and special access services to begin after approval of intraLATA access tariffs. IntraLATA MTS competition would only be allowed 18 to 24 months later, after the SPF-to-SLU transition has been completed and rate rebalancing has occurred. Contel supports competition for billing and collection and operator services as contained in the May 1989 settlement submitted in I.88-04-029. Contel also supports entry by resellers into any markets for which competition has been authorized.

Citizens Utilities of California (Citizens) supports a phase-in of intraLATA competition, in which competition would first be permitted for 800 services, all private line services, and operator services. After a period of 12 to 18 months, competition would be permitted for MTS and WATS services. Citizens opposes competition in any other intraLATA services. Citizens believes that the transition to intraLATA competition should be planned within certain constraints. It submits that the Commission should identify its ultimate objectives for intraLATA competition and should rapidly resolve issues such as the revenue support mechanisms for high cost companies and the necessary repricing that increased competition may require so that it can proceed with the transition to intraLATA competition.

Roseville Telephone Company (Roseville) also supports a gradual phase-in of intraLATA competition, beginning with resellers and other non-facilities based carriers of all interexchange services. As a second step, facilities-based competition for all

interexchange services except MTS would be allowed 12 to 18 months later. Finally, competitive MTS would be permitted after an additional 12 to 18 months.

CP National and seven other small independent telephone companies[3] (CP National) suggest that phased competition may be required based upon review of projected revenue impacts resulting from reducing intraLATA toll rates to competitive levels, with specifics determined in the implementation phase and the settlements workshop.

Calaveras Telephone Company and eight other small independent companies[4] (Calaveras) state that they do not doubt that the Commission can expand intraLATA competition in a way which does not adversely affect rural telephone subscribers. However, they oppose expansion of intraLATA competition until such time as a specific proposal and its impacts on smaller local exchange carriers are presented in testimony which has been tested by cross examination and until the Commission's consideration of pooling, settlements, and the California High Cost Fund are completed and a new process for subscriber protection, if necessary, is in place and tested.

The independent companies oppose presubscription, and tend to support continuation of the existing pooling and settlements process, with expansion to include intraLATA access services with the advent of competition. Contel and Citizens state

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3 CP National is joined by Evans Telephone Company, GTE West Coast Incorporated, Kerman Telephone Co., Pinnacles Telephone Company, Sierra Telephone Company, The Siskiyou Telephone Company, and Tuolumne Telephone Company.

4 Calaveras is joined by California-Oregon Telephone Co., Ducor Telephone Company, Foresthill Telephone Co., Happy Valley Telephone Company, Hornitos Telephone Company, The Ponderosa Telephone Co., The Volcano Telephone Company, and Winterhaven Telephone Company.

that an independent company should be allowed to withdraw from the pooling process if it agrees with Pacific on alternative intercompany compensation arrangements. As part of the settlements workshop, the mid-sized local exchange carriers (Contel, Citizens, and Roseville) and Pacific presented alternatives to pooling which would transfer funding of their access and toll costs in excess of Pacific's from the pooling process to a to-be-created California Universal Network Access Fund. In anticipation that rate rebalancing may lead to lower toll rates and lower contribution to the settlement pools, all the local exchange carriers support expansion of funding sources of the California High Cost Fund. Positions on settlements and high cost fund issues are described in detail in Section VIII.

D. Division of Ratepayer Advocates

The Commission's Division of Ratepayer Advocates (DRA) recommends a phased transition to intraLATA competition. As a first step, rates would be reduced by July 1, 1990 for intraLATA switched toll services (MTS, coin toll, operator assisted toll, and optional calling plans) to the prevailing rates for comparable interLATA intrastate services, with proportionate reductions in rates of related services such as WATS. The resulting revenue shortfall would be offset through elimination of the existing toll and exchange surcredits and addition of an incremental surcharge on exchange services, with additional recovery through the California High Cost Fund if required for the smaller independent companies.

The local exchange carriers would be granted interim pricing flexibility immediately for 800 services and on January 1, 1991 for other intraLATA toll services, with an interim price floor equal to the sum of the Carrier Common Line Charge (CCLC) element of their interLATA access tariff, plus twice the local switching rate element of that tariff, with a 25 percent markup to cover interoffice network services including transport and switching.

The LATAs would then be opened to competition on July 1, 1991 or following completion of the implementation phase, whichever is later. DRA opposes presubscription for intraLATA switched toll services.

DRA proposes that the interim rate reductions and pricing flexibility be allowed prior to competitive entry in order to allow local exchange carriers to better meet competition, prevent market skimming by competitors, and provide immediate consumer benefits.

DRA also makes recommendations regarding methodologies for pricing and costing of telecommunications services and for establishing ranges of pricing flexibility to facilitate the transition to competition.

E. Toward Utility Rate Normalization

Toward Utility Rate Normalization (TURN) suggests that the Commission endeavor to determine a priori which local exchange carrier services will remain monopolistic over the long term; for those services the regulatory emphasis would be on economic feasibility, unbundling of service elements, and avoidance of cross subsidization and discrimination. For services in transition to more competitive conditions, the focus would be on bringing rates to cost, separation from other offerings, and establishing open entry, comparable opportunities to serve, and other "level playing field" service conditions.

To ensure against cream skimming and mandate that an acceptable level of competition is reached, TURN submits that the Commission should consider establishing "minimum presence" criteria whereby interexchange carriers would be required to serve all exchanges in a LATA, with such criteria invoked alternatively only for AT&T, for all interexchange carriers, or only for those carriers which pass a threshold level of subscribership.

TURN suggests various criteria for assessing whether natural monopoly or effective competition conditions exist, recommending in particular that local exchange carriers be required

to produce studies regarding any economies of scale inherent in providing their services. TURN also emphasizes the need for careful monitoring of the development of competition, particularly in rural areas. Regarding rate design, TURN recommends that a ceiling be set for basic service rates equal to their specific operational costs.

F. AT&T Communications of California

AT&T Communications of California, Inc. (AT&T) proposes a framework that would allow intraLATA competition for all switched toll (MTS, 800, WATS, 900, ZUM, and new toll services), operator services, and private line services. Viewing the local exchange network as a continued natural monopoly, AT&T submits that competition for services which could duplicate the local exchange network raises complex public policy issues which should be examined, if desired, in a separate investigation rather than in this forum.

AT&T also suggests rate rebalancing by Pacific and GTEC that could be implemented immediately to realign prices more closely with costs and to permit them to compete fairly while supporting universal service goals. In an interim Phase III decision, Pacific and GTEC would be ordered to immediately lower their MTS, WATS, and 800 rates to comparable AT&T rate levels through adjustments to their surcharges/surcredits and with offsetting revenues collected from local exchange services. Permanent rate adjustments would be made in a supplemental rate design proceeding held in 1990, with competition effective January 1, 1991.

G. MCI Telecommunications Corporation

MCI Telecommunications Corporation (MCI) submits that the Commission should allow entry into any intraLATA service an entrant wishes to offer, in order to increase the potential for telecommunications services to serve the needs of users at the

lowest possible cost. MCI sees no need to delay or phase in eased entry requirements.

H. US Sprint Communications Company

US Sprint Communications Company Limited Partnership (Sprint) believes intraLATA competition should be allowed for switched toll (including 800 and 900) services, dedicated access services, and virtual private network services. Sprint proposes that local exchange carriers retain their 1+ dialing advantage for intraLATA switched toll, but that the lower value of interexchange carriers' 10XXX access be reflected through imputation of a 25 percent access premium in local exchange carriers' intraLATA toll rates.

I. Metropolitan Fiber Systems

Metropolitan Fiber Systems (MFS) recommends that intraLATA competition be expanded in two stages. First, immediate entry would be allowed for all intraLATA private line services without restriction as to transmission method or data rates. Second, a "Local Equal Access" plan would require (1) unbundling of the local loop bottleneck and (2) economically efficient direct connection of competitive carrier facilities to local exchange carrier wire centers. MFS's plan would permit competitors to obtain direct access to end users through the local loop and would allow competition in local switching and in local transport between local exchange carriers' wire centers and competitors' points of presence.

J. California Association of Long Distance Telephone Companies

The California Association of Long Distance Telephone Companies (CALTEL) believes that intraLATA competition should be authorized for all intraLATA services, including local exchange services. Recognizing that some services, including local exchange services, are commonly characterized as natural monopolies, CALTEL is nevertheless concerned that any express limitation on

competition in exchange services may be construed as prohibiting competition in activities such as interconnection of end users or development of private networks.

K. Intellicall, Inc.

Intellicall, Inc. (Intellicall) states that competition for automated billing and call completion services for intraLATA pay telephone calls has been authorized by prior Commission orders and should be affirmed in Phase III. Intellicall also supports intraLATA competition for toll and local exchange services.

Intellicall provides a detailed description of automated billing and call completion functions performed by payphones and describes specific technical capabilities of its products and how they offer advantages to payphone providers and consumers.

In reply to Pacific, Intellicall states that fair competition for operator services would require that Pacific and other local exchange carriers impute the tariffed rates of billing and collection and calling card validation in their own operator services rates. Further, Intellicall submits that if Pacific's proposal to limit competition to non-local intraLATA calls from payphones is approved, competitive payphone providers would lose the opportunity to earn revenue from approximately 38 percent of payphone traffic.

L. California Payphone Association

The California Payphone Association (CPA) supports expanded intraLATA competition, especially for operator and billing services, stating that expanded competition is in the public interest because the payphone services market is among the most competitive. It submits that expansion of competition into operator services would trigger the abolition of certain competitive restrictions on the use of new payphone technology in Pacific's service territory provided in a settlement in I.88-04-029, the Commission's investigation into the payphone industry. CPA emphasizes that the pricing flexibility and

unbundling rules adopted in Phase II should apply to any expanded competition authorized in Phase III.

M. CENTEX Telemanagement

CENTEX Telemanagement, Inc. (CENTEX) believes that California's telephone users would benefit from a competitive marketplace with unrestricted facilities-based competition for all services.

It also stresses a view that the Commission must ensure that local exchange carriers do not frustrate development of competition by discriminatorily pricing or selectively denying access to their networks and services to any class or size of telecommunications users, especially smaller users. To this end, CENTEX submits that there should be only two classes of customer, business and residential, and that all business customers should have access to all network services and all other monopoly services on an unbundled basis. As part of its proposal, CENTEX submits that access charges should be included and explicitly stated on an unbundled basis as part of the tariff for any service providing access to local exchange carriers' networks.

N. California Bankers Clearing House Association/County of Los Angeles

California Bankers Clearing House Association and the County of Los Angeles (CBCHA) propose that the Commission proceed cautiously in formulating policies regarding intraLATA competition, with initial emphasis on establishing specific policy objectives regarding, among other things, the pricing and availability of intraLATA services and overall efficiency of production, and then determining whether unrestricted intraLATA competition or some other regulatory device can best achieve those objectives.

In CBCHA's approach, the Commission would first determine the appropriate long term relationship between fixed monthly charges and usage-based charges and what access charge policies would be required to achieve those policies, and then assess

whether the kind of competition that would develop under such policies would increase or decrease the overall efficiency with which intraLATA switched services are provided. On that basis, the Commission could then decide whether its pricing policies and efficiency goals would be better served under a single- or multi-vendor market model.

CBCHA submits that in order to assess likely competitive developments, the Phase III inquiry should be expanded to include an analysis of the economics of intraLATA services, including how effective potential entrants would be in competing with rebalanced local exchange carrier prices.

O. Department of Defense/Federal Executive Agencies

The Department of Defense and other Federal Executive Agencies (DOD/FEA) support maximum effective competition for the broadest spectrum of services they use, including MTS, WATS, and 800 services, with intraLATA equal access available to interexchange carriers. The federal agencies also request competitive procurement for all intraLATA services as well as volume discounts for large toll users.

DOD/FEA cites a highly distorted toll and access rate structure and supports rate restructuring for the local exchange carriers, in order to enhance efficiency and reduce incentives to expand economically unjustified private line facilities.

P. Western Burglar & Fire Alarm Association

In reply testimony, the Western Burglar & Fire Alarm Association (WBFAA) states that at least the local facilities service elements of local exchange carriers' low speed private line services should remain in Category I for pricing purposes and that competition should not be permitted, based on its belief that viable, sustainable competition does not presently exist, at least for services used by the alarm industry. Because of its view that analog private lines are not discretionary and are not truly

competitive, WBFAA submits that they should not be priced above cost or be considered candidates for Category II treatment.

WBFAA also opposes Pacific's rate rebalancing emphasis on business and low speed private line rate increases, asserting that if intraLATA competition has ratepayer benefits, residential ratepayers should bear their fair share of the cost for receiving those benefits.

Q. API Alarm Systems

API Alarm Systems (API) responds to Pacific's and GTEC's proposed regulatory treatment of private line and other services used by API in the provision of burglar and fire alarm services, notably their fundamentally differing proposals regarding opening up private line services for competition. API recommends that any authorized changes apply equally to Pacific and GTEC and that private line costs be examined in the implementation phase before a commitment is made to increase rates, as requested by Pacific.

R. California Cable Television Association

In reply testimony, California Cable Television Association (CCTA) submits that the Commission should remove its ban on intraLATA competition for all services, with perhaps some brief transition period. It is concerned that a substantial period of time should not be allowed to pass between downward intraLATA toll rate adjustments and the allowance of competitive entry, and sees no need for the lengthy transition period contemplated by Pacific in particular. CCTA also emphasizes that Phase III should not be used to erode the safeguards for ratepayers and competitors established in Phase II.

S. Cable & Wireless Communications, Inc.

In reply testimony, Cable & Wireless Communications, Inc. (CWC) supports opening the LATAs in early 1991 for both switched services and low speed private line competition. It submits that local exchange carriers' toll rates should reflect imputation of the same access charges assessed interexchange carriers. While

supporting presubscription, CWC agrees that local exchange carriers may initially retain their 1+ advantage, but with discounted access charges for interexchange carriers, until problems associated with pooling, settlements, and other revenue requirement issues are resolved.

T. Mtel Digital Services, Inc.

Mtel Digital Services, Inc. (Mtel) is a certificated interexchange carrier whose primary business is providing transport facilities for large interexchange carriers. In reply testimony, Mtel submits that intraLATA competition should be authorized, including for local and ZUM calls, and that any subsidies of the local loop should be carefully targeted to those residential end users who truly need such support.

U. Associated Communications of Los Angeles, Inc.

In reply testimony, Associated Communications of Los Angeles, Inc. (ACLA) supports elimination of all major barriers to intraLATA competition as quickly as possible. In ACLA's view, unfettered competition should be allowed unless it can be demonstrated that such competition will have serious unacceptable negative impacts. It sees no logical reason to categorically prohibit local exchange competition, though it appears to anticipate competitive restrictions within the local loop due to natural monopoly characteristics and supports a continued monopoly over 911 service to prevent customer confusion.

ACLA opposes collection of any local network contribution from access charges and particularly from private line networks which do not connect with the switched network. It supports colocation of competitors' facilities within local exchange carriers' end offices and tandems.

IV. Expansion of IntraLATA Competition and Rate Design Changes to Further Regulatory Goals

A. The Current IntraLATA Market

Many parties give examples of intraLATA competition which has developed since intraLATA competition was banned in D.84-06-113. Areas in which such competition exists include the following:

-Incidental intraLATA traffic carried by authorized interexchange carrier services, including outbound WATS-type services offered via special access connections, inbound 800 services, and virtual private line services;

-Alternate operator services;

-Customer-owned pay telephone services;

-IntraLATA high speed digital private line services, for which competition was authorized in D.88-09-059;

-Switched toll bypass via local exchange carrier private line and special access services, foreign exchange service arbitrage, facilities-based bypass providers, and customer-owned bypass facilities;

-Metropolitan Area Networks and Local Area Networks;

-IntraLATA switched toll traffic routed to interexchange carriers via seven-digit Feature Group A access or 950-XXXX Feature Group B access;

-Cellular services and new experimental Personal Communications Networks;

-Competitive inside wiring installation and maintenance services;

-Competitive directory advertising providers;

-Alternatives to custom calling and Centrex services such as PBXs, "smart" telephone instruments, and answering machines; and,

-Billing and collection services offered by credit card companies as well as by some interexchange carriers.

The local exchange carriers complain that many factors constrain them from responding fully to the increased competition: the legal restrictions which prohibit both Pacific and GTEC from providing interLATA services or engaging in other business activities such as customer premises equipment sales and equipment manufacturing, lack of pricing flexibility, and unequal notice requirements for price adjustments and introduction of new services. They also allege handicaps due to their inability to price services based on incremental costs and in particular the fact that rates for switched toll services have been set well above both their own costs and the rates which interexchange carriers can charge for interLATA switched toll services. They also point to provider of last resort and statewide average rate requirements which constrain their rates to cover high cost areas while interexchange carriers can target more lucrative areas.

In turn, interexchange carriers point to other compensating factors which in their opinion provide advantages to local exchange carriers; these include the ubiquity of the local exchange network and resulting routine customer contacts due to the provision of basic service. According to Sprint, concerns over incidental intraLATA call completions have delayed introduction of some services and the current intraLATA holding out restrictions likewise impair interLATA marketing efforts.

Citizens and others see this ever-increasing competition as driven by new technological developments and as being inevitable and unstoppable. Citizens stresses its view that regulators cannot prevent markets from becoming competitive by regulation and that attempts to limit competition are likely to increase costs to

consumers in both the short run and the long run, with increased bypass increasing costs and prices for those customers remaining on the public network.

Parties debate the extent to which some intraLATA services may continue to exhibit natural monopoly characteristics (defined by DRA as having a supply function dominated by increasing returns to scale or scope over the relevant range of production volumes).

DRA believes that the ban on intraLATA competition could be maintained effectively for outbound toll services for residential, small business, and medium-sized business traffic. DRA submits that it would be difficult and impractical to prohibit intraLATA traffic for outbound services provided via special access or for inbound services such as 800 (since local exchange carriers do not know where 800 calls terminate), and concludes that erosion of intraLATA toll traffic by interexchange carriers, joint use providers, resellers, authorized intraLATA private line providers, and others will likely increase for all but the residential and small business market segments.

In AT&T's opinion, local exchange networks continue to be natural monopolies by virtue of their economies of scale, regulatory franchises, and right-of-way constraints.

CBCHA submits that provision of many intraLATA services, including exchange access, local and toll usage, and carrier switched access services, is in general a natural monopoly activity characterized by significant entry barriers and economies of scale and scope. CBCHA asserts that it may be considerably less efficient for an interexchange carrier to transport an intraLATA call than for the local exchange carrier to handle the entire call on its own, noting that while an intraLATA call provided by the local exchange carrier is generally handled either on a trunk basis or involves one or rarely two tandem switching points, handling by

an interexchange carrier almost always involves at least five or six switching operations.

CBCHA also submits that, while interLATA services involve significant traffic aggregation and a high density network, intraLATA services (with some exceptions) usually do not permit such aggregation. CBCHA further believes that these natural monopoly characteristics extend to large business customers, not just residential and small business customers. While large customers can sometimes concentrate their outbound switched toll traffic, CBCHA submits that terminating usage generally cannot be aggregated similarly and thus that terminating access charges are often paid for such traffic. CBCHA states that use of private line networks even for intra-company traffic has declined in recent years as interexchange switched network services have become less expensive.

CBCHA also is of the opinion that local exchange carriers are likely to retain the overwhelming majority of low speed analog and digital private lines because of the highly dispersed, low concentration of demand. As examples, CBCHA cites private line networks servicing applications such as automated teller machines; state lottery facilities; branch banks; travel agencies; alarm services; police, fire, and other public safety agencies; and government facilities.

CBCHA finds Pacific's anecdotal evidence regarding Metropolitan Area Networks misleading and asserts that claimed "competitive inroads" for the most part can be attributed to uneconomic pricing of local exchange carriers' services, for example, switched access, and that the source of competitors' interest is not that they believe they can produce services at lower cost but that they can sell services at prices lower than local exchange carriers' mandated rates. CBCHA concludes that economic barriers to entry would be formidable with rate rebalancing even if existing legal barriers are removed.

WBFAA agrees with CBCHA that local exchange carriers are monopolies for users such as the alarm industry which require a relatively few communications channels to a dispersion of remote and constantly changing locations. WBFAA submits that there are no truly acceptable alternatives to the low speed private line services used predominantly by alarm dealers. Switched network installations, while lower cost, are less reliable and thus unacceptable for many applications. Both cable television facilities and radio are being used on a limited basis but, with rare exceptions, not as stand alone systems.

MFS and ACLA agree with CBCHA that the local loop functions as a monopoly bottleneck since the loop network, and especially distribution plant, carries small volumes of traffic and is spread over wide geographic areas. MFS states that, at least using present technology, costs to duplicate this network would be far in excess of any potential revenues. These parties assert, however, that competition may be viable within other portions of the local exchange. MFS contends that the local switching and interoffice transport portions of the network are geographically concentrated and carry high volumes of traffic. As discussed in Section VI.A, MFS argues that competition in these portions of the network is economically sustainable because new technologies including fiber optic transmission and digital switching, multiplexing, and cross connection have dramatically reduced costs and space requirements.

MCI takes exception to CBCHA's and DRA's assertions that local exchange carriers are more efficient providers of intraLATA switched toll services. According to MCI, this claim appears to rest on assumptions (a) that LATA boundaries were drawn to divide accurately between services most efficiently provided by a single firm and those most efficiently provided by multiple firms, and (b) that a very large portion of intraLATA toll traffic is now carried over direct trunks between end offices and that it would be

switched more if carried by interexchange carriers. MCI asserts that LATAs were not set up based on the cited criterion and further that dynamic changes in technology and demand would have altered the appropriate boundaries in any event.

MCI submits that interexchange carriers would be equally efficient at carrying those intraLATA calls that now go through two toll tandems. Further, MCI argues that the number of times a call is switched is not determinative of the relative efficiency of overall service provision, and that the total costs of switching, transmission, billing, collecting, marketing, and, in some cases, value-added services must be considered. MCI concludes that the market can determine which firm is most efficient much better than can any legal or analytic process.

DRA notes that telecommunications technology and competitive forces do not distinguish between regulatory boundaries. Like MCI, DRA sees little ratepayer benefit from trying to distinguish monopoly services and sees only a fair market test as determinative.

Parties also discuss the state of competition in other jurisdictions. Sprint reports that 42 states now permit interexchange carriers to provide intraLATA service on a resale basis, with 28 permitting some form of facilities-based intraLATA competition. MCI notes further that fourteen states ranging from Massachusetts to Texas currently allow full intraLATA entry with no restrictions, and submits that these states have experienced no problems.

Taking a different view, CBCHA reports that nondominant firms have captured miniscule market shares in intraLATA markets in which legal entry barriers have been removed, citing experiences in the states of Washington and New York. CBCHA also reports that in several states including Massachusetts, Minnesota, and New York where intraLATA switched competition has been allowed, the major interexchange carriers' rates are higher than local exchange

carriers' rates for some or all mileage bands, suggesting that these providers either are unable to compete or are not interested in competing. TURN reports similarly that in Minnesota competition has not developed in a robust fashion outside the Minneapolis-St. Paul area even though entry has been possible for some time.

Discussion

No party disputes that there is increasing competitive activity in intraLATA markets and that LATA boundaries are blurring for many services, though there is disagreement regarding the extent of continuing local exchange carrier market power.

There are strong indications that at this time natural monopoly-type conditions prevail in much of the local loop, particularly for basic exchange service, residential and small and medium business customers' originating calling, and all customers' call terminations. While recognizing that use of local exchange technologies such as cellular services is growing and that new technologies such as Personal Communications Networks and Basic Exchange Telecommunications Radio Service (BETRS) may become economically competitive in the future, we can still use this information in rate design, e.g., in deciding that significant contributions can still be obtained from switched access, particularly the terminating portion.

Existing knowledge about the competitiveness of other portions of intraLATA networks is more mixed. We do not doubt that there are some local switching functions and interoffice routes with natural monopoly characteristics, e.g., in rural areas. There are other high density end offices and routes which may allow multiple providers in an economic fashion. And, as WBFAA and CBCHA assert, some customer applications are such that they will continue to rely on local exchange carriers due to the dispersed nature of their calling patterns and their changing customer locations even though some portion of their traffic may follow high density routes. In establishing the regulatory framework for such mixed

markets, we must balance potential benefits of competition with the need to safeguard those customers which do not have realistic alternatives to local exchange carrier services.

B. Regulatory Strategies in a Mixed Monopoly/Competitive Market

Parties make various suggestions regarding how the Commission should go about formulating regulatory strategies in the mixed monopoly and competitive intraLATA markets.

Citizens stresses that regulators cannot make markets competitive by deregulating them and cannot prevent markets from becoming competitive by regulation. Because of this lack of control, Citizens submits that regulators must use their authority within the technological developments and market constraints to achieve the goals they set. They must devise ways to accommodate competition as it becomes more pervasive, placing emphasis on ways to bring the benefits of new technology and competition to customers while providing whatever regulatory protections are necessary. According to Citizens, regulators must also recognize that attempts to set rates above the prices of alternatives in order to generate the historical contribution to local exchange services, while perhaps successful in the short run, will lead to customers seeking out less expensive alternatives in the long run.

Citizens submits that the Commission cannot realistically expect to resolve all intraLATA competition issues at this time, but should distinguish the more immediate, short run issues from longer run issues which must also be addressed. Citizens states that in the short run the Commission should introduce or ratify competition in areas where alternative providers are available or where competition can be accomplished easily while benefitting customers. For other services, the Commission may wish to begin to introduce competition but may wish to buy some time to first deal with current conditions such as existing contribution levels from toll to local exchange costs. Citizens submits that local exchange

carriers may also require some time to prepare themselves for additional competition. Citizens also believes that additional study is needed before deciding whether to allow competition for services such as local exchange access, to decide how the need for ongoing support for local exchange pricing is to be reconciled with competition.

DRA submits that competition is not an end in itself, but asserts that it can be instrumental in driving prices downward and providing services otherwise unavailable. DRA sees little ratepayer benefit from trying to delineate monopoly services and prohibit competition on that basis, being instead of the opinion that only a fair market test can determine whether a local exchange carrier or another company can best meet the price and quality concerns of intraLATA consumers. DRA states that if competitive entry occurs either (a) the service is not truly a monopoly, (b) tariffed prices are above cost and thus encourage uneconomic entry, or (c) the entering firm misjudges market conditions.

DRA holds that it is not in the public interest to protect a firm from competition or from a mistaken judgment regarding market conditions. DRA submits instead that deploying regulatory resources to keep tariffed prices in line with costs and to protect ratepayers from market power in selected markets makes more sense than seeking to protect "monopoly" services from competitive entry. As a result, DRA states that it presents what it views as a reasonable scenario for introducing intraLATA competition and for controlling the prices of local exchange carriers. DRA recognizes that certain ratepayer interests are promoted by exclusive service franchises in exchange for policies that promote public interests. As a result, DRA does not support unlimited competitive entry into LATAs at this time.

MCI submits that the Commission should allow entry into all intraLATA services an entrant wishes to offer and that the market itself will determine whether effective competition actually

develops. In its view, potential entrants are unlikely to build facilities that are truly wasteful because that would only impose losses on their stockholders. MCI states that if new entrants provide lower cost services, it simply means that regulatory barriers to entry have been protecting high cost companies.

CBCHA agrees with DRA that competition should not be, in and of itself, the ultimate policy goal. Instead, CBCHA believes that the Commission should identify and establish specific policy objectives regarding, among other things, the pricing and availability of intraLATA services and the overall efficiency of their production, and then undertake to determine whether intraLATA competition or some other regulatory device can best achieve those objectives. To this end, it recommends that Phase III be expanded to include issues such as whether potential entrants could compete effectively under various local exchange carrier pricing scenarios.

CBCHA recommends that the following steps be taken in the following sequence in formulating policies regarding expansion of intraLATA competition:

1. The Commission should determine the appropriate long term relationship between fixed monthly charges and usage-based charges as a prerequisite to examination of whether intraLATA competition or direct prescription is the most effective means of reducing usage rates.

2. The Commission should determine what specific access charge policies would be required to achieve its desired pricing policies if switched services competition is introduced, since the effectiveness and efficiency with which a policy of unrestricted intraLATA competition would achieve policy goals will depend heavily upon the carrier access charge policies adopted.

3. The Commission should attempt to determine the nature of intraLATA switched services competition before it is allowed, since resale only would provide little real

opportunity for innovation and efficiency gains.

4. Finally, based on the initial three steps, the Commission should determine whether the kind of competition that is likely to develop will increase or decrease the overall efficiency with which intraLATA switched services are provided and on that basis whether its pricing policy and efficiency goals would be better served under a single- or multi-vendor market model.

TURN suggests that the Commission should determine which services will remain monopolistic over the long term; for those the regulatory emphasis would be on their economic feasibility, unbundling of service elements, and the need to avoid cross subsidization and discrimination. For services in transition to increasingly competitive conditions, the focus would be on bringing rates to cost, separation from other offerings, and establishing open entry, comparable opportunity to serve, and other "level playing field" service conditions.

TURN lists several criteria which it sees as indicating that a service may remain monopolistic in the long run: the existence of economies of scale, excessive start-up investments, limited customer approachability or opportunity to serve, insufficient demand, the existence of patents or other legal restrictions, or rate structure requirements.

TURN suggests that the Commission should first require local exchange carriers to provide studies regarding which services exhibit economies of scale that would hinder sustainable competition from developing. The analysis could then proceed to the question of whether monopoly services are viable at affordable rate levels or whether a levy on other services (e.g., an across-the-board surcharge) is needed to support such services.

Discussion

We certainly agree with DRA and CBCHA that intraLATA competition is not the ultimate policy goal and that competition should not be pursued if such an avenue would not further our regulatory goals.[5] At the same time, we must recognize the realities of the marketplace, keeping in mind as Citizens reminds us that allowing competitive entry would not make markets competitive nor would prohibiting competition prevent it entirely.

TURN and CBCHA would have us undertake detailed a priori assessments of whether intraLATA competition would be economically viable or whether monopoly conditions would prevail for intraLATA services under various local exchange carrier pricing scenarios. Just as we concluded in D.87-07-017 for AT&T, we do not see that such an approach, while theoretically appealing, would give us a reliable factual record. Such an approach would require massive amounts of largely unavailable or unpredictable information including, for example, competitors' production functions, future technological advances and customer demand patterns, and demand elasticities over a wide range of potential prices for a variety of services.

We also agree with MCI that technology-based assessments of markets can ignore other factors crucial to the development of competition and ratepayer benefits. Not all firms, especially monopolists, may be able to achieve the theoretically optimal cost

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5 The Notice of En Banc Hearing and D.89-10-031 describe in detail what we see as our primary regulatory goals in undertaking this reevaluation of the intraLATA regulatory framework. Briefly, these goals include universal service, economic efficiency (both pricing and productive efficiency), encouragement of technological advances, financial and rate stability, efficient utilization of the local exchange network, avoidance of cross subsidies and anticompetitive behavior, and low cost, efficient regulation.

structure. Further, for some services network and engineering costs may be a relatively small part of the market equation. Business functions like marketing, billing, and customer service lack monopoly characteristics and are crucial to competitive success and customer satisfaction; we have no ability to predict which firms or entrepreneurs will prove best at these.

We agree with DRA and MCI that only market experience can provide enlightenment regarding the viability of competition for various intraLATA services. Because of this and because of the potential benefits of properly structured intraLATA competition detailed in Section IV.C, we conclude that it is in the public interest to create a regulatory structure that will allow economically efficient competition to develop if viable while protecting ratepayers regardless of the extent to which competition actually develops for particular services.

To this end, we conclude that we should take steps to accommodate those competitive developments which are beyond our control, encourage technological advancements, structure competition in ways so that benefits accrue to ratepayers and ratepayers are reasonably protected from risks, establish "level playing field" conditions where competition is authorized (or inevitable), and prohibit competition where within our control if such prohibitions further our overall regulatory goals (e.g., maintenance of universal service or prevention of rate shock).

An important component of this regulatory structure is continued movement toward a more cost-based rate design aimed at promoting economic efficiency while protecting universal service. We emphasize that this rate design goal has merit regardless of the extent to which intraLATA competition develops because cost-based rates send more accurate price signals, provide customers more reasonable rates for services such as switched toll, and discourage uneconomic bypass and other uneconomic competition. As developed in Section V, implementation of the imputation principles adopted

in D.89-10-031 will help ensure that desired contribution levels are maintained through local exchange carriers' access charges.

C. Regulatory Goals

Various parties address the extent to which their proposals, as well as the proposals of other parties, would further the Commission's regulatory goals.

Pacific recognizes that regulatory goals must be considered jointly and in balance. It stresses that Commission policy should make certain that economies of scale and economies of joint production (economies of scope) are made use of so that efficient production occurs, and that prices reflect both economies of scale and economies of scope. At the same time it recognizes that the Commission also needs to consider effects on the goal of providing universal service and access to new information age services.

Pacific submits that the Commission's goals can best be met by adoption of a set of policies which begins to rely on market forces rather than regulatory processes to provide a wide range of customer choices at affordable prices. To this end, Pacific's regulatory package combines rate design changes to more closely align prices with costs and an orderly transition to expanded intraLATA competition in a manner aimed at creating a "level playing field" for itself and its competitors. In Pacific's view, its proposal also provides for appropriate consumer safeguards and continuation of universal service.

Pacific is of the view that both consumers and businesses are likely to be made better off by increased competition, citing benefits arising from increased choices which competition creates as well as resulting competitive pressures to reduce intraLATA toll rates toward costs, a move which should lead to a significant gain in consumer welfare through increased toll calling.

In Pacific's view, the overall objective when competitive entry is permitted should be to create a level playing field for

competition by considering the relative competitive advantages and disadvantages of the various service providers. Though it recognizes that the exact definition of this often-heard term is difficult to make precise, its view is that a level playing field occurs when each competitor is able to utilize its competitive advantages which it brings to a market to the greatest extent possible without competition being harmed. In Pacific's view, competition and economic efficiency should be the goals in establishing a level playing field, with individual competitors neither favored nor hindered.

While recognizing that some increase in basic residential rates may result from its 1993 subsidy transition plan and other competitive pressures, Pacific sees no reason to believe that universal service would be threatened, emphasizing that lifeline service provides protection for low income customers. Pacific submits that the Commission should target subsidy flows to services priced below incremental costs as needed to reduce the subsidy burden.

Pacific concludes that, if adopted, its proposals would send the correct economic signals, provide Pacific with sufficient flexibility to meet the evolving competitive challenge, and assure a wide choice of services to California customers.

GTEC emphasizes that its proposal for limited intraLATA competition is consistent with the goal of universal service since it would not require the dramatic rate restructuring that allegedly would be necessary to enable local exchange carriers to fairly compete in a more broadly competitive intraLATA market. In GTEC's view, if the Commission adopts a policy in favor of intraLATA competition beyond what GTEC has proposed it would also have to permit a significant acceleration in the rate of capital recovery, with appropriate increases in basic rates, so that local exchange carrier plant lives and investment bases would be more in line with the competitive market place.

GTEC also views its proposal as being consistent with the Commission's goal of financial and rate stability. Since its limitation on MTS competition to 10XXX calling would not place at risk the total revenue stream from MTS, GTEC does not expect this additional competition to cause major financial disruptions or require radical changes to tariffed rate levels. On the other hand, unrestricted intraLATA competition with presubscription would, in GTEC's view, adversely affect financial and rate stability, as competitors quickly take over a large share of the most lucrative business markets due to the uneconomic cost factors and pricing characteristics that currently exist.

In GTEC's view, its proposal is also consistent with the Commission's goal of full utilization of the local exchange network, since it limits risks that a significant share of existing network traffic would be shifted to competitive facilities. GTEC submits that 1+ intraLATA toll competition would result in a decline in usage of network facilities as competitors shift usage to their own networks to have greater end-to-end control over their service offerings and to avoid payment of access charges.

GTEC also submits that its proposal to allow intraLATA 10XXX toll competition would foster economic efficiency, encourage technological advancement, be consistent with the goal of low cost efficient regulation, and maintain the goal of avoiding cross subsidies and anticompetitive behavior because it does not require any significant changes to the new regulatory framework adopted in Phase II, adopted to carefully provide for attainment of these Commission goals.

GTEC asserts that full intraLATA competition would undermine the system of price cap rate indexing put in place by the Phase II decision issued only last October, since in its view the indexing mechanism would not make sense in a fully competitive environment where the market place rather than an index would dictate prices charged for services. GTEC further argues that

opening the LATAs to significantly expanded competition would greatly diminish the ability of local exchange carriers to achieve the productivity levels adopted in D.89-10-031 because growth in usage, which has been an important component of historical productivity improvements forming the basis of the adopted "stretch" productivity levels, would not necessarily accrue to local exchange carriers. In GTEC's opinion, the new regulatory framework does not contemplate wholesale changes to the regulatory environment, including the realignment of all Category I rates to cost on a flash cut basis. Yet, GTEC submits, this would be the result if greatly expanded intraLATA competition were permitted. It argues that in that situation the Commission would have to adjust the 4.5 percent productivity factor in the price cap index, allow local exchange carriers to offset revenue losses due to increased competition as a Z factor adjustment in the price cap formula, and accelerate capital recovery rates.

Finally, GTEC submits that fundamental fairness dictates that local exchange carriers be given an opportunity to recover the enormous capital investments they have made to build a modern telephone network, asserting that investors are entitled to a reasonable opportunity to recover their investments before a radical change in the competitive environment is allowed.

Citizens agrees that the Commission's stated regulatory goals are reasonable ones to pursue in today's telecommunications conditions, but emphasizes the aspects of these goals that offer protection to those consumers who do not have choices in the market. Citizens stresses the need to protect such customers from monopoly pricing and price increases to subsidize competitive offerings, as well as its view that universal service concerns in today's more competitive context may require new financing mechanisms as the traditional sources of contributions become more difficult to sustain.

DRA submits that its proposed regulatory changes would promote economic efficiency through a more rational rate design and relaxation of regulatory barriers to allow competitive market forces to enforce efficient pricing. It asserts that a more competitive market structure would offer ratepayers a choice of services and recommends pricing policies which in its view would transmit meaningful price signals and discourage uneconomic bypass of local exchange carrier facilities.

DRA asserts that its proposal would encourage technological innovation for the obvious benefits available to ratepayers and the network. Network improvements that take advantage of technical efficiencies may lead to lower toll network costs and provide more and improved network services to customers. Given broader choices, customers would respond to utility price signals and construct services that meet their needs.

DRA also believes that its proposed terms and schedule for expanded competition can lead to expanded choice and quality of service, which would expand network use, with toll rate reductions stimulating increased call volumes and lowering per-unit costs.

DRA submits that its proposed standardization of the access charge structure and intraLATA toll rates would make tariffs easier for ratepayers to understand as well as for the Commission to administer. Along with the orderly transition to competition, DRA sees these proposals as furthering a simple and direct regulatory framework.

DRA also believes that its proposed introduction of intraLATA toll competition and toll rate reductions would not affect the ongoing goal of maintaining universal service. It points out that any revenue shortfalls arising from toll price reductions will be partly made up due to resulting increased toll usage. Further, DRA submits that even if local basic exchange rates are increased somewhat, the typical residential telephone subscriber may well end up with the same or lower total monthly

bill, due to toll rate reductions. Finally, DRA notes that existing funding mechanisms such as the Universal Service Fund and the California High Cost Fund can be modified if needed to target specific groups of subscribers.

Interexchange carriers emphasize several consumer benefits arising from expanded intraLATA competition, including lower intraLATA rates and a broader choice among competing intraLATA services based on price, service quality, and service options. AT&T points to more efficient use of local exchange networks resulting from more cost-based rates, and also stresses its view that competition for new toll services would increase overall network utilization and provide additional demand for access, thus providing additional contribution to basic exchange rates without eroding existing revenue streams.

Sprint believes that its proposal of limited intraLATA competition can be adopted without serious effects upon local exchange carriers or upon the Commission's universal service goals. Due to the proposed 10XXX restriction, Sprint does not expect a mass migration of customers to interexchange carriers. Further, any impact on local exchange toll revenues would be mitigated by a number of factors, including toll market growth, price elasticities, access revenues, and cost savings associated with any toll traffic losses.

CALTEL points to the lifeline program as a protection for universal service even if exchange rates are set closer to costs, and notes moreover that any increases in exchange rates would be somewhat offset by toll rate reductions.

MFS stresses that the Commission must not unduly constrain potential competitors and must protect them against unfair exercises of monopoly power, in order that Californians realize the full benefits of competition. MFS contends that its Local Equal Access plan would promote universal service because it would provide incentives for maintenance of a unified network and

local exchange carriers would derive revenues for all loops in service, whether used for bundled local exchange carrier services or used by competitors. Further, in its view, competitive pressures for local switching and local transport between wire centers and competitors' points of presence would tend to drive local exchange carriers' prices for these functions toward economic costs, thus promoting pricing efficiency and productive efficiency goals.

Discussion

We have long recognized the potential benefits arising from competitive market forces. Properly structured competition can further our regulatory goals by providing increased consumer choices as well as increased incentives for technological advancements and innovations, incentives for service providers to minimize costs, and increased utilization of the network with resulting decreases in unit costs. Because of these benefits, we conclude that intraLATA competition should be encouraged to the extent consistent with meeting other regulatory goals. We also recognize the inevitability of certain intraLATA competition, and believe that regulators should embrace and accommodate such competition rather than make futile attempts to fend off such advancements. However, there is still significant indication that at least portions intraLATA markets continue to exhibit natural monopoly characteristics and that a certain portion of current competitive forces arises due to local exchange carrier rate-cost disparities.

We are very aware, as DRA cautions, that decisions on market structure and terms and conditions of competitive market entry may be difficult or impossible to reverse. We heed DRA's warning that great care must be taken in properly defining the terms and conditions for all entrants prior to lifting existing bans.

Because we do not have and cannot amass the empirical evidence that would be necessary to accurately assess a priori the true economic viability of intraLATA competition, we conclude that our approach in structuring an intraLATA competitive market framework should place particular emphasis on protection of ratepayers whether or not removal of entry barriers actually leads to development of viable competition.

Further, because the significant potential benefits of competition can be realized only if the competition is truly economic, based on an underlying competitive nature of the markets rather than driven by imposed market distortions such as pricing anomalies or legal entry barriers, the market structure should encourage level playing field competition to the extent within our control and consistent with ratepayer protection goals.

We agree with Pacific and numerous other parties that a more cost-based rate design is an essential component of level playing field competition. Contrary to certain parties' view, however, we believe that reliance on competitive entry as a tool to force such rate redesign is a back door and potentially harmful approach. We prefer to make the needed rate design changes on an affirmative basis, in order to retain control and ensure ratepayer protection.

While protection of universal service is an uppermost component of any rate design, in Phase III we seek to set guidelines for the upcoming implementation phase so that the resulting rate design will also enhance economic efficiency, encourage efficient use of the network, and discourage uneconomic bypass. We cannot emphasize strongly enough that ratepayers stand to benefit significantly from this approach regardless of the extent to which increased competition develops.

As developed in later portions of this decision, this rate redesign has several components. In particular, we identify the current level of intraLATA switched toll rates as problematic

independent of the degree of intraLATA competition. We plan to lower these rates to create substantial consumer benefits. Rates will also be more closely aligned with costs in the cost-based elements of access services, with reflection of economies of scale and scope to the extent they can be ascertained but with strict application of adopted imputation principles. The CCLC component of switched access charges will continue to be used to derive significant on-going contribution to the maintenance of affordable local rates, but will be bifurcated so that the bulk of that contribution may be obtained from the terminating CCLC (or originating CCLC for inbound toll services). We will also consider increases in basic rates, if needed to permit an appropriate realignment of intraLATA switched toll rates. We are encouraged by the evaluation of DRA and others that limited basic rate increases are possible without harm to universal service.

Finally, steps will be taken to make rate structures more consistent to discourage arbitrage and uneconomic service bypass, and high volume discount toll packages will be allowed so that local exchange carriers can compete more fairly with interexchange carriers which have access to special access and other serving arrangements unavailable to local exchange carriers.

D. "Level Playing Field" Issues

Parties are in general agreement that, to the extent intraLATA competitive entry is allowed, fair "level playing field" regulatory conditions should exist. Several parties offer opinions regarding both current inequities in intraLATA market conditions and steps which could be taken to create fairer competitive conditions. Not surprisingly, their views tend to reflect their respective positions on this playing field.

There are many aspects of the current telecommunications market and of any regulatory framework which we may wish to impose on it which, taken individually, provide relative advantages or disadvantages to one or more players. Some arise because of

superior capabilities which one firm might possess. Others come about due to factors such as historical happenstance or regulatory constraints.

As various parties mention, local exchange carriers bring with them to the intraLATA market certain inherent advantages, including the ubiquity of their networks, economies of scale and scope in offering a range of intraLATA services, widespread name recognition and reputation, and routine customer contacts due to provision of basic local exchange service. CALTEL points to customer inertia as an important factor favoring local exchange carriers. At the same time, they operate under certain constraints, including a requirement to have sufficient capacity to meet demand and function as the provider of last resort, certain line of business restrictions (e.g., interLATA, customer premises equipment, and manufacturing), mandated rates which are not always cost-based, and stricter regulatory controls over rate changes. GTEC complains that long capital recovery periods contribute to local exchange carriers' competitive disadvantages.

Local exchange carriers in particular view interexchange carriers as having significant advantages, including the ability to tailor offerings to geographic areas, use contracts for all services, and offer full intraLATA and interLATA services. GTEC submits that potential competitors can selectively enter high density, low cost service areas with modern, low cost plant and offer services to high volume users at rates which are below the rates local exchange carriers must charge. Other advantages include the ability to offer services nationwide and to fashion discount packages based on combined intraLATA and interLATA usage, nationwide advertising, and nationwide market power. Their regulatory structures are much simpler and more flexible than those of local exchange carriers, with AT&T having limited pricing flexibility for its intrastate services and other interexchange

carriers having broad tariffing flexibility and reduced notice requirements of rate changes and new service offerings.

A primary interexchange carrier disadvantage is a central focus of Phase III, that is, current entry restrictions on the provision of intraLATA services. Other disadvantages exist as well. Contrary to assertions, we note that interexchange carriers have the same intrastate contracting restrictions as do local exchange carriers. Further, while it is true that interexchange carriers can elect to offer services only in selected areas, they must abide by statewide average rate requirements in all areas which they do choose to serve.

Parties have varied views regarding steps the Commission should take in Phase III to further level playing field competition.

Many parties submit that rebalancing of local exchange carriers' rate to a more cost-based rate design is needed so that the local carriers are not competitively disadvantaged. In Pacific's view, each competitor should be allowed to utilize its competitive advantages to the greatest extent possible without competition being harmed, with the goal being promotion of competition and economic efficiency, with individual competitors neither favored nor hindered.

CBCHA submits that if the Commission adopts an open LATA policy, it should not allow arbitrary and artificial constraints to be imposed upon new entrants or otherwise permit local exchange carriers to gain an unfair competitive edge as a consequence of their embedded customer base and network infrastructure. It comments that local exchange carrier advantages fall into two categories: those that result from real economies of scale and/or scope (e.g., lower costs due to fewer switching operations or high traffic levels) and those whose existence is primarily attributable to the exercise of market power (e.g., prohibition of presubscription or colocation). In its opinion, advantages falling

in the first category should be exploited, since by so doing the efficiencies can be made directly available to consumers. However, in its view restrictions or service limitations imposed to protect the market and/or revenue stream of local exchange carriers should be minimized or eliminated. CBCHA concludes that if there is substantial public benefit in protecting a local exchange carrier from competition the Commission should simply reject entry altogether, rather that permit entry subject to a laundry list of constraints and roadblocks.

Discussion

A fully competitive market automatically provides the balancing mechanism to weigh relative advantages and disadvantages of various competitors; no third-party overseer is needed. In establishing a regulatory framework for intraLATA telecommunications, we must act as a proxy for this "invisible hand."

CBCHA's demarcation of the types of competitive advantages and disadvantages is useful in focusing our analysis. As a general principle, we agree with CBCHA and Pacific that the goal of economic efficiency is of great importance. We do not believe that level playing field competition encompasses competition for its own sake or at any cost, nor that the goal should be to favor or handicap individual companies. Rather, our aim should be to fashion a competitive regulatory framework which encourages economic competition and discourages uneconomic competition, within the context of other regulatory goals.

We agree that movement toward a more cost-based rate design for local exchange carriers is desirable to the extent consistent with universal service and other regulatory goals, because it would promote level playing field competition while discouraging uneconomic competition. As a general principle, economies of scale and scope should also be exploited, because that will serve to enhance economic efficiency, with overall societal

benefits. We also agree that leveraging of inherent market power should be discouraged, for a similar reason: such anticompetitive conduct generally results in additional societal costs and can work to the detriment of other regulatory goals as well, including encouragement of technological advancements and efficient utilization of the local network.

An assessment of whether a given regulatory structure constitutes a "level playing field" is necessarily judgmental because the effects of various components such as technical constraints (e.g., lack of readily available and costless presubscription technology), legal restrictions (e.g., the Modified Final Judgment restrictions), and historical happenstance (e.g., name recognition and customer inertia) cannot be reliably quantified or weighed in a balance.

While the guideline of encouraging economic efficiency is useful, it has limitations in evaluating and balancing certain "level playing field" components, for example, whether presubscription should be allowed and, if not, whether intraLATA access charges should be discounted. As discussed in Section V, intraLATA presubscription will not be required at this time. While we know that lack of presubscription will give a distinct competitive advantage to local exchange carriers, all other things being equal, this advantage is not practically or reliably quantified. We prefer to attempt to balance factors such as the lack of presubscription which are not quantifiable or which have no directly attributable economic basis as we devise the overall regulatory framework rather than perform largely judgmental price adjustments such as the access charge discount proposed by some parties.

Many of the parties' Phase III proposals would change the tilt of a competitive playing field. Proposals to increase local exchange carriers' pricing flexibility, rebalance rates, reflect efficiencies in the access charge imputation process, impute

special access costs in switched toll discount calling plans for high volume users, and delay competition until some time after rate rebalancing occurs would all benefit local exchange carriers. On the other hand, removal of all entry barriers, presubscription, direct access to the local loop, colocation of competitors' equipment in end offices, and competitive entry before local exchange carrier pricing flexibility is allowed would all accrue to the benefit of interexchange carriers.

For some of these proposals, there is no "right" solution that clearly promotes economic efficiency. However, as explained throughout the remainder of this decision, we have structured an overall regulatory package which, in our judgment, promotes economic efficiency and creates a fair market structure in which competitive forces can operate. Major components of this package include:

- -Simultaneous rate rebalancing (with phase-ins if needed to prevent rate shock), pricing flexibility, and competitive entry.

- -The contribution from access charges and local exchange carriers' intraLATA switched toll rates (above their fully allocated embedded costs) should be isolated in the CCLC element of access charges, in order to equalize the contribution from local exchange carrier and interexchange carrier services.

- -Tariff consistency is promoted to reduce uneconomic bypass opportunities.

- -Phase II pricing flexibility rules are continued for services with competitive entry, to fairly allow local exchange carriers to respond to competitive conditions while protecting both ratepayers and competitors, except that local exchange carriers may propose rate floors based on incremental costs.

- -Presubscription is not required at this time, and no access charge discount is imposed.

-Statewide average local exchange carrier toll and access rates will be established.

-Efficiencies should be recognized in the access charge imputation process, with demarcation of virtual points of presence for local exchange carriers as an indication of the extent to which monopoly conditions extend into local exchange networks.

-Discount toll packages for high volume users will be allowed so that local exchange carriers can compete fairly with interexchange carriers which have alternative access options.

-Direct access and colocation are not required at this time, due to inadequate information.

-Current interexchange carrier regulatory frameworks are extended to the intraLATA market for these competitors.

Because we see a continued need to proceed cautiously in restructuring the telecommunications regulatory framework, on certain issues such as presubscription we have preferred an incremental approach if ramifications of dramatic departures from the status quo could jeopardize our regulatory goals. Parties may well take issue with our assessment that this package creates a reasonable level playing field. As time goes by, it may be that further experience and technological developments will indicate the need for change in one or more of these components. We will monitor this framework carefully, as discussed in Section X, and make such changes if warranted.

E. Timing of IntraLATA Competition, Rate Design Changes, and Pricing Flexibility

While most parties support some degree of expansion of intraLATA competition accompanied by local exchange carrier rate design rebalancing and pricing flexibility for services subject to competition, there is wide disagreement about the timing of these steps. Some parties argue that rate changes should occur

immediately, with time allowed for market response before competitive entry is allowed; others support immediate competitive entry with rate design changes phased in subsequently. A similar range of views exists regarding the timing of local exchange carrier pricing flexibility relative to competitive entry.

In general, the local exchange carriers, DRA, and AT&T are of the view that local exchange carrier rates should be adjusted before competitive entry occurs, though DRA and AT&T would have both rate redesign and competitive entry occur more expeditiously than would the local exchange carriers. These parties all assert that local exchange carriers should have a reasonable opportunity to compete using rates that more accurately reflect costs and that this approach would help prevent uneconomic entry by competitors looking at current cost structures. They submit that it would also allow for an orderly transition to competition, which would permit local exchange carriers time to prepare for competition, allow time to assess impacts, and permit the Commission to modify the process and mitigate unwanted results if conditions so merit.

In Pacific's view, stage two of its proposal (MTS, WATS, and 900 competition) should not begin until use of incremental costs for competitive services is resolved, asserting that it would be competitively disadvantaged otherwise.

The smaller independent local exchange carriers submit that, given the importance of toll revenues, premature intraLATA competition could irreparably harm them. In addition to rate rebalancing, they contend that no expansion of intraLATA competition should occur until impacts of any expansion of competition on the smaller independents are quantified and the California High Cost Fund is augmented as needed.

DRA, AT&T, GTEC, and DOD/FEA share the view that there should be immediate intraLATA toll rate reductions to AT&T's current interLATA levels. DRA submits that rates for MTS, coin

toll, operator assisted toll, and optional calling plan toll services should be adjusted downwards on July 1, 1990 to at least match those of AT&T, based on its view that current interLATA prices provide an approximation of where intraLATA rates would be under a comparable competitive structure if interLATA switched access charges are applied on an intraLATA basis. DRA sees these recommended intraLATA toll cuts as so deep that implementing them at the same time that competition is initiated would be imprudent. DRA fears that the current pricing disparities would create the impression that local exchange carriers are the high cost providers, and submits that interim price cuts would prepare local carriers for competition and provide critical data on customer response to price cuts. DRA asserts also that interexchange carriers would begin marketing immediately following a Commission decision even if competition is implemented at a later date.

AT&T makes a similar recommendation, and in reply testimony GTEC and DOD/FEA support the DRA and AT&T proposals.

DRA and DOD/FEA are joined by several parties, including MCI, Sprint, CCTA, and CENTEX, in opposing the local exchange carriers' proposed delays in competitive entry until after the currently scheduled interLATA SPF-to-SLU transition is completed. In DRA's view, such a delay would unnecessarily perpetuate pricing distortions, allow resellers of private line and foreign exchange services to continue to benefit from arbitrage, and delay benefits of toll competition. As time goes by, DRA fears that rate rebalancing may entail larger revenue shifts and become more difficult. AT&T states that the local exchange carriers could match interexchange carrier rate reductions due to SPF-to-SLU after competition is allowed without placing significant pressure on local rates.

MCI particularly opposes any phasing in of entry on a service-by-service basis, submitting that carriers are more likely to participate and make investments if there are no constraints on

the offerings they can make through their facilities. Sprint envisions that any necessary realignment of toll rates and pooling changes should be accomplished and competition authorized by the end of 1990. Sprint discounts other parties' concerns regarding rate shock if toll rates are decreased suddenly, citing as mitigating factors an expected increase in toll usage, continued revenues from access charges, and retention of considerable competitive advantage by local exchange carriers if a 1+ restriction is maintained.

CCTA and CENTEX express concern that allowing a substantial period of time to pass between intraLATA toll rate reductions and competitive entry could permit local exchange carriers to consolidate their control over intraLATA markets so that effective competition would not develop at all. CENTEX states that the seriousness of DRA's concerns regarding premature marketing efforts by would-be competitors is unclear, since prior to implementation of competition local exchange carriers would continue to block all intraLATA traffic placed over Feature Group C and Feature Group D access facilities.

DOD/FEA asserts that intraLATA toll competition should occur at the conclusion of the implementation and supplemental rate design proceeding or by July 1, 1991, whichever is earlier.

Mtel supports having local exchange carriers receive intraLATA rate adjustments simultaneously with introduction of intraLATA competition, on the basis that local exchange carriers should not be accorded special treatment but rather should have to compete fairly with alternative intraLATA carriers. CALTEL has no objection to rate adjustments occurring simultaneously with intraLATA competition, but believes it would be wholly unfair to permit local exchange carriers to adjust rates prior to competition.

In reply testimony, Pacific and DRA assert that proposals that competition begin immediately would only benefit the narrow

interests of competitors by allowing cream skimming with no consideration of impacts on local exchange carriers and universal service. Pacific maintains that important matters such as reducing toll rates, shifting subsidies, and addressing pooling concerns require the Commission's attention before competitive entry is permitted. Pacific states that it is not fundamentally opposed to competition on an earlier schedule than its basic proposal as long as its preconditions are met, though it continues to prefer that changes be phased in to mitigate the effects of any price increases on customers.

Pacific is also concerned that the proposals by DRA and AT&T (supported by GTEC and DOD/FEA) to restructure rates and surcredits immediately would be premature and inaccurate, arguing instead that early and comprehensive rate design hearings are needed to ensure a thoughtful, balanced, and comprehensive rate design decision. Pacific submits that surcredits should not be eliminated or decreased until reconciled with the Phase II objectives of expanding local calling areas and eliminating the charge for residential (and possibly business) Touch Tone service.

Regarding local exchange carrier pricing flexibility, DRA submits that pricing flexibility should be granted prior to competitive entry; the local exchange carriers generally support flexibility on a concurrent basis with competition; and parties such as CALTEL submit that local exchange carrier pricing flexibility should be allowed only after effective competition has developed for a service.

Because it believes that competitors are poised to commence active competition as soon as a decision is announced, DRA recommends that interim pricing flexibility be implemented immediately for 800 services and on January 1, 1991 for other switched toll services.

Pacific submits that pricing flexibility at the time competition is permitted is the appropriate treatment for services

for which competition is authorized, on the basis of both ordinary fairness and sound economics, and cites Phase I of this proceeding, in which the Commission authorized pricing flexibility and expanded competition for intraLATA high speed private line services concurrently.

CALTEL, CENTEX, CBCHA, CCTA, and Mtel argue that actual, not merely authorized, competition should be examined before expanding local exchange carriers' pricing flexibility. CCTA submits that the intent of D.89-10-031 was that local exchange carriers must make a factual showing that substantial and effective competition will emerge before pricing flexibility is granted. CENTEX asserts that DRA's interim rate flexibility proposal is also inconsistent with D.89-10-031 and would allow conduct which would discourage or preclude competitive entry and result in less, rather than more, competition. CENTEX concedes in its reply testimony that pricing flexibility could be allowed simultaneously with competition or promptly thereafter. CALTEL suggests that pricing flexibility for local exchange carriers be delayed and considered in a separate docket after some experience is gained with competition, similar to the approach taken for AT&T in the interLATA arena.

Pacific and Contel respond that local exchange carriers should not be required to prove that effective competition exists for intraLATA toll services before receiving pricing flexibility, arguing that the mere fact that competition is allowed is sufficient reason. In Pacific's view, the new incentive regulatory framework coupled with the provision that only downward pricing flexibility is allowed for Category II services greatly decrease, or even eliminate, the incentive of a local exchange carrier to cross subsidize a service facing competition. Contel fears endless debates over whether effective competition exists, and concurs with Pacific that the Phase II decision provides guidelines sufficient to protect competition.

Discussion

The controversies over timing of rate rebalancing, pricing flexibility, and competitive entry arise from parties' concerns about level playing field competition. Local exchange carriers understandably want reductions in the current disparity between intraLATA toll rates and interLATA access charges to enhance their competitive position. They also want pricing flexibility so that they can respond to competition as it develops; understandably, potential competitors would prefer an opportunity to develop their intraLATA customer base before local exchange carriers are given broad pricing flexibility.

We see no need to provide for a transitional phase-in of competition based on the assertion that parties need time to prepare. Since I.87-11-033 was issued in November 1987, we expect that many parties have already begun contingency planning in anticipation of increasingly competitive conditions; today's decision will provide further guidance. Further, it could easily be twelve months or more before the implementation phase is completed and rate changes and competitive entry actually implemented. Surely this is adequate preparation time.

In Section IV.F and Section IV.G, we adopt policies that will move toward a more cost-based rate design, most notably a conceptual relationship between access charges and local exchange carrier switched toll rates which would largely eliminate the disparity between local exchange carrier and competitor switched toll rates. These rate design changes should alleviate much of the local exchange carriers' concern regarding rate rebalancing.

We do not find convincing Pacific's argument that competition for MTS, WATS, and 900 services should be delayed until incremental cost methodologies are adopted.

Consistent with the concerns of the smaller independent companies, we propose in Section VIII a restructuring of pooling and reliance on the California High Cost Fund. This restructuring

will maintain affordable rates for the small companies within the overall competitive regulatory framework, and will be completed well before the new framework is implemented following the implementation phase.

Because we adopt more cost-based rate design policies to enhance level playing field competition between local exchange carriers and their competitors, with possible phase-ins if needed to prevent rate shock, and because we take steps to protect the smaller companies within this new competitive regulatory framework, there is no need to implement the rate design changes some period of time prior to allowance of competition. Further, parties have been unpersuasive in their arguments that competitive entry should be delayed, either to allow more time to prepare for competition or to consider incremental cost methodologies. For these reasons, we conclude that competitive entry should be allowed to occur on a simultaneous basis with the needed rate design changes, following the implementation phase, so that expected benefits of expanded competition are not unnecessarily delayed.

While permitting local exchange carrier pricing flexibility before competitive entry would benefit local exchange carriers and permitting competition before pricing flexibility would benefit competitors, neither approach would provide obvious benefits to ratepayers or be consistent with the goal of a fair competitive market. Contrary to representations by CCTA, the standard for pricing flexibility adopted in Phase II is "discretionary or partially competitive services for which the local exchange carrier retains significant (though perhaps declining) market power" and we explicitly provided that local exchange carriers could request in Phase III that they be granted pricing flexibility for services for which competition is proposed (D.89-10-031, mimeo. pp. 152, 157). Consistent with our findings in Phase II, we conclude that concurrent pricing flexibility and

competitive entry is most consistent with the level playing field concept and as a result should be adopted.

F. Rate Rebalancing

1. Parties' Proposals

A number of parties present rate rebalancing proposals in Phase III. The local exchange carriers in particular view rate rebalancing as an essential adjunct to any expansion of intraLATA competition. Several parties focus on the current disparities between intraLATA and interLATA switched toll rates, emphasizing that local exchange carriers would be at a significant competitive disadvantage if intraLATA competition were allowed while intraLATA rates are significantly above comparable interexchange carrier rates. In addition, several parties address the extent to which contribution toward local network costs should continue to be derived from switched access charges, intraLATA switched toll rates, and/or other sources.

Pacific asserts that a realignment of prices is the most important policy required for creation of a reasonable competitive framework. Pacific submits that in 1988 the average contribution per minute from intraLATA switched toll services was $.107 whereas the comparable contribution from intrastate interLATA switched access was $.075, and that after the on-going SPF-to-SLU transition ends in 1992 the interLATA contribution will drop to between $.03 and $.04 per minute. Pacific asserts that if this unequal relationship continues Pacific will lose customer usage and experience a large decrease of revenues and a damaging erosion of its subsidy funding sources.

Pacific notes that the present SPF-to-SLU methodology results in nearly all intraLATA services, including intraLATA toll, experiencing offsetting price increases through adjustments to current surcredits. Pacific proposes restricting the 1991 and 1992 SPF-to-SLU shifts to below-cost business services in order to

prevent further toll increases which it submits are plainly unreasonable.

As described in more detail in Section VIII, Pacific also proposes that the toll settlement payments from Pacific to GTEC be phased out over three years.

Pacific submits that all of its billing surcredits (which as of January 1990 total approximately $700 million annually) except the portion needed to implement expanded local calling areas and elimination of the Touch Tone charge for residence (and possibly business) services should be used to reduce intraLATA toll and access rates, with emphasis on intraLATA toll discount plans targeted to high-volume users who are particularly vulnerable to competition.

Pacific's proposed transition plan commencing in 1993 is aimed at further reducing its toll rates to a more competitive level. Pacific envisions that the transition would last a number of years and operate on a routine annual basis as does the current SPF-to-SLU plan. Cost recovery would be shifted by reducing intraLATA toll rates and increasing rates of those residence and business services priced below cost. While specific plan requirements and implementation procedures would be developed in the implementation phase, Pacific asks that a clear and firm policy be established now.

Pacific submits that following competition the greatest proportion of contribution to fund below-cost services and the non-traffic sensitive costs of the network should be derived from switched access charges rather than from intraLATA switched toll service revenues (apart from imputed access charges), as long as access charges are not made so expensive that significant amounts of uneconomic bypass occur. Otherwise, Pacific asserts, it would be put at a competitive disadvantage and first order economic efficiency losses could occur. Pacific also suggests an alternative contribution source which it views as preferable to

either access charges or toll rates: a surcharge on all interexchange intraLATA calls, including switched toll, MEGACOM-type toll using special access, and private line usage. Each intraLATA carrier would be assessed a percentage surcharge on its bills for intraLATA services and access charges would be priced at incremental cost. This surcharge could be decreased over time as the Commission moves basic exchange rates closer to cost.

While its proposal is less detailed, GTEC agrees with Pacific that rates should be rebalanced to bring intraLATA toll rates more in line with costs. GTEC submits that intraLATA MTS rates are on average 21 percent higher than those of AT&T for interexchange toll calls in the same mileage bands, and that this gap must be narrowed if there is to be competitive entry in order to prevent competitors from receiving a windfall at the local exchange carriers' expense. At a minimum, GTEC believes that optional toll calling plans targeted at customer groups most vulnerable to competition should be allowed. GTEC believes that after the current interLATA SPF-to-SLU transitions are completed the total CCLC revenue requirement should be capped and the per-minute CCLC gradually decreased due to unit growth in switched access demand. GTEC agrees with Pacific's assessment that their pooling arrangements should not be continued.

Contel does not believe that the Commission should reduce the level of contribution flowing from toll to basic exchange services below the currently authorized SLU level. Contel also submits that local exchange carriers should be allowed to adjust their prices for competitive services such as private line/special access to a level at least recovering their costs and preferably to a level providing some contribution to local service.

Citizens submits that continued recovery of a portion of non-traffic sensitive local exchange costs through access rates is the only rational approach to allocation of these costs, stressing that intraLATA access rates should be set to provide the same level

of support as do current intraLATA toll rates if the Commission wishes to avoid upward pressure on local exchange rates.

In addition to the proposed intraLATA toll reductions to AT&T's levels effective July 1, 1990 discussed in Section IV.E, DRA recommends that in the implementation phase basic business lines and other services be increased to cost, with the resulting revenues used to finance reductions in intraLATA toll and the intrastate CCLC. DRA also suggests that further modest increases in residential basic exchange rates be considered, to allow additional reductions in the CCLC and toll charges, as long as the majority of residential and lifeline customers would be better off in terms of their total telephone bills.

DRA holds that the Commission needs to look at total ratepayer bill impact as much as at specific rates for local calls in assessing rate design changes. DRA requests that local exchange carriers be ordered to develop billing data including a sample of individual bills that would enable assessment of the distribution of consumer bill impacts of proposed rate design changes. GTEC agrees with this proposal.

AT&T recognizes a need for local exchange carrier rate rebalancing, noting a "perverse relationship" in intraLATA and interLATA toll rates. AT&T submits that intraLATA rates should be reduced to more accurately reflect their costs, increase economic efficiency, reduce customer confusion, and permit full and fair competition for toll services. Like DRA, AT&T recommends immediate interim intraLATA toll rate reductions to AT&T's levels, with permanent rates set in the implementation phase. AT&T states that SLU cost allocations should be continued after 1992 or, alternatively, the CCLC should be adjusted based on a price index adjusted to reflect growth in minutes of use.

In reply testimony, AT&T argues that Pacific's proposal to freeze basic residential rates until 1993 is untenable and

emphasizes its view that residential rate increases are needed in order to reduce the "subsidy" from toll.

MCI suggests frequent reevaluation of the appropriate level of access charges, fearing that if access charge levels remain where they will be when the SPF-to-SLU transition is completed bypass pressures may mount if bypass costs continue to decline.

CBCHA states, in a rather roundabout fashion, that it would be difficult to disagree with the notion that local exchange carrier and competitor switched services should make an equivalent contribution to the non-traffic sensitive costs of basic subscriber loop plant.

CCTA submits that access charges can be structured to retain whatever level of contribution this Commission judges appropriate.

MFS stresses that any system of subsidies or cost pooling should be applied statewide in a rational and consistent manner. It submits that local exchange carriers, competitors, and private bypassers should participate equally and that all switched or nonswitched, interLATA or intraLATA services should be tapped in a nondiscriminatory manner. MFS emphasizes that local loop bypassers should help contribute toward the goal of universal service, but recognizes that legislative action may be required to give the Commission jurisdiction over private bypassers.

DOD/FEA, ACLA, and Mtel assert that all non-traffic sensitive local exchange costs should be eliminated from access rates. In their opinion, access charges should be set at the actual costs of providing the service and should not be viewed as a subsidy source. ACLA emphasizes especially its view that private line services which do not interface with the switched network should not be assessed any form of contribution, on the basis that technological developments should not be stifled by imposition of such fees.

WBFAA takes exception to Pacific's proposals to raise business and private line rates and to limit price increases needed to offset interLATA SPF-to-SLU shifts solely to business services. WBFAA submits that if intraLATA competition has ratepayer benefits, residential ratepayers should bear their fair share of the cost for receiving the benefits.

TURN agrees with other parties that rates for those services in transition to competition should be moved toward cost, but emphasizes pricing of basic local services. TURN asserts that in the past basic service ratepayers, due to residual pricing policies, have stood as "guarantors" of full recovery of carrier costs and that techniques such as direct embedded costing of favored services have resulted in inadequate allocations to such services and claims of "contributions" to basic services. TURN asserts that the specific operational costs of basic services should be determined and should serve as a ceiling for basic service rates, with any charges not covered allocated to other offerings.

In reply testimony, TURN comments that DRA and AT&T proposals to set local exchange carriers' toll rates equal to AT&T's may not be desirable because such a step would fail to disclose the low cost provider to subscribers, e.g., between Pacific and AT&T. It sees other rate restructuring proposals as more reasonable, e.g., alignment of interLATA and intraLATA access charges and restructuring of private line and special access charges, but emphasizes that such restructuring does not require competitive entry as a precondition.

TURN cautions that the total bill analysis recommended by DRA may not take into account that some services such as custom calling features are discretionary, nor impart any weighting for the traditional view that local service is a necessity while toll is a luxury. Thus, total bill methods may not consider the

comparative value of services to consumers in terms of overall utility.

2. Revenue Impacts of Parties' Proposals

Pacific does not provide detailed revenue impacts of its proposal, stating that it would reduce intraLATA toll rates by approximately $475 million to $525 million by 1993 and that the proposed transition plan commencing in 1993 is aimed at closing what it sees as the remaining gap of approximately $500 million between its toll rates and those of AT&T.

DRA and AT&T provide estimates of the rate reductions necessary to realign local exchange carriers' toll rates with those of AT&T. Recognizing inaccuracies in its analysis, AT&T submits its results as a reasonable "order of magnitude" estimate of revenue shifts and their impacts on local exchange rates.

In opening testimony, DRA estimates that its proposed reduction in intraLATA toll rates effective July 1, 1990 would reduce intraLATA toll billings by approximately 11.6 percent. DRA recommends that local exchange carriers other than Pacific and GTEC be authorized to file for recovery of their offsetting revenue requirement increases through the California High Cost Fund, and that Pacific and GTEC recover their revenue requirement impacts through changes in their billing surcharges. DRA estimates that Pacific's exchange billing surcharge would need adjustment to generate $68.5 million additional revenue while GTEC would have to adjust its exchange surcharge to generate an additional $90.9 million. In reply testimony, DRA corrects its estimates to include effects of optional calling plans and to update the customer billing bases. Its revised estimates show that in order to match AT&T's toll rates, Pacific's exchange billing surcharge would require a $372.4 million adjustment and GTEC's would require a $156.0 million adjustment.

In its opening testimony, AT&T estimates that average reductions of 16 percent in local exchange carriers' MTS rates,

14 percent reductions in WATS rates, and 41 percent reductions in 800 rates would bring them to AT&T's current rate levels. AT&T estimates the total revenue effect of these rate reductions as $125 million for Pacific and $70 million for GTEC and that these amounts, if applied to all local exchange services on a surcharge basis, would increase residential access rates by 22 cents per month for Pacific and 93 cents per month for GTEC.

AT&T reports that Pacific's low speed analog private line rates are approximately five percent higher than AT&T's, while GTEC's are lower by 20 to 25 percent. Pacific's (and GTEC's, since GTEC concurs in Pacific's digital private line tariffs) digital private line rates are lower than AT&T's for 9.6 kilobits per second (kbps) and 56 kbps DDS services but higher for 56/64 kbps ADN service. Lacking demand data, AT&T does not calculate revenue changes necessary to realign private line rates, but comments that the overall impact would be small relative to switched toll changes.

In reply testimony, AT&T refines and expands its analysis to include additional intraLATA toll rate reductions to match interexchange carriers' flow-through of the remaining interLATA SPF-to-SLU reductions, market growth for toll and local services, competitive losses, access losses, and the embedded inside wire investment phase-out that will be completed in September 1991. AT&T estimates that the total revenue effect of matching AT&T's rates in 1993, including SPF-to-SLU reductions, is $619 million for Pacific and $193 million for GTEC. On this basis, AT&T projects basic flat rate residential rates in 1993 of $8.49 for Pacific and $12.08 for GTEC.

In reply testimony, Pacific takes issue with both DRA's and AT&T's economic analyses contained in their opening testimony.

Pacific submits that two errors in DRA's calculations--use of an outdated billing base and an incorrect use of messages rather than revenues in one calculation--substantially understate

the revenue shifts from toll to exchange necessary to align local exchange carrier and AT&T toll rates. Pacific contends that the 11.6 percent reduction shown in DRA's testimony should be 17.4 percent.

Pacific also points out that AT&T and DRA do not mention any repressive effects of price increases on exchange services, submitting that both repression and stimulation should be considered in rate rebalancing. It also argues that the differing elasticity values used by DRA and AT&T have not been tested and cannot simply be assumed for interim purposes. Pacific also asserts that neither DRA nor AT&T considered changes in costs that result from either stimulated or repressed demand due to price changes, or competitive losses that will arise from introduction of competition.

Pacific further notes that DRA and AT&T do not reflect in their analyses any basic rate impacts of pending changes such as expansion of local calling areas and elimination of separate Touch Tone charges. Pacific concludes that if the errors and omissions are corrected the effect on local residential rates will be larger than DRA's and AT&T's estimates.

In its reply testimony, GTEC also disagrees with DRA and AT&T assessments of impacts of toll rate reductions on revenues, presenting alternative figures based on its assessment that a 15.4 percent reduction in MTS rates, an 8.7 percent reduction in WATS rates, and a 30.3 percent reduction in 800 service rates would be needed to match AT&T's rates. GTEC concludes that it would experience a reduction in toll revenues of $106.3 million annually if these reductions were made.

GTEC notes that several other rate rebalancing activities may affect basic exchange rates and provides the following estimates of rate shifts currently under consideration for GTEC:

Item	Estimated Annual Impact	Estimated Impact (Per line/month)
Toll rate reduction	$106,270,321	$ 2.90
SPF-to-SLU transition	50,000,000	1.37
ZUM expansion	19,545,000	0.53
Touch Tone charge elimination:		
Residential customers	21,671,687	0.59
Business customers	9,960,488	0.27
Local calling area expansion	59,000,000	1.61
Toll settlements phase out	195,288,000	5.33
Total	$461,735,496	$12.61

GTEC concludes that the indicated potential $12.61 per line per month may need to be phased in to prevent rate shock.

3. Discussion

Some of the parties' proposals cannot be fully evaluated on the basis of the Phase III record absent evidentiary hearings and thus cannot be adopted at this time. However, we set certain general policy guidelines which will be useful in narrowing the scope of the implementation phase. We will retain broad flexibility within these guidelines until we can examine potential rate impacts through evidentiary hearings.[6]

Rate design for utility services always involves a careful balancing of competing objectives such as maintenance of universal service, prevention and/or mitigation of rate shock, and promotion of economic efficiency in addition to ensuring that overall revenue objectives are met. With increasingly competitive conditions, a new goal that rate design should promote level

6 In general, the term "rates" used throughout this decision encompasses both rates and charges unless specified otherwise.

playing field competitive conditions is of growing importance. This goal is closely linked with the goal of economic efficiency, i.e., if rates are set according to economic pricing principles economic competition can develop based on various competitors' costs rather than uneconomic competition based on divergence of local exchange carrier rates from costs.

While economic efficiency is becoming of increasing importance in rate design, we stress that other goals such as universal service aimed at protecting monopoly ratepayers cannot be neglected.

Economists tell us that in an economy with fully competitive markets economic efficiency is furthered when prices for a service are equal to the average incremental costs of supplying the entire quantity of that service (Exhibit B-38, p. 7). While our knowledge regarding incremental costs for local exchange carriers is somewhat limited at this time, it is generally assumed that such a pricing approach would not allow local exchange carriers to recover their embedded plant costs.[7] As DRA points out, in this situation the regulatory problem becomes one of developing a pricing structure that is fair to customers and the utility and that checks the exercise of market power of the utility in certain bottleneck services while producing (to the extent possible) efficient patterns of production and consumption.

Economic theory recommends ways of pricing services to enhance economic efficiency in such situations where the revenue is constrained above incremental costs. Generally called Ramsey

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7 It is not clear whether this divergence between incremental and embedded costs is because natural monopoly conditions persist throughout most of the network or instead because embedded costs are simply higher than current incremental costs (due possibly to reasons such as depreciation practices or new technology improvements).

pricing rules, these require that revenue needs be met by setting prices above incremental costs for services for which demand is relatively inelastic and closer to incremental costs for services with relatively elastic demand. For telecommunications, this approach suggests that a large portion of non-traffic sensitive costs of the local loop should be recovered through non-usage sensitive charges levied on inelastic services. This runs counter to our current practice of recovering significant portions of these costs through usage-based rates for services such as intraLATA switched toll whose demand is becoming increasingly elastic as competitive alternatives expand.

Economic pricing can benefit ratepayers as well as local exchange carriers, because correct price signals enhance overall consumer welfare (as long as universal service goals are maintained) at the same time they allow local exchange carriers to compete more effectively. Further, reductions in uneconomic bypass can help stabilize basic rates by maintaining contribution to the extent possible from services other than local exchange service.

Based on the Phase III pleadings, there are several rate design principles which we can adopt at this time which will further economic pricing without jeopardizing other regulatory goals.

We agree with Pacific's view that all monopoly Category I business access services and indeed all Category I services not explicitly targeted for support should be priced at or above their fully allocated embedded costs, as a general principle, so that they recover their total costs. However, we are not willing to impose this principle inflexibly, because other goals such as prevention or mitigation of rate shock may require a phase-in of any rate increases needed to bring business access services to costs. As a result, we adopt instead the principle that all Category I services not explicitly targeted for support should be priced at or above their fully allocated embedded costs to the

extent possible while meeting other regulatory goals including prevention or mitigation of rate shock. Whether particular services should be priced to obtain contribution above fully allocated embedded costs can be examined in the implementation phase or on a case-by-case basis (e.g., through advice letters) as appropriate.

Several parties emphasize the competitive disadvantages faced by local exchange carriers if intraLATA switched toll competition is allowed while local exchange carriers' intraLATA switched toll rates exceed potential competitors' rates. We agree that this could significantly erode contributions to local exchange costs and lead to unnecessary increases in basic exchange rates.

We note that the current rate structure is based on a view that the prohibition of intraLATA toll competition was fairly secure and as a result that intraLATA switched toll rates could be set significantly above rates in the more competitive interLATA market. With erosion of the intraLATA regulatory monopoly, this view has become less accurate, and more uneconomic bypass and tariff arbitrage is occurring.

Further, this overpricing of intraLATA switched toll services means that ratepayers call less than they would if toll rates were more cost-based. Economic pricing is not just a matter of finding a secure source for contribution to support the fixed costs of the network, it is also a matter of pricing so that ratepayers can make full and effective use of that network. It makes little sense to invest in the world's most modern public telephone network and then set prices which unnecessarily discourage ratepayers from using it.

Because lower intraLATA switched toll rates would benefit consumers by allowing lower-priced calling and would encourage the development of economic "level playing field" competition, we conclude that intraLATA switched toll rates should be reduced and

that the current disparity between intraLATA and interLATA switched toll rates should similarly be reduced or even eliminated.

Some parties contemplate that access charges could be changed as needed to modify contribution levels. CCTA states that access charges can be set at whatever level we deem appropriate. Citizens suggests that intraLATA access charges be set to provide the same level of support as derived from current toll rates. However, Pacific, GTEC, DRA, AT&T, and perhaps other parties as well appear to believe that the only way to reduce the disparity between intraLATA and interLATA toll rates is to reduce intraLATA toll rates, with current interLATA access charge levels being inviolable (except for possible decreases). That is not the case, for several reasons:

- -Our present interLATA access charge pricing policies were set during a time when the intraLATA monopoly appeared fairly secure, so that intraLATA toll rates could be tapped disproportionately as a source of contribution toward local exchange costs.

- -The substantial surcredits currently in place on access billings have resulted in effective rates for cost-based components of access charges which may well be below costs. In Section V.C.1 we adopt the principle that cost-based components of access charges should be based on fully allocated embedded costs, even if this increases rate levels for these components.

- -Parties unanimously agree (see Section V.C.1) that if intraLATA switched toll competition is authorized access charges should be uniform for both intraLATA and interLATA access.

- -Parties give strong indications in their Phase III testimony that for many services, including the terminating portion of outbound switched toll and the originating portion of inbound switched toll, access to the local network continues to function as a monopoly bottleneck and thus access rates can continue

to be priced somewhat above cost without significant bypass occurring.

For all these reasons we believe it is completely appropriate to reevaluate in the implementation proceeding, along with basic rate levels, whether the current SPF-to-SLU policy should be modified and whether interLATA access charges should be increased from currently effective levels.

Pacific and MFS suggest that contribution to local exchange costs should be derived from a broader base of services, through either a surcharge on all interexchange intraLATA services or a broader surcharge on all switched or non-switched, interLATA or intraLATA services. We agree with these parties that contribution from as broad a base as possible could spread the contribution burden more equitably and with less economic dislocation. However, as MFS recognizes, obtaining contribution from private bypassers or from facilities-based carriers which do not connect to the network is problematic, and could require authorizing legislation. Absent such legislation, we do not want to assess surcharges on local exchange carriers' private line and special access services, because that would only heighten incentives to bypass the local exchange network altogether. We conclude that these proposals should not be adopted.

Absent a broad-based surcharge, Pacific suggests that the biggest contribution should come from access rather than from intraLATA switched toll rates, in order to allow local exchange carriers to compete more effectively with competitors whose only contribution requirements are through the access charge. We agree with Pacific and, apparently, CBCHA on this point. While this conceptual approach was not widely discussed by other parties in their Phase III testimony, we tentatively adopt the principle that the contribution (above fully allocated embedded costs) from these services to network costs and any below-cost services which is found reasonable in the implementation phase should be isolated in

the CCLC. Under this approach and with imputation of access charges in local exchange carrier switched toll rates (see Section V.C.5), local exchange carriers and their competitors will be allowed to compete under level playing field conditions, with success depending on factors such as relative efficiencies, the offering of desirable service options, and quality of service rather than on the ability of some carriers to take advantage of pricing disparities.

Because the increasing differential between intraLATA and interLATA rates has led to arbitrage, because of the need for level playing field conditions if intraLATA competition is allowed, and because of near-unanimous agreement regarding administrative and other problems associated with maintenance of different intraLATA and interLATA access charges (see Section V.C.1), we believe that consistency between intraLATA and interLATA access charges and derivation through the CCLC of the amount of contribution which is derived from access services and local exchange carrier switched toll rates (above their fully allocated costs) are more important goals than maintenance of interLATA access charges at current levels and certainly more important than reductions in the CCLC below the SLU-based level. It may well be that interLATA access charge increases are needed, at least for a short time, in order to meet these goals. That decision awaits our implementation hearings.

We recognize that the CCLC contributes to some extent to uneconomic bypass problems. Equalizing interLATA and intraLATA access charges, isolating contribution from access charges and toll rates in the CCLC, imputing access charges in local exchange carrier switched toll rates, and allowing high volume discount toll plans should significantly reduce uneconomic bypass from a local exchange carrier's switched toll services to competitors' switched toll services. Recovering most of the CCLC from terminating access for outbound switched toll services and originating access for

inbound switched toll services (if adopted in the implementation phase, see Section V.C.3) would also reduce uneconomic bypass to private line services. Further, the pricing flexibility which we authorized in D.88-09-059 for high speed digital private lines and which we plan to authorize for low speed private lines (see Section VI.B) will allow local exchange carriers to compete for private line bypass to the extent it continues to occur, thus contributing to efficient use of the network. We believe that these steps in combination will allow contribution to be derived from switched toll services while minimizing uneconomic bypass.

Because potential bypass problems due to the CCLC may still persist, we recognize that there may be value in bringing the CCLC below the level needed to maintain contribution levels currently derived on a combined basis from intraLATA switched toll and interLATA access, either immediately or on a phase-in basis similar to SPF-to-SLU. To this end, we will look in the implementation phase at what the overall contribution level should be without unacceptable impacts on residential exchange rates and universal service. We believe that there is some room to raise basic rates without jeopardizing universal service, and that some basic rate increases may well be appropriate in light of increasingly competitive conditions, the fact that local exchange customers stand to benefit from increased competition, and the fact that California ratepayers currently enjoy some of the lowest basic rates in the nation.

Our goal is not to eliminate all uneconomic bypass, but rather to find an appropriate balance between cost-based rate design and derivation of contribution sufficient to maintain affordable basic exchange rates. While some basic rate increases may be found appropriate in the implementation proceeding so that the CCLC can be reduced, we stress that basic rate levels will act as a constraint on the level at which the CCLC can be set.

As detailed in Section X, we require local exchange carriers and other parties to present several rate design scenarios based on different CCLC levels in the implementation phase, though they may also present alternative scenarios if they disagree with this basic principle and may propose phased changes to the CCLC.

As MCI suggests, evaluation of bypass problems will need to be an ongoing activity. It may well be that the rate redesign emanating from the implementation phase will be sufficient to largely eviscerate any uneconomic bypass movement that exists today. Even so, if new bypass technologies develop and/or costs decline, reevaluation will still be needed in the future. We stress, however, that some amount of uneconomic bypass is likely to continue to be acceptable as a tradeoff for maintenance of affordable local exchange rates.

With these basic principles set regarding pricing of monopoly services, the relationship between access charges and local exchange carrier toll rates, and the overall level of the CCLC, other Phase III proposals are more easily resolved. We will allow the 1991 SPF-to-SLU shift to go forward pending our reevaluation in the implementation phase of access charges and the CCLC in particular. However, we will not adopt Pacific's proposal that the 1991 SPF-to-SLU shifts be focused on business services, since it assumes that those business services are below costs and we have not yet examined those costs.

We will not adopt DRA's and AT&T's requests for interim intraLATA toll rate reductions, since the implementation phase will reevaluate overall access charges.

TURN calls for use of "operational costs" in setting basic rates. While it is not clear whether by this term TURN means incremental costs or some other measure of costs, we reiterate that basic residential rates will continue to be set primarily on the basis of universal service goals.

Without passing any judgment regarding the reasonableness or accuracy of the revenue impact estimates, the list which GTEC provides of potential pressures on basic rates is useful to help illustrate the rate design tradeoffs which will occur in the implementation phase. We emphasize in particular the items for toll rate reductions, the SPF-to-SLU transition, and reductions in contributions to GTEC's costs from toll settlements.[8] Together these three items comprise about three-quarters of the revenue shifts contemplated. We will evaluate each of these potential revenue shifts, and emphasize at this time that their advantages must be weighed against potential basic rate impacts not only of each individual item but of these and other potential revenue shifts which may compete for whatever basic rate increases may be acceptable in light of our strong commitment to affordable basic rates and universal service. In order to maintain Commission control over basic rates so that we can ensure that universal service goals are met, we conclude that the Commission, rather than Pacific and GTEC through negotiation, should determine whether and to what extent current contributions to GTEC's costs from Pacific should be phased down.

We agree with DRA that the total ratepayer bill impacts and distribution of bill impacts should be examined for each rate design scenario considered in the implementation proceeding, in order to evaluate effects on universal service and identify any potential problems with rate shock. To this end, we instruct local exchange carriers to provide such information for each scenario they present in the implementation phase. They should also cooperate fully with other parties which wish to obtain total bill impact and distributional information regarding alternative rate

8 In Section VIII we describe the settlements contributions to GTEC's costs from Pacific in more detail.

comments on the ALJ's proposed decision, interLATA bill impacts should also be examined and interexchange carriers should cooperate in such efforts.

As parties point out, the potential need for rate increases for other services as a result of switched toll rate decreases would be mitigated somewhat due to demand stimulation which can be expected as a result of the rate decreases. However, the disparities among DRA, AT&T, and GTEC estimates regarding potential impacts of reducing local exchange carrier switched toll rates to AT&T's levels highlight the importance of careful and thorough examination of inputs such as demand elasticities (including demand repression for services experiencing rate increases, demand stimulation for those with rate decreases, and the functional form of the demand curves used for these estimates) and marginal costs incurred or saved due to demand stimulation or repression. We expect parties to fully support their assumptions on these and other components of the various proposed and alternative rate designs presented in the implementation phase.

G. Pricing Flexibility for Local Exchange Carrier Services Facing Competition

Parties have various suggestions regarding pricing flexibility policies for local exchange carrier services for which competition is expanded as a result of Phase III. While some parties such as Contel and Intellicall support extension of the pricing flexibility rules adopted in Phase II (with ceilings at existing rates and floors based on direct embedded costs), parties make other suggestions as well.

Pacific and Citizens suggest that pricing treatment for individual services should be addressed in the implementation phase. Pacific requests Category II or possibly Category III (with the maximum pricing flexibility allowed by law) as the appropriate treatment for services for which competition is authorized, stating that Category II treatment would allow Pacific to respond to market developments in a timely manner without excessive regulatory interference from its competitors.

In GTEC's view, local exchange carriers should be allowed the same pricing flexibility granted nondominant interexchange competitors: the maximum flexibility allowed by law with the primary restriction being a price floor set at long run incremental costs. Price ceilings would be established by the marketplace. GTEC perceives a competitive disadvantage because it does not have the flexibility to bring new services to market nearly as fast as competitors or to adjust prices in a timely manner.

While proposing broad pricing flexibility for MTS and optional calling plans, GTEC supports what it characterizes as Category I treatment of these services for purposes of rate rebalancing. GTEC recognizes that this approach would create a unique challenge of regulating a partially competitive service in Category I. Yet it submits that these services must remain in Category I until prices are more reflective of costs. GTEC is concerned that placement in Category II could create cost recovery

problems for the local exchange carriers: as contribution from toll declines, local exchange carriers would be unable to recover this lost contribution from Category I services. In GTEC's view, D.89-10-031 did not contemplate changes in Category I rates to offset revenue impacts of rate changes in Category II services. GTEC submits that the Commission can place MTS either in Category I with pricing flexibility within Commission oversight or in Category II but with rebalancing of basic exchange rates as contribution levels decline. GTEC sees the first alternative as preferable, stressing regardless that local exchange carriers' pricing flexibility must be equal to that of competitors. GTEC also states that it would be difficult to classify optional calling plans as either Category I or Category II and that the administrative burden required to justify reclassification would negate benefits of any pricing flexibility afforded by Category II treatment.

GTEC submits that WATS and 800 services should be classified as Category II services after rate rebalancing to align these rates with those of competitors. Since WATS and 800 services face significant competition from interexchange services such as AT&T's MEGACOM and MEGACOM 800, in GTEC's view they should be afforded the pricing flexibility available to Category II services.

Roseville submits that local exchange carriers should have full pricing flexibility (except for the requirement of statewide average toll rates), with incremental or marginal costs for floors and fully allocated embedded costs for ceilings only if necessary for transition purposes.

DRA agrees that downward rate flexibility should be granted for local exchange carriers' toll services, in light of the flexibility enjoyed by interexchange carriers and the fact that such carriers will be able to aggregate a customer's interLATA and intraLATA traffic in determining the customer's rate or a volume discount, and supports Category II pricing flexibility rules.

CALTEL submits that there is no reason to provide more pricing flexibility for local exchange carriers than AT&T receives. CALTEL is joined by CWC in supporting equal pricing flexibility for local exchange carriers and AT&T.

MFS proposes that Commission restrictions be imposed on competitive local exchange carrier services only to the extent needed to prevent cross subsidization. However, while MFS proposes that entry barriers for low speed private line services be lifted expeditiously, it submits that such services should not be classified as "competitive" for pricing purposes until after its Local Equal Access plan is implemented, because it sees that these services will continue to be "basic" for most users because the low traffic density makes construction of competitive loop facilities uneconomic for most customers.

Pacific and DOD/FEA reiterate earlier positions that price floors should be based on incremental rather than direct embedded costs, with Pacific asserting that it will be competitively disadvantaged otherwise. CENTEX states that the Commission should continue to use embedded costs as the lower limit for pricing Category II services until such time as it establishes clear rules governing the definition and equitable application of incremental cost pricing for California.

Stressing the importance of timing of price changes and the introduction of new services, Pacific requests that it be permitted to make tariff changes on the same basis as its competitors, noting particularly the shortened notice requirements its competitors receive. Pacific further requests that the advice letter process permit new services to start or changes to be effective while any protest is considered by the Commission, to prevent intervenors from delaying its competitive actions. Pacific emphasizes that symmetry of regulatory treatment would provide customers with a broad range of services and price options.

Pacific, GTEC, and DOD/FEA also propose that use of contracts be expanded as an alternative to tariffed pricing flexibility. Pacific requests that the Commission permit contracts with the same degree of flexibility as its competitors for all services where competition is authorized, in particular MTS, WATS, and 800 services, asserting that large customers desire these services when purchasing contracted services. Pacific submits that AT&T's Tariffs 12 and 15 provide packaged services, and many customers can contract directly with other interexchange carriers or other vendors for private line networks offering MTS, WATS, and 800-like services at discounted prices. Pacific also requests cessation of the current preapproval requirements, particularly that imposed under the Phase I settlement for governmental contracts. DOD/FEA strongly supports Pacific's proposal to reinstitute carriers' authority to engage in government contracts without prior Commission approval.

AT&T agrees that local exchange carriers should have no more restrictions on special contracts than are placed on competing carriers in General Order 96-A, Section X. However, AT&T emphasizes that interexchange carriers must demonstrate that contracts are warranted by unusual or exceptional circumstances and comply with other procedural requirements. AT&T agrees to the elimination of preapproval requirements for government contracts for all carriers. MCI emphasizes that relaxation of rules regarding government contracts should apply to all utilities, not just local exchange carriers.

CCTA opposes local exchange carrier requests to shorten notice periods applicable to rate change proposals, to allow proposed tariff revisions to take effect prior to resolution of protests, and to remove the requirement of Commission preapproval of special contracts with individual customers, stating that these changes would strike at the heart of regulatory safeguards adopted in Phase I and Phase II. CCTA sees the first two proposals as

nothing more than restatements of rejected Phase II positions, and stresses that oversight of special contracts should not be relaxed since such arrangements can be misused to discriminate among customers and to bypass adopted unbundling and price imputation principles. CENTEX echoes this view that reconsideration of rejected Phase II proposals is not within the subject matter of this phase.

DRA holds that tariffs rather than customer-specific contracts should be used to make services available to customers which have common characteristics. DRA notes AT&T's Tariff 12, in which the FCC allows AT&T to design tariffed services for a class of customers with similar needs. DRA holds that this approach strikes a better balance between local exchange carriers' needs to respond to market conditions and customer needs for protection from local exchange carriers' substantial market power. In addition, DRA cautions that the ongoing need to review contracts could impose large burdens on Commission staff if wider reliance is placed on special contracts. DRA also opposes lifting the Phase I requirement of prior review and authorization of government contracts, arguing that the prior approval requirement should not prove a competitive disadvantage if comparable review procedures are established for all telecommunications firms.

Discussion

We find arguments regarding the extent of local exchange carrier pricing flexibility for services for which competition has been allowed, including placement in Category II or Category III, notice periods, effectiveness of protested tariff revisions, and ability to enter into special contracts to be largely restatements of arguments made and dealt with in Phase II. With one exception, parties have presented no new information or changed circumstances that would lead us to change our conclusions in Phase II regarding these issues. With the effectiveness of competition for MTS, WATS, and 800 services, we agree with Pacific that it would be

appropriate for carriers to be allowed to enter into special contracts including these services, so that they can be marketed on an equal basis with alternatives such as private line services. As a result, all carriers should be allowed to enter into contracts for MTS, WATS, and 800 services when intraLATA competitive entry is allowed for these services.

Contrary to assertions, current Commission orders protect against anticompetitive behavior in contract situations. Both local exchange and interexchange carriers are subject to the same intrastate contract requirements and restrictions, including a showing of special circumstances, and a requirement that costs be covered (for local exchange carriers, this includes imputation of appropriate tariffed rates for monopoly building block components, as required by D.90-04-031). We note that preapproval requirements for government contracts are being reconsidered in Application (A.) 90-03-008 and that modifications to notice requirements for nondominant interexchange carriers have been adopted in D.90-08-032.

As contemplated in D.89-10-031, we will allow local exchange carriers to submit incremental cost studies for our consideration in the implementation proceeding. If such studies are found to be reasonable, we may adopt rate floors based on incremental costs at that time. In presenting proposals to base rate floors on incremental costs, parties should address our concerns regarding incremental costs stated in D.89-10-031 at mimeo. pages 159 and 160.

A new issue has been raised in Phase III regarding pricing of local exchange carrier services for which competition is authorized: specifically, how rate ceilings are to be set for Category II services on an on-going basis. This issue comes to our attention as a result of the proposal by GTEC to place MTS and optional calling plans in Category I and the proposal by Pacific that with the advent of competition for operator services it be

allowed to shift the alleged contribution currently recovered through its operator services to other services (see Section VI.C). Other than use of incremental costs and certain imputation issues dealt with in Section V.C.5, parties did not question the principles regarding Category II rate floors adopted in the Phase II decision.

Essentially by definition, local exchange carriers retain some degree of market power for Category II services, since otherwise they could be placed in Category III. For this reason, in Phase II we established ceilings on the rates which utilities could charge for Category II services, in order to protect customers from undue exercise of market power. We set the ceilings at existing rates since those were the earnings levels assumed in setting remaining rates in the prior rate designs. These ceilings may or may not be cost-based; as Pacific alleges for its operator services, they may have embedded some level of contribution.

In adopting the Category II pricing structure, as GTEC points out, we did not provide for rate rebalancing from Category II services to Category I services. As part of the adopted incentive regulatory framework, utilities were placed at risk for their ability to actually recover revenues implied by the rate ceilings, either through pricing at or near the ceiling or through demand stimulation.

Facing potential application of the Category II pricing structure to a broader array of services with much greater revenue impacts, GTEC and Pacific essentially do not want to be placed at risk for the contribution embedded in current rates for switched toll and operator services. The utilities question their ability to continue to recover revenues equal to current rates in these competitive markets. Particularly for MTS, there is ample indication that they probably could not.

Whether the Category II rate ceiling approach should be modified in light of on-going contribution recovery needs was not

fully addressed in other parties' Phase III submittals; as a result parties should be allowed to comment on this issue in the implementation phase. However, we tentatively adopt an approach in which rate ceilings for a Category II service would be greater than or equal to the tariffed rates of any Category I services bundled in the service plus fully allocated costs of the remaining portions of the service. Under this approach, ceilings would be consistent with adopted imputation principles and would allow for recovery of at least the service's fully allocated costs, but may also reflect market conditions in order to maintain contribution above fully allocated costs.

Consistent with the Phase II decision, rates for Category I services will be set in the implementation phase based on the assumption that Category II services are priced at their rate ceilings. Thus, the local exchange carrier will continue to be at risk that it can either charge rates close to the ceiling due to continued strong market power or increase sales.

In Section IV.F, we tentatively adopt the principle that all the contribution that is found reasonable from switched toll and access rates (above the fully allocated costs of these services) should be isolated in the CCLC component of switched access charges, a Category I service. If the principles adopted today regarding rate ceilings and the CCLC are affirmed in the implementation phase, the rate ceilings and revenues assumed for switched toll services would be set equal to (rather than greater than) imputed access charges plus the fully allocated costs of remaining portions of these services.

GTEC suggests that MTS be placed either in Category I with pricing flexibility or in Category II but with future shifts of the contribution level to Category I services. Either of these hybrid approaches runs counter to the fairly straightforward pricing structure we established in Phase II. The alternative which we tentatively adopt, in which contribution is isolated in

the CCLC, appears preferable to either of GTEC's proposals because it is conceptually simple, is consistent with the adopted Phase II pricing principles, and is more consistent with the level playing field goal.

Parties should comment on our preferred approach to setting rate ceilings for Category II services in their testimony submitted in the implementation phase, and may suggest alternative approaches.

MFS suggests that low speed private line services remain in Category I for pricing purposes if its Local Equal Access plan is not implemented, based on its view that these services will continue to be "basic" for most users because construction of competitive loop facilities is not economic for most customers.

In evaluating MFS's proposal, it is helpful to review the purpose of pricing flexibility and the purpose of Category I treatment. A primary purpose behind Category II placement and pricing flexibility is to allow local exchange carriers to respond to competitive market conditions and to put them at risk for their pricing decisions. If competitive pressures do not materialize, local exchange carriers may keep rates at or near the ceilings. Since the Commission has found the ceilings to be reasonable, customers are protected even if no competition materializes. On the other hand, local exchange carriers may lower rates toward the floors based on direct embedded costs (or perhaps incremental costs if approved at a later date) if competitive forces make such pricing decisions attractive. Competitors are protected by the Commission-authorized floors.

For services in the monopolistic Category I, the Commission retains control over revenue shifts among the services, without intrusion of market forces or utility decision making. Thus, the Commission can continue to design rates for these services more or less in a traditional manner: some services can be priced below cost because of universal service or other policy

goals while others can be priced above cost if desired to derive contribution to embedded local exchange costs or services priced below cost.

The only potential purposes to be served by placement in Category I of a service for which competition has been authorized that we see are (a) protection of competitors by constraining the price above the price floor that would be in place with Category II treatment, or (b) protecting ratepayers by constraining the price below the ceiling. Either result would run counter to our goal of level playing field competition. We conclude that Category II treatment should be allowed for all local exchange carrier services for which competition is authorized (with the possibility of Category III treatment if the carrier shows successfully that it has insignificant market power, as explained in D.89-10-031).

V. IntraLATA Switched Toll Competition

A. General

This section addresses competition for interexchange switched toll services. Whether ZUM competition should be allowed is considered in Section VI.A.

Almost all parties support competition for intraLATA switched toll services (including MTS, WATS, 800, and 900 services), with the primary disagreement being over timing of authorized entry relative to timing of the rate design changes also proposed, as discussed in Section IV.E.

Pacific supports expanded competition for 800 services as soon as a decision in the implementation phase becomes effective. It recommends, however, that competition for MTS, WATS, and 900 services be deferred until 1993, with the cited preconditions being appropriate intraLATA toll price reductions, approval of incremental cost methods, cessation of GTEC toll subsidies, and further movement beyond SPF-to-SLU in the reduction of local

exchange non-traffic sensitive cost allocations to toll rates and access charges.

GTEC puts forth a similar set of preconditions, but does not specify a date by which its proposed rate design and pooling changes should be achieved and competition allowed. GTEC argues that at a minimum, if the Commission allows additional competition before its preconditions are met, competing carriers should be required to pay access charges plus the difference between access and end user toll rates for all authorized intraLATA usage. GTEC asserts that this recommendation is consistent with the approach to intraLATA compensation adopted in D.88-11-053 for AT&T's MEGACOM services. MCI replies that such compensation on authorized intraLATA traffic would be very bad public policy because, it asserts, interexchange carriers would lose money by carrying such calls while local exchange carriers would be better off not carrying the calls.

The smaller local exchange carriers in general also support switched toll competition on a phased-in basis. Contel proposes that the Commission allow competition for WATS and 800 services as soon as intraLATA access tariffs are approved but that MTS competition not be allowed until the SPF-to-SLU transition is complete in 1992 and toll prices have been adjusted accordingly. Citizens makes a similar proposal, but would defer WATS as well as MTS competition initially. Roseville would begin with reseller competition before proceeding with facilities-based competitive entry. The smaller local exchange carriers emphasize the need for detailed review of financial impacts on them as a prerequisite for authorization of competition.

DRA recommends that competition be allowed for all switched toll services on July 1, 1991 or following completion of the implementation phase, whichever is later, based on its conviction that continuation of the current ban is no longer in the long run interest of California ratepayers and that market forces

require adoption of a rapid schedule for opening the LATA. DRA believes it would be appropriate at that time to eliminate the intraLATA compensation requirements now placed on AT&T's outbound MEGACOM services by D.88-11-053.

AT&T supports immediate competition for new toll services, and competition for all intraLATA toll services commencing January 1, 1991. It states that consumers would benefit from MTS and WATS competition due to rate decreases for these services to competitive levels as well as the ability to choose among carriers based on price, service quality, and service options. AT&T foresees that local exchange carriers will remain effective competitors by virtue of their current position as the incumbent 1+ and 0- intraLATA carriers, by providing stand alone basic WATS at competitive rates, and by providing unique services such as Service Area WATS and shared WATS with AT&T. AT&T suggests that local exchange carriers can choose to offer similar services with other interexchange carriers as well.

MCI submits that the Commission should allow entry into all intraLATA switched toll services (and, indeed, any intraLATA service an entrant wishes to offer), and that the market itself will determine whether effective competition actually develops.

Sprint submits that elimination of the intraLATA toll ban is appropriate because (1) interLATA competition has been implemented without the dire consequences considered possible when D.84-06-113 was issued, (2) other states have successfully introduced intraLATA competition without adversely affecting universal service, and (3) the intraLATA barrier inhibits certain interLATA competition as well.

Sprint proposes that intraLATA competition be permitted for virtual private network services such as its VPN service, noting that the Commission has considered these services in A.85-05-081, A.87-09-027, A.89-04-025, and I.86-05-036. MCI supports Sprint, stating that since these services are currently

provided only by interexchange carriers immediate authorization of intraLATA competition would not jeopardize local exchange revenues.

CALTEL supports competition for switched toll and all other intraLATA services, noting that certain toll calls of a very long distance are intraLATA, e.g., calls within the entire coastal area from Watsonville and Santa Cruz to the Oregon border, or calls within the heavily populated area from Ventura south to the Orange County-San Diego County border. CALTEL submits that surely it is time to open these important markets to toll competition.

CBCHA expresses skepticism regarding the viability of economic intraLATA competition, concluding that most intraLATA competition would only be resale of underlying switched access services acquired from the local exchange carrier. Further, even that resale would take place only if the margin between access charges and local exchange carrier toll rates is sufficient to offset other transaction and networking costs. CBCHA concludes that the Commission should proceed cautiously in formulating policies on expansion of intraLATA competition and that it should base its determination on more fundamental policy goals which should be established first.

Pacific, GTEC, Contel, and DRA would impose certain restrictions on carriers which offer competitive intraLATA services, particularly 800 services.

GTEC recommends that permanent authority to carry intraLATA traffic by READYLINE-like 800 services and further expansion of competition in the intraLATA 800 market be linked to interexchange carrier participation in local exchange carrier 800 data bases, asserting that true competition is not possible otherwise, so that customers can select among all providers without having to change 800 numbers each time they change carriers.

With the same aim of improving marketability of local exchange carrier 800 services, Pacific and DRA propose that, when intraLATA 800 service competition is allowed, all interexchange

carriers which offer a combined intraLATA and interLATA 800 service should also be required to participate in the local exchange carriers' data bases and offer interLATA-only 800 services which can be combined with local exchange carrier 800 services to provide complete area coverage. These parties fear that otherwise customers would migrate to the combined interLATA and intraLATA offerings of interexchange carriers even if local exchange carriers offer attractive prices, features, and options for their intraLATA 800 services. Pacific points out that the settlement in AT&T's READYLINE proceeding (subsequently adopted in D.90-04-023) includes a complementary serving arrangement to be offered by AT&T, and submits that this requirement should be extended to all interexchange carriers. DRA recommends that the Commission direct all affected parties to develop a proposal for an interLATA add-on 800 service in workshops.

Contel makes a similar proposal, but does not limit it to 800 services. It submits that interexchange carriers should be required to make available all interLATA services in such a manner that local exchange carriers can market an entire intrastate service provided in combination by the local exchange carrier and interexchange carrier in a manner that is somewhat transparent to the customer. Contel is concerned that if this restriction is not imposed local exchange carriers would be at an extreme marketing disadvantage since they cannot provide interLATA services.

Interexchange carriers uniformly oppose imposition of add-on and data base requirements, arguing that local exchange carriers can be effective competitors without such requirements and that the market should determine whether joint provisioning is a more efficient arrangement than having separate services.

While recognizing that the READYLINE settlement contains such terms, AT&T submits that carriers should have freedom to choose service arrangements that best meet their needs, arguing that Commission-mandated arrangements are antithetical to a fully

competitive marketplace. MCI asserts that mandatory participation in local exchange carrier 800 data bases could unnecessarily restrict entry or raise costs, neither of which would benefit the public in its view. Sprint states that joint services will be made available without a Commission-imposed requirement if local exchange carriers make available on reasonable terms 800 access services which would allow joint provisioning of 800 services. It notes that Sprint and Pacific have publicly announced their intention to provide joint 800 services utilizing Pacific's 800 data base as soon as Pacific's access and end user tariffs are approved. AT&T similarly states its intention to continue to offer an interLATA Basic 800 service with local exchange carriers.

On this topic, WBFAA comments from a user's perspective that if competition is allowed for intraLATA 800 services it would be very helpful if a customer could keep the same 800 number regardless of the identity of its service provider.

Discussion

Many issues parties raise regarding competition for switched toll services are addressed in other sections of this decision on a broader basis, including timing of competitive entry relative to rate design changes, protection of smaller independent local exchange carriers, and redesign of local exchange carrier rates. We believe that we have adequately resolved these issues raised as possible impediments to authorization of full intraLATA competition for all switched toll services.

Consistent with our prior discussions and our findings regarding needed rate design changes and protection of high cost carriers, we conclude that full intraLATA competition for all switched toll services, including MTS, WATS, 800 services, and transmission of information providers' 900 services, should be authorized to be effective upon adoption of revised access charges in the implementation phase, because such competition would promote innovation, efficiency, and customer choice. Such competition

would also encourage more effective interLATA competition by eliminating holding out restrictions currently in place which may hamper interexchange carriers' marketing efforts. While effective competition may not develop in some portions of intraLATA switched toll markets, the "level playing field" competitive regulatory framework adopted today provides protection to ratepayers in such an event and allows a market test whereby all carriers may compete on the basis of their overall efficiencies as well as abilities to fashion innovative service options and price/quality combinations which consumers may desire.

If access charge revisions which isolate the local exchange contribution from access charges and switched toll rates in the CCLC are adopted in the implementation proceeding, consistent with the policy we adopt today, there will be no remaining need for compensation requirements such as proposed by GTEC. If parties propose other access charge structures in the implementation phase, they should address the need for compensation requirements in their testimony.

In D.88-11-053 AT&T was granted interim authority to provide interLATA MEGACOM and MEGACOM 800 services. The MEGACOM and MEGACOM 800 compensation arrangements were adopted on an interim basis and A.88-07-020 was consolidated with I.87-11-033 "for final resolution of the intraLATA issue." AT&T and other parties may address in their implementation testimony whether AT&T's MEGACOM and MEGACOM 800 authority should be modified in any way as a result of today's order or due to any implementation issues.

In the READYLINE proceeding (A.89-03-046, consolidated with A.88-07-020 and A.88-08-051), AT&T requests that it be relieved of holding out restrictions regarding READYLINE services prior to completion of the implementation phase. In D.90-04-023 the Commission ordered that this restriction remain in place

pending further order in I.87-11-033 or, alternatively, in the READYLINE proceeding.

We note that pursuant to the READYLINE settlement AT&T provides local exchange carrier compensation (beyond interLATA access charges) only for READYLINE usage of customers who previously subscribed to the joint Basic 800 service offered on a shared basis by AT&T and the local carriers. No compensation in excess of interLATA access charges is paid for intraLATA traffic generated on "wholly new" READYLINE business of AT&T. Because significantly more contribution is received through local exchange carriers' switched toll services than through interLATA access charges, we cannot find on the basis of the Phase III record that elimination of current holding out requirements prior to revisions of access charges in the implementation phase would either be in the best interest of ratepayers or promote a level playing field competitive market. As noted in D.90-04-023, AT&T may address this issue further after the conclusion of the rebuttal phase of the main READYLINE proceeding.

AT&T supports immediate competition for all new toll services, on the basis that there are neither existing revenue streams to be eroded nor significant cross-elastic effects with existing services. We cannot reach such blanket findings at this time, but will continue to allow interexchange carriers to request new toll services with intraLATA components on a case-by-case basis pending implementation of full intraLATA competition for switched toll services.

In the ALJ's proposed decision, intraLATA competition would have been allowed effective immediately for virtual private network services, partially on the basis that no parties expressed opposition to Sprint's proposal. DRA, Pacific, and GTEC take issue with this view in their comments on the ALJ's proposed decision, arguing because virtual private network services are a switched toll service that their general positions regarding the timing of

switched toll competition apply to this service as well as to the switched toll services explicitly identified in their Phase III submittals. These parties assert that intraLATA competition through discounted virtual private network services would have the same effect as competition from MEGACOM and other similar services. They do not oppose authorization of virtual private network competition coincident with other switched toll competition.

We agree with DRA, Pacific, and GTEC that the present terms and conditions regarding provision of virtual private network services, including intraLATA holding out restrictions, should continue to apply until rate design and pricing flexibility changes are made in the implementation proceeding, so that local exchange carriers can compete more fairly with this service. Consistent with our conclusions regarding intraLATA competition for switched toll services in general, we conclude that intraLATA competition for virtual private network services should be authorized to be effective following the implementation phase of this proceeding.

While number portability is undoubtedly an attractive feature for customers, we agree with interexchange carriers that blanket add-on and data base requirements should not be imposed, because we believe that market forces generally can be relied upon to guide interexchange carriers in their decisions regarding such service offerings. This does not preclude us from considering such service configurations on a case-by-case basis, for example in the pending READYLINE decision.

B. Presubscription

For interLATA and interstate switched toll calls, most of the telecommunications network now has the technical capability to allow each end user to preselect, or "presubscribe," an interexchange carrier. This is also called "equal access." All "1+" interLATA and interstate calls are routed automatically to the

selected interexchange carrier,[9] and other carriers can be reached by dialing a "10XXX" code. At this time, all 1+ intraLATA calls in California are carried by the local exchange carrier and 10XXX intraLATA calls are blocked.

Most parties, including all the local exchange carriers, DRA, and Sprint, urge that local exchange carriers not be required to provide customers the option of presubscription to intraLATA switched toll competitors. Instead, customers would have to dial 10XXX (or 950-XXXX) if they wish to access interexchange carriers for completion of such calls,[10] and all 1+ intraLATA traffic would continue to be carried automatically by local exchange carriers.[11]

These parties argue against intraLATA presubscription on a variety of grounds, stressing primarily technical implementation problems, competitive disadvantages, and revenue losses which allegedly could jeopardize universal service goals.

Pacific cites several implementation feasibility issues which it asserts are unresolved and also questions the technical and economic feasibility of blocking competitors from completing local calls if intraLATA presubscription capability were required. GTEC raises concerns about expenses involved in implementation of intraLATA presubscription, including switch conversion costs, balloting (if required), and business office systems, procedures, and training costs.

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9 As GTEC notes, the term "1+ toll" commonly includes access obtained through operator assisted 0+ direct dialed toll calls charged to a credit card.

10 This dialing restriction does not apply for 800 and 900 services, which are routed automatically to the providing carrier.

11 GTEC reports that only relatively minor software changes to central office switches would be required to permit 10XXX access on an intraLATA basis.

DRA believes that no technology currently exists to permit a customer to presubscribe an intraLATA carrier different from an interLATA carrier. Parties suggest that such a capability would require substantial changes to switch software as well as additional switching equipment. Absent such investments, Pacific and GTEC would be precluded from being the intraLATA toll provider for presubscribed customers because a customer would have to choose a single carrier for both intraLATA and interLATA presubscription.[12]

In addition to current technical constraints, these parties stress the competitive advantages which presubscription would allegedly provide interexchange carriers. They assert that competitors would be able to offer "one stop shopping" whereby customers could arrange for both intraLATA and interLATA toll service from a single carrier whereas, in order to use the local exchange carrier's intraLATA toll service, such customers would be required to deal with both the local exchange carrier for intraLATA toll service and an interexchange carrier for interLATA service.

The local exchange carriers in particular argue that significantly greater market share would be captured by competitors under presubscription than if presubscription were not allowed. They express grave concerns about resulting revenue losses which could erode contribution currently used to keep basic rates down, to the point that universal service could be undermined. GTEC estimates that whereas intraLATA toll competition absent presubscription could be expected to result in a 5 percent switched

12 Of the California companies, current restrictions against interLATA service apply only to Pacific and GTEC. Contel notes that it is not legally restricted from providing interLATA services, but has chosen not to do so because of its limited local exchange territories.

toll traffic loss, presubscription could increase traffic loss to 50 percent of current traffic levels.

These parties submit that the alternative of 10XXX dialing would allow interexchange carriers adequate access to those customers most interested in competitive alternatives. They point out that many customers, particularly larger customers which would be the more attractive targets of interexchange carriers, can use PBXs, Centrex together with adjunct processors, other "smart" telephone equipment, or even the local exchange carriers' own speed dialing services to dial 10XXX with one-button convenience. DRA notes that advanced PBX switches could be preprogrammed to route intraLATA toll calls to the low cost carrier based on information about various carriers' toll structures. Even residential customers with speed dialing equipment could access interexchange carriers with relative ease for frequently dialed calls. These parties conclude that these alternatives would mitigate any detriments of a lack of presubscription and would provide sufficient customer access for interexchange carriers so that the expense of providing presubscription should not be undertaken.

As support for this position, GTEC asserts that a requirement of dialing extra digits has not proven to be an overwhelming impediment in other settings. It points to the fact that in 1989 it billed 116 million minutes of use for interexchange carriers' 10XXX interLATA "casual calling" usage, which customers generated despite little or no advertising or encouragement by interexchange carriers, along with the fact that prior to divestiture nondominant carriers such as MCI and Sprint were able to capture 10 percent of the national long distance market utilizing Feature Group A access even though it required a 22-digit dialing pattern (compared to the 16-number pattern associated with 10XXX service).

Contel questions customer understanding of LATA boundaries and is also concerned about potential confusion if separate balloting for intraLATA carriers were required.

According to Sprint, prohibition of presubscription at this time would allow the Commission to observe the effects of limited intraLATA authority before consideration of a broader introduction of intraLATA toll competition through presubscription and balloting.

Citizens sees equal access as a long run issue and believes additional study and policy planning are prudent before allowing presubscription, since it has the potential to change the industry dramatically. Citizens stresses, however, that the Commission should begin studying this and other long term issues to begin planning for the long run environment.

DRA submits that in deciding the presubscription question the Commission must balance the competitive disadvantage which no presubscription creates for interexchange carriers against the obstacles to local exchange carriers of federal restrictions as well as the genuine unavailability of software to implement presubscription. DRA concludes that its present position rests on facts--unavailability of switch software, the ban on Pacific and GTEC entry into interLATA markets, and service obligations to provide local loops priced below cost. It suggests that the Commission may wish to reexamine the presubscription issue if technological, judicial, or regulatory developments alter any of these facts.

Several parties including MCI, CALTEL, and DOD/FEA believe that presubscription should be allowed, viewing it as a necessary component of intraLATA toll competition in order to provide a more level playing field. They assert that there is no insurmountable technical obstacle to implementation of presubscription and that a requirement that customers dial 10XXX for access to a competitive carrier would provide local exchange

carriers with an artificial and unfair market advantage so strong as to preclude effective competition.

MCI asserts that lack of a presubscription option would severely limit the benefits of competition to the majority of telephone subscribers for several reasons. First, most consumers do not understand LATA boundaries and thus are unlikely to know when to dial a 10XXX code to reach an alternative intraLATA carrier. Second, consumers view extra digits as making the service of lower quality. MCI asserts that most residential customers do not have CPE such as autodialers to ease the inconvenience of 10XXX calling. It alleges that 10XXX calls can only be billed by local exchange carriers, increasing costs to interexchange carriers and allowing local exchange carriers to maintain a monopoly over billing. MCI also submits that, contrary to local exchange carriers' arguments, no carrier can offer one stop shopping (unless local exchange service resale is permitted).

Some parties comment without taking a position on presubscription. CALTEL believes that, with or without presubscription, the more sophisticated customers will select a carrier (or carriers) based on prices offered for various routes and services and that local exchange carriers will attempt to compete on a price basis for intraLATA traffic. It submits further that customer inertia favors local exchange carriers, whether or not presubscription is allowed. CBCHA comments that if there is substantial public benefit in protecting local exchange carriers from franchise encroachment, the Commission should simply reject entry altogether rather than permit entry subject to constraints such as prohibition of presubscription. Mtel similarly submits that it would be illogical to hamper competition by requiring customers to dial superfluous numbers to reach the carrier of their choice.

CWC argues that in the long run fairness compels removal of the local exchange carriers' 1+ monopoly. However, it agrees

with DRA that the technology necessary for customers to presubscribe to separate interLATA and intraLATA carriers, while under investigation in other jurisdictions, is still in its infancy. CWC submits that the Commission should be fully apprised of options and capabilities before deciding whether to adopt intraLATA equal access. On this basis, it suggests that intraLATA competition may be adopted at this time without public detriment by allowing local exchange carriers to retain their 1+ advantage until this and other issues are resolved.

Various parties debate other states' experiences with presubscription. DRA reports that in only parts of one state--Iowa--are customers permitted access to local toll competitors by dialing 1+, that two other states have ordered but not yet implemented intraLATA presubscription, and that three states have ruled against it. In support of presubscription, MCI presents testimony of Randall D. Young, Director of Telecommunications Policy Planning for the Minnesota State Planning Agency and chair of the IntraLATA Equal Access Implementation and Presubscription Study Committee formed by the Minnesota Public Utilities Commission. Mr. Young describes the status of presubscription in Minnesota. Minnesota has adopted a policy of intraLATA presubscription but has not yet implemented it. The committee has rendered its recommendations but the Minnesota commission has taken no action to date. Other parties argue that presubscription may not be the preferable approach in California even if it is successfully implemented in other jurisdictions such as Iowa and Minnesota. Pacific reiterates that presubscription's impact on the ability to provide universal service must be taken into account, noting that Minnesota's basic exchange rate is $14.61 and that there is less toll calling in Minnesota than in California.

Discussion

Pacific, GTEC, DRA, and other parties raise certain unresolved technical issues surrounding presubscription. In

particular, DRA and CWC contend that current technology would preclude the choice of a local exchange carrier as a customer's presubscribed intraLATA carrier and an interexchange carrier for interLATA calling. Thus, it appears, a customer wishing to presubscribe to a local exchange carrier for intraLATA traffic would be required to revert to 10XXX dialing for all interLATA calls. Parties do not assert that current technical problems are unresolvable; the issue appears to be instead a question of cost and time requirements.

Certain of the arguments regarding presubscription appear largely self-serving. Parties on both sides assert that their preferred resolution of the presubscription issue would alleviate customer confusion. We believe that customer education will be an ongoing need at least as long as telecommunications markets are fragmented with local exchange carriers unable to provide interLATA service; the option of intraLATA presubscription would change but not necessarily simplify customer information needs. In Section VII.C we take steps to expand the information which local exchange carriers must provide their customers, as part of our ongoing efforts to aid customer understanding of the significant telecommunications market changes still occurring.

Local exchange carriers, particularly GTEC, confusingly argue both sides of the revenue loss issue in attempts to persuade us that intraLATA presubscription should not be allowed: on one hand, presubscription allegedly would cause so much traffic and revenue loss that universal service would be jeopardized; on the other hand, GTEC states that "the 10XXX dialing requirement would not be a deterrent to the use of the service..." (Exhibit B-8, p. 7) and that it "does not believe that 10XXX access significantly limits the attractiveness of competitive toll services..." (Exhibit B-8, p. 21.) GTEC should make up its mind.

We have little doubt that the unavailability of presubscription would inhibit some amount of interexchange carrier

usage. At the same time, it is clear that many larger users can take advantage of equipment such as PBXs or speed dialers to largely eliminate any inconvenience caused by the 10XXX dialing requirement. Thus, we doubt that the resulting interexchange carrier disadvantage is quite the insurmountable barrier to competition claimed by the interexchange carriers.

MCI asserts incorrectly that 10XXX dialing can only be billed by local exchange carriers, though we agree that local exchange carrier billing would probably reduce the uncollectibles rate and that interexchange carriers may well need to subscribe to Pacific's Billing Name and Address service if they bill for 10XXX usage themselves.

The potential revenue losses and threats to universal service feared by local exchange carriers if presubscription is allowed appear to us to be resolvable to some extent through rate design; indeed, our decision today to isolate contributions to non-traffic sensitive local exchange costs in the CCLC so that all switched toll service, whether provided by interexchange carriers or local exchange carriers, contributes equally should alleviate much of this concern.

In evaluating the pros and cons of intraLATA presubscription, we are left with the conclusion that, viewed in isolation, presubscription would give interexchange carriers a distinct competitive advantage because of their ability to provide 1+ switched toll services on a combined intraLATA, interLATA, and interstate basis. On the other hand, no presubscription would advantage local exchange carriers because of the inconvenience and higher billing costs of 10XXX dialing. However, this issue does not exist in isolation and is instead an integral component of the overall competitive regulatory framework being developed.

As discussed in Section IV.D, a central aim in fashioning this framework is to encourage economic competition while discouraging uneconomic competition. Neither option

(presubscription or no presubscription) by itself clearly furthers this goal since the relative advantages or disadvantages are due largely to the legal prohibitions on Pacific's and GTEC's offering of interLATA and interstate services rather than to economic factors. Because of this, we see resolution of this issue as hinging on a largely judgmental assessment of which alternative would be most consistent with the goal of "fair" competition in the context of the overall regulatory framework.

In Section IV.D we examine the various components of the existing intraLATA market, the parties' Phase III proposals, and the adopted regulatory framework. On balance, the interLATA and interstate prohibitions on Pacific and GTEC coupled with their stricter pricing requirements which we believe continue to be appropriate lead us to conclude that it is unlikely that a presubscription option would promote fair competition and thus that presubscription should not be required at this time. This resolution of the presubscription issue does not hinge on development of the needed presubscription technologies.

Another important consideration is the pace of change indicated by the two options: maintenance of all 1+ intraLATA calling by local exchange carriers is a more cautious, incremental approach whereas a requirement that presubscription be allowed could result in more rapid change in the intraLATA market. Thus, we see the choice to not provide presubscription at this time as consistent with the caution shown in prohibiting intraLATA competition six years ago in D.84-06-113. This approach will prudently provide time to observe the effects of intraLATA competition and the adopted rate design policies.

Because of the competitive importance of presubscription, we believe that a schedule should be established to revisit this issue. Many issues are already slated for our consideration in 1990, 1991, and 1992, most notably the implementation phase and the 1992 review of the regulatory framework adopted for Pacific and

GTEC in D.89-10-031. To initiate this undertaking, Pacific and GTEC should file reports in I.90-02-047 no later than 24 months following the effectiveness of switched intraLATA competition in which they report the status of technical issues regarding intraLATA presubscription and provide their assessment regarding the desirability of allowing such presubscription at that time. Procedural steps by which the Commission will consider these reports will be established following the filing of these reports.

C. Local Exchange Carrier Switched Toll Rates and Access Charges

The Assigned Commissioner's Ruling delineating the scope of Phase III testimony required that parties address the structure of intraLATA access charges and the setting of local exchange carriers' intraLATA toll rates, including rate floors and ceilings if pricing flexibility is authorized. We find it useful as a prelude to consideration of intraLATA access charge issues to describe the existing interLATA switched access charge structure. Switched access charges currently include the following (somewhat simplified) list of rate elements:

End office charges:

End office (local) switching
Intercept
Line termination

Local transport (end office serving the end user to end office serving the interexchange carrier's point of presence)

Information surcharge

Carrier common line charge (CCLC)

The CCLC is discounted in central offices not equipped for interLATA and interstate equal access ("Feature Group D" or "premium") connections and the end office switching charge depends

on the type of access utilized.[13] Terminating access is charged at the same rate as originating access.

1. Relationship among IntraLATA, InterLATA, and Interstate Access Charges

Almost all parties agree that intraLATA access charges, if intraLATA switched toll competition is allowed, should be set equal to interLATA access charges. They cite administrative simplicity, customer understanding, the desirability from a marketing standpoint of consistent interLATA and intraLATA toll rates, and avoidance of arbitrage as factors supporting a unified intraLATA and interLATA access charge tariff. Pacific and DRA also submit that the economic cost of providing access does not vary between intrastate interLATA and intraLATA access. Parties recommend that any structural or rate changes be made on a combined interLATA and intraLATA basis.

The primary dissenters from the view that interLATA and intraLATA access charges should be identical are those that submit

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13 There are four types ("Feature Groups") of end office originating connections to interexchange carriers. Feature Group A and Feature Group B access arrangements were made available to interexchange carriers other than AT&T prior to the equal access connections mandated as part of divestiture. Under these arrangements, a customer connects to the interexchange carrier's switch via a local number (for Feature Group A) or by 950-XXXX (Feature Group B) and then completes the call by entering the desired telephone number and an authorization code.

Feature Group C was the trunk-side connection used by AT&T prior to equal access and is still used in non-equal access central offices. Feature Group D is the equal access (premium) connection which allows 1+ presubscription and 10XXX access to nonpresubscribed carriers. All major interexchange carriers, including AT&T, use Feature Group D where available, though some carriers continue to use Feature Group A and Feature Group B access for some of their services, e.g., travel card usage. DRA reports that only 4.4 percent of 1989 intrastate toll calling in California occurred via Feature Group A or Feature Group B access.

that there should be an intraLATA access charge differential if intraLATA presubscription is not allowed, as discussed in Section V.C.2.

DRA, Contel, and GTEC suggest that state access tariffs should be as similar as possible to FCC access tariffs. DRA submits that a common intrastate and interstate access rate structure would offer administrative, economic, and regulatory advantages and would enhance both government and company accountability. In its view, a simple and common tariff structure would reduce opportunities for obfuscation and help this Commission focus on relevant issues.

DRA notes that current intrastate surcredits have produced rates for most intrastate access elements (except the CCLC) below federal cost-based levels and have reduced the effective CCLC below the SPF-to-SLU required levels. DRA recommends access charge rebalancing to a more cost-based structure, with rates for below-cost elements increased as needed to reflect fully allocated costs. DRA believes that recovery of fully allocated costs from this service is consistent with economic principles and would promote ratepayer interests.

In its reply testimony, Pacific states that it supports simplification of intrastate access charge tariffs, but recommends that conformity with interstate tariffs, like other potential changes, be considered in the implementation phase. Pacific states that while DRA appears to suggest elsewhere in its testimony that the existing surcredits should be reflected in final access rates, this is probably not possible if, as DRA also suggests, intrastate access rates are also raised to interstate levels. Pacific notes that D.85-01-010 adopted a policy of operational parity between state and interstate tariffs and concludes that further parity should be considered in the implementation phase where revenue and cost impacts can also be considered.

Discussion

Putting aside for a moment the issue of the appropriateness of a discount due to no intraLATA presubscription, we find persuasive the uncontested views that common intraLATA and interLATA access tariffs should be established.

Based on uncontested statements by Pacific and DRA, there is no cost basis to assess different intraLATA and interLATA access charges. Further, parties generally agree that the current disparity between the non-cost based contributions through intraLATA and interLATA switched toll rates to non-traffic sensitive local exchange costs should not be maintained after competition. We conclude that intraLATA access tariffs should be developed and maintained in parity with interLATA tariffs, in order to reflect equivalent cost structures, to promote fairness in the CCLC contribution between intraLATA and interLATA toll users and reduce tariff arbitrage, to enhance customer understanding, and to promote administrative simplicity for local exchange carriers, competitors, and regulators alike.

Consistent with our overall move toward a more cost-based rate structure, we agree with DRA that the cost-based components of access tariffs should be based on fully allocated costs, and instruct that appropriate changes be developed in the implementation phase.[14] Based on statements by DRA and others as well as our own comparison of current intrastate and interstate access charges, we realize that this policy may well result in increases to at least some components of the access charge tariffs, particularly in light of the significant surcredits now in place. Rates for other components may decrease.

14 We have already adopted a policy of cost-based pricing for the central office-to-point of presence link in high speed digital special access tariffs (D.88-09-059, confirmed by D.89-10-031).

As Pacific points out, the Commission has adopted a policy of operational parity between intrastate and interstate access tariffs. We note that D.85-01-010 required operational parity only "to provide a starting point for analysis" and did not require that intrastate tariffs be adjusted automatically to match future changes in interstate tariffs. Further, the Commission did not address the issue of parity of rate structure and rate levels.

As parties discuss, there are at least some structural differences (in addition to rate differences) between current intrastate and interstate tariffs. We agree with DRA, Contel, and GTEC that structural as well as operational parity is, as a general principle, a worthwhile objective. In Section VIII of this decision, we determine that statewide average access charges should be implemented with the advent of intraLATA competition. This fact alone could preclude full structural parity between intrastate and interstate access tariffs. Further, as a result of our assessment of access costs we may well find that intrastate costs differ from FCC-adopted interstate charges.

As Pacific suggests, we conclude that the issue of parity with interstate tariffs should be explored further in the implementation phase. The local exchange carriers should set forth and justify clearly in their testimony submitted in that proceeding any structural or operational differences between their interstate access tariffs and proposed intrastate tariffs.

2. Switched Access Charge Discount If No Presubscription

Several competitors submit that intraLATA switched access charges should be discounted if equal access is not made available: MCI, Sprint, CALTEL, CWC, and Mtel.

MCI asserts that interexchange carriers should receive a switched access charge discount or, alternatively, that a higher floor on local exchange carrier switched toll rates should be

imposed if there is no presubscription. Otherwise, MCI submits, local exchange carriers would be virtually guaranteed a continued monopoly since interexchange carriers would have to offer a discount to induce customers to dial 10XXX for their services and since 10XXX dialing imposes higher billing and collection costs on interexchange carriers.

Sprint submits that if interexchange carriers may carry switched intraLATA traffic only on a 10XXX basis, intraLATA interexchange carrier access and local exchange carrier access are not "like services" and as a result that intraLATA access charges should reflect the differences. Sprint argues that it would be unfair and discriminatory to simply mirror interLATA switched access rates when customers can access their presubscribed interexchange carrier by dialing 1+ for interLATA calls whereas they must dial 10XXX for intraLATA calls. Rather than an access charge discount, Sprint suggests that there should be a 25 percent premium imputed in local exchange carriers' switched toll rates if presubscription is not allowed. In reply testimony it suggests alternatively that the level of discount or premium should be determined in the implementation phase.

CWC submits that fairness dictates that, until intraLATA equal access becomes available, interexchange carriers should be afforded a switched access discount equal to the value of the 1+ advantage retained by local exchange carriers. CWC further submits that such a discount should be keyed to encouraging local exchange carriers to move quickly on conversion. Mtel similarly argues that if presubscription is not permitted access charges should be lower than those imputed to local exchange carriers to reflect the inferior quality of the service received.

The local exchange carriers and DRA oppose such discounts on a variety of grounds.

DRA and Pacific assert that access services should be based on cost, submitting that economic costs do not vary between

intraLATA and interLATA access nor depending on whether 1+ or 10XXX is dialed. Pacific asserts that non-cost based discounts would place the least cost provider at a disadvantage, which could lead to first order efficiency losses. DRA argues similarly that discounting cost-based switching and transport costs would make no economic sense and that discounting the CCLC would simply shift this revenue requirement from more sophisticated customers whose equipment enables them to readily dial 10XXX to residential and small business customers who continue to use local exchange carriers for intraLATA toll services.

GTEC does not believe that 10XXX access significantly limits the attractiveness of competitive toll services, especially since interexchange carriers would benefit from economies in combining intraLATA and interLATA traffic. GTEC concludes that this access service is clearly not non-premium access as it was when the FCC provided for lower non-premium access rates due to a 22-digit dialing requirement and lower quality line side connections prior to equal access. GTEC asserts that MCI and Sprint identify no technical differences affecting transmission or service quality which might justify a switched access charge discount.

Roseville points out that only originating Feature Group D connections are affected by whether presubscription is available. Since all terminating traffic, originating Feature Group A and Feature Group B traffic, and 800, 900, and like services will be provided access identical to that provided local exchange carrier traffic, Roseville concludes that pricing differentials are not justified.

Contel emphasizes its view that the markets which interexchange carriers are likely to enter involve users with sophisticated equipment that enables those customers to automatically add extra digits to a normal call.

CP National states that the value-of-service pricing concept used by MCI and others to support a pricing differential if presubscription is not allowed is difficult to reconcile with their insistence elsewhere on cost-of-service pricing. It asserts that discounted access charges would introduce both unneeded complexity and unneeded charity into the intraLATA marketplace. DRA similarly asserts that there is no reason for captive ratepayers to subsidize services purchased by interexchange carriers to help them compete.

Parties reiterate their views regarding the extent to which presubscription (or lack thereof) would provide an undue benefit to interexchange carriers (or local exchange carriers). Contel and Citizens suggest that it is just as valid to contend that local exchange carriers should receive a discount or, alternatively, that interexchange carriers should pay a premium, since interexchange carriers have significant advantages such as availability of nationwide service, nationwide advertising, and nationwide market power, and since local exchange carriers cannot offer one stop shopping for all toll services. Sprint takes issue with the one stop shopping argument and emphasizes that GTEC recognizes the competitive value of 1+ dialing in its prediction of substantially greater toll losses if presubscription is allowed (50 percent versus 5 percent with no presubscription).

Pacific asserts that Sprint's proposed 25 percent discount or premium is based on no economic analysis and, while based on the differential adopted in Minnesota, does not recognize differences between Minnesota and California. Pacific points out that California has twice as many LATAs while over half of all access lines in Minnesota are in a single LATA about as large as only the third largest California LATA. Contel recommends that, if the Commission believes a discount is warranted, a small discount be applied only to the originating switched access rates since the origination of a call is the only portion viewed as making the service of lower quality due to the extra digits dialed.

Discussion

In evaluating the various claims regarding the appropriateness of a switched access charge discount in light of our determination that intraLATA presubscription should not be required at this time, we do not find convincing the local exchange carriers' claims that unavailability of presubscription does not disadvantage their potential competitors. Indeed, such a claim runs directly counter to their arguments that presubscription would result in significant migration to competitors and significant revenue losses to the local exchange carriers. We are convinced that the 10XXX dialing requirement will inescapably act as a deterrent, albeit to an unknown degree, to customers which might otherwise test the competitive waters. Further, it will probably increase interexchange carriers' billing and collection costs.

It is uncontested, however, that 10XXX traffic costs the same to process and enjoys the same transmission quality as does local exchange carriers' 1+ traffic. As a result, any differential in interLATA and intraLATA switched access charges based on the unavailability of intraLATA presubscription would be value-based rather than cost-based, and would necessarily be largely judgmental.

As parties point out, and as we discuss in more detail in Section IV.C, any competitive framework we might devise would contain aspects which, taken individually, create relative advantages or disadvantages for different parties. Rather than attempt to estimate the value of presubscription, we prefer to deny the competitors' request for a switched access charge discount but keep in mind this relative disadvantage, necessarily on a qualitative basis, as we structure the overall regulatory framework for intraLATA competition.

3. Structural Changes in Access Charges

Several parties address potential structural changes in access charges in only general terms. Pacific states that it plans

to propose structural changes in switched access charges in the implementation phase. It believes that access charges should be reduced, a separate call set-up charge should be implemented, and the originating CCLC should be lower than the terminating CCLC. CP National and AT&T join Pacific in the view that changes to access charges should be addressed in the implementation phase. AT&T submits that at that time the local switching, line termination, and intercept charges should be combined, premium and non-premium distinctions should be eliminated, and time-of-day differentiation should be considered.

The Assigned Commissioner's Ruling queried whether access charges should be time-of-day differentiated. Parties' responses vary. TURN and DOD/FEA support time-of-day differentiation, but DRA and Contel see little value in such a change, based on current knowledge regarding cost profiles. MCI states that the question of time-of-day access charges should be addressed in conjunction with the structure of local exchange carrier toll rates. It submits that if costs really are caused by peak usage, there is no reason why toll rates should have a peak/off peak structure but access charges should not. MCI also points out that if access charges mirrored the time-of-day pattern of toll rates imputation would be easier.

The Assigned Commissioner's Ruling also asked for parties' views regarding whether distance sensitivity in access charges should be changed. Pacific responds that the local transport elements are currently priced above their embedded costs and that increasing competition for transport requires that appropriate price reductions be reflected. DRA similarly states that the local transport element should probably be less mileage sensitive than are current rates. DOD/FEA expresses an opinion that increased use of fiber optic cables has reduced the distance sensitivity of access costs.

Several parties besides Pacific support a differential in the originating and terminating CCLC component of switched access charges. The view is that differentiation similar to what the FCC has adopted for interstate switched access charges would reduce bypass incentives. This is because a customer's outbound calling is usually concentrated at the originating end (i.e., the customer's premises) but is distributed over a large variety of destinations that are readily served only through switched terminating access. For inbound toll services (800- and 900-type services) the concentration patterns are reversed, with calls originating from dispersed sites but terminating at the customer's premises. Because of these traffic patterns, possibilities for bypassing switched terminating access for outbound calling (or switched originating access for 800- and 900-type calling) are sharply limited. Thus, shifting the non-traffic sensitive revenue recovery to the terminating CCLC (or the originating CCLC for 800- or 900-type services) would reduce the potential for uneconomic service or facilities bypass while allowing continued toll contributions to local exchange costs.

DRA suggests that the originating CCLC for all outbound switched toll services should be set to zero and the entire CCLC be recovered in the terminating access charge. Similarly, the terminating CCLC for inbound switched toll services would also be set to zero with the entire CCLC shifted to the originating access charge. DRA holds that this structure, which would be phased in, must be in place before the start of intraLATA competition. As a first step, DRA recommends that the 1991 interLATA SPF-to-SLU reductions apply to originating access only.

GTEC objects to DRA's proposal to reduce the originating CCLC to zero at this time and states that it would support increases in the terminating CCLC only as a short-term measure as part of an overall program to phase out all or most of the CCLC.

Contel believes that there should be a differential in both the CCLC and the traffic sensitive elements of the originating and terminating portions of access charges, asserting that this change would help accomplish the objectives of continuing toll contributions and statewide average toll rates, discouraging uneconomic bypass, and encouraging alternative carriers to serve higher cost rural areas.[15] Citizens also expresses support for differentiation between the originating and terminating portions of access charges. Contel shares GTEC's concern that DRA's recommendation goes too far and could encourage development of terminating bypass. Contel asserts that the originating CCLC should, at least, make a minimum contribution to recovery of non-traffic sensitive costs.

Discussion

We see based on the general nature of parties' comments that definitive conclusions regarding structural changes in cost-based access elements must await examination of the cost studies being prepared. In keeping with the policy adopted in Phase II that the rate structure of monopoly building blocks be based on their cost structure, we instruct the local exchange carriers to provide as part of their testimony in the implementation phase their assessment of whether structural changes to switched and special access rate structures are appropriate in light of the new cost studies.

Pacific expresses one concern which warrants comment and raises the possibility of a refinement to the fully allocated cost pricing policy for access charges adopted in Section V.C.1, and

15 Contel's concern about bypass in high cost areas is tied to its concept that independent local exchange carriers may choose to exit toll and access pools and instead recover revenue requirements through higher company-specific terminating access charges, as discussed in Section VIII.

that is that there is increasing competition for transport. While we have not allowed unbundling of switched access services (see Section VI.A.2), we are aware that alternative forms of competition can occur if transport rates are too high, in particular the phenomenon commonly called "POP proliferation," in which interexchange carriers construct more points of presence than are economically justified. Cost-based transport rates could discourage such investment to the extent that it constitutes uneconomic bypass, with resulting societal benefits. Because of this, we concur with Pacific and others that the transport rate element should be cost-based and that its distance sensitivity should be examined in the implementation phase. Local exchange carriers may propose either direct embedded or incremental costs in setting transport rates in the implementation phase.

We maintain the policy that, on a total basis, access charges should recover fully allocated costs. However, parties may propose for our consideration in the implementation phase that the fully allocated costs be assigned among the access charge rate elements based on factors such as elasticity and marketing considerations, as long as each rate element is priced above direct embedded or incremental cost. Such an approach, if designed properly, could meet our criterion of appropriate overall revenue recovery while being more effective than pro rata allocation of overheads in discouraging uneconomic bypass.

Since the CCLC is not cost-based, consideration of the arguments regarding bifurcation of the CCLC need not await completion of the new cost studies. There is general agreement that, if done properly, institution of a differential between the originating and terminating CCLC so that a disproportionate amount of the cost recovery occurs through the terminating CCLC component for outbound switched toll services and the originating CCLC component for inbound switched toll services could mitigate to some

extent the uneconomic bypass incentives created by recovery of non-traffic sensitive local exchange costs through the usage-based CCLC. On this basis, we conclude that the CCLC should be bifurcated into originating and terminating components.

We cannot, based on the Phase III pleadings, endorse DRA's proposal that the entire CCLC be shifted to the terminating portion, i.e., that the originating CCLC be set to zero, even on a phased basis. The most appropriate balance between originating and terminating portions will depend on the overall level of non-traffic sensitive cost recovery maintained through the CCLC, as well as an assessment of the level at which a high terminating CCLC component might itself engender incentives for terminating bypass. These are properly implementation issues. Parties should fully justify specific bifurcation proposals (which could include the status quo 50-50 split) in their testimony in the implementation proceeding. Parties may also propose other methods of refining CCLC recovery (e.g., time-of-day differentiation) to maximize CCLC recovery. We agree with DRA that anticipated revenue increases resulting from reduced bypass should be examined in the implementation hearings and taken into account in setting the new CCLC, in order to maintain total revenues at the assumed levels.

4. Access for Telecommunication Service Providers

Pacific submits that access charges should be applied to telecommunication service providers, including cellular and paging companies, shared service providers, shared tenant providers, and enhanced service providers, so that all service providers interconnect to Pacific's network on comparable terms, conditions, and prices. We agree with the ALJ's February 20, 1990 ruling excluding cellular and radiotelephone interconnection and access issues from Phase III, and will not discuss that portion of Pacific's testimony further.

Pacific recognizes that full access charges could pose significant barriers to development of the enhanced service

provider industry, which remains in a start-up mode with limited demand; as a result it proposes to offer a phase-in of line side access charges to enhanced service providers.

DRA and Contel join Pacific in complaining that some telecommunication service providers improperly use local exchange services to access their customers. In particular, they submit that intraLATA foreign exchange (FX) serving arrangements[16] allow customers of resellers, shared tenant providers, or Centrex-based shared use providers to receive intraLATA switched toll service without incurring toll charges and that this FX service makes little or no contribution and may, in fact, be priced below cost. DRA proposes that all business customers which purchase intraLATA FX service be required to also purchase Feature Group A access service, stating that such a requirement would conform intraLATA and interLATA FX tariffs and provide a level playing field for firms competing to acquire access to customers. Contel references D.87-08-048 and D.85-06-115 as requiring that all resellers order their services from access service tariffs and specifically prohibiting such access through residually priced 1MB service, FX lines, or exchange private lines.

Taking a very different view, CENTEX asserts that all business customers should be entitled to order and employ all tariffed local exchange carrier services on the same terms and conditions for equal volumes of service. CENTEX supports

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16 DRA describes intraLATA FX service as essentially a private line that connects one central office (home) with another one (foreign) within the LATA. The charge for this service is distance- but not usage-sensitive. As a result, calls are charged as if they originated from the foreign central office. For high volume traffic, the difference between intraLATA toll rates and the effective per-minute rate using FX creates an arbitrage margin for resellers, shared tenant providers, or Centrex-based shared use providers, which act as traffic aggregators to compete with local exchange carriers' outbound switched toll services.

elimination of distinctions among classes of business customers, permitting all business customers including interexchange carriers to purchase network services from any tariff. Business customers would be entitled to act collectively, with or without a representative, in ordering and using any service. MFS supports CENTEX on this issue.

CENTEX asserts that access charges should be imputed to all network services that include access functions, with the access elements unbundled and separately priced in the tariff. In its view, such imputation would obviate the need for different classes of business customers as well as eliminate disputes over whether a particular business customer is most appropriately treated as an "end user," a "carrier," an "enhanced service provider," or as a member of some other ill-defined class. Further, such a step would dramatically reduce local exchange carriers' ability to discriminate among business customers based on their view of the category into which the customer falls and would help smaller businesses share the benefits of competition.

In reply testimony, CENTEX states that Pacific's proposal runs counter to the regulatory goals of simplifying the regulatory framework, promoting economic efficiency, and permitting market forces rather than regulatory distinctions to govern customers' choices of services. CENTEX argues that no common features are apparent among the groups of customers Pacific would designate as telecommunication service providers to explain why they should be treated identically. CENTEX also complains that Pacific gives no rationale for reversing the conclusion in D.87-01-063 that access charges do not apply to Centrex-based services nor explains why access charges would be imposed on some Centrex customers but not others. While CENTEX submits that the Commission should reject Pacific's proposal as a whole, it argues that at a minimum there must first be hearings to determine whether any factual basis

exists for imposing charges and reversing policy established in D.87-01-063.

Sprint believes that consideration of the application of access charges to telecommunication service providers is beyond the scope of this proceeding and would unnecessarily delay implementation of intraLATA entry.

DRA agrees with Pacific that the Commission should examine the enhanced service provider access issue in the implementation phase. API opposes Pacific on this point, stating that FCC policy is to treat enhanced service providers as end users instead of carriers for access charge purposes. API fears that Pacific's proposal would embroil the Commission in endless line drawing to determine who is an end user and who is an enhanced service provider.

DRA states that its proposal to modify intraLATA FX to bring it in line with interLATA FX resolves the FX-related problems raised by Pacific and Contel. DRA reiterates that requiring intraLATA FX users to purchase usage from access tariffs would move prices towards cost and could reduce use by resellers to avoid access charges. DRA states that it is investigating methods for dealing with exceptional situations in which FX offers the only way some customers may obtain economic telephone service.

Pacific notes that DRA's proposal is consistent with its own criticism of CENTEX. Pacific asserts that CENTEX's proposal would allow interexchange carriers to purchase below-cost business lines or FX between their points of presence and Pacific's end offices, thus avoiding access charges which recover non-traffic sensitive costs and help support low residence exchange rates. Pacific reiterates its position that all intraLATA service providers should be required to purchase access services.

Discussion

In order to further our goals of universal service and affordable local exchange rates, we have long applied the general

principle that all interLATA switched traffic should pay access charges, including a usage-based CCLC contribution to non-traffic sensitive costs, and that intraLATA switched toll should be priced above cost for the same reason. Exceptions have been made only if found appropriate to meet other policy goals.

It is not clear whether CENTEX in eliminating business customer distinctions would have business users pay the CCLC for all usage, including local usage, or whether it would simply eliminate the CCLC. Neither alternative is acceptable to us. While we today adopt a policy that Category I business access services should at least cover their fully allocated embedded costs, we are not willing to impose access charges in addition. We affirm that the benefits of universal service and affordable local exchange rates, including business rates, fully support discrimination between access for local usage and access for interexchange usage. As a result, CENTEX's proposal that distinctions among classes of business customers be eliminated is rejected.

We agree with Pacific, DRA, and Contel that with the advent of intraLATA competition resellers and shared tenant providers should be required to pay intraLATA access charges in order to maintain contribution to non-traffic sensitive costs. With a new intraLATA market structure very similar to the interLATA market structure and with implementation of consistent intraLATA and interLATA access charges, including the CCLC, LATA boundaries will be blurred for these service providers. D.87-01-063 and D.87-08-048 require that shared tenant providers and resellers as well as facilities-based interexchange carriers must pay interLATA access charges. Consistent with the new market structure, we find it reasonable to apply the same requirements to the intraLATA market.

The practice by shared use providers such as CENTEX whereby Centrex-based intraLATA toll traffic is aggregated via FX

connections is troublesome because it end runs our principle of obtaining contribution from interexchange traffic through access charges. DRA proposes that all business FX customers be required to pay Feature Group A access charges, thus reducing the attractiveness of this arbitrage practice. While DRA's proposal has surface appeal, we are concerned that such a step may eliminate the usefulness of FX service for its intended purpose, which is to allow customers whose primary communities of interest lie in "foreign" exchanges to maintain telecommunication contact at affordable rates. Also, reductions in intraLATA switched toll rates and implementation of the adopted policy that business services should be cost-based may make this practice less attractive. We instruct parties to explore the appropriate role and structure of FX service further in the implementation phase.

Finally, we do not wish to use either Phase III or the implementation phase to revisit our access policies for enhanced service providers. If it wishes, Pacific may bring this matter to our attention in another forum such as I.90-02-047.

5. Access Charge Imputation in Switched Toll Rate Floors

As this proceeding has progressed, the Commission has built the regulatory framework through which local exchange carriers' toll services can be offered on a competitive basis. In Phase I, the Commission granted intraLATA competition and local exchange carrier pricing flexibility for high speed special access services (D.88-09-059); in Phase II the Commission characterized such services as "discretionary or partially competitive" and placed them in the flexibly priced Category II. The Commission also found that switched access and low speed special access were basic monopoly services, placing them in Category I for pricing purposes; in Section VI.B we announce an intention to allow competition for low speed special access services and to place them in Category II.

In Phase II, the Commission adopted a principle of imputation to guide rate design of bundled services:

> "[I]n order to prevent anticompetitive price squeezes, the local exchange carriers should be required to impute the tariffed rate of any function deemed to be a monopoly building block in the rates for any bundled tariffed service which includes that monopoly function [footnote omitted]. However, because of economic efficiency considerations, the local exchange carriers should be allowed to propose that tariffed rates reflect any cost differences between provision of the monopoly function as part of a bundled utility service and provision of that function on an unbundled basis. Absent such a showing, the bundled rate must be at or above the sum of tariffed rates for the bottleneck building blocks and the costs of nonbottleneck components, even if there are floors for a flexibly priced service lower than the tariffed rates." (D.89-10-031, mimeo. p. 141.)

In D.90-04-031, the imputation principle was extended to bundled services offered through special contracts as well. In Phase II, the Commission did not identify monopoly building blocks for all local exchange carrier services but rather required that the adopted unbundling and imputation principles be applied on a case-by-case basis for services facing competition.

Several controversies arise in Phase III regarding how local exchange carriers will impute access charges in their competitive intraLATA switched toll rates. The issue of whether, absent presubscription, a switched access charge discount should be provided to interexchange carriers is addressed in Section V.C.2. Other issues concern the mechanics of the imputation process, including whether cost differences between the provision of interexchange carrier access and the access portion of local exchange carrier switched toll services should be reflected, whether for some high volume toll options special access rates or costs rather than switched access rates should be imputed, and

whether imputation should be on a service-by-service or more aggregated basis.

Pacific bases its imputation proposal on three underlying principles: recognition of cost differences between providing access to a competitor and providing switched toll services directly to its own customers, imputation of lower access costs in discounted toll services which compete with services such as AT&T's WATS, MEGACOM, and Software Defined Network (SDN) services (all of which incur access costs lower than switched access rates), and use of incremental costs once they are developed.

For toll packages where competitors do not purchase both originating and terminating switched access services from Pacific, Pacific's position is that it should not be required to impute the switched access tariff rate, but instead that the rate floor should be comprised of the overall incremental cost of the non-monopoly portions of the toll service plus the tariffed rate for any monopoly elements of the access services actually purchased by competitors. For example, for customers whose usage levels make MEGACOM an economic alternative, Pacific suggests that it be permitted to offer a competing toll service with a rate floor set at the incremental cost of the entire service apart from terminating switched access, for which tariffed rates would be imputed. In this example, Pacific assumes that MEGACOM's originating access (high speed special access) is not a monopoly building block and thus that its incremental costs rather than its tariffed rates should be included in Pacific's switched toll rate floor.

GTEC takes the rather extreme view that no portion of access charges should be imputed in local exchange carriers' switched toll rates at all, and that switched toll rates should be based only on incremental costs. GTEC states that it is difficult to match local exchange carrier and interexchange carrier toll services; as a result, difficulties would arise in determining

which access charges should be imputed. GTEC asserts that it would be placed at a serious competitive disadvantage if it were required to impute access charges in its switched toll rates when its competitors can avoid such charges by offering services like MEGACOM or private networks. GTEC also asserts that since a local exchange carrier may use different facilities to provide intraLATA switched toll than it uses to provide carrier access, it would be unreasonable to include a uniform charge for access which would burden the local exchange carrier with costs it does not incur.

DRA submits that imputation of only the access services that a local exchange carrier uses is crucial to ensuring that ratepayers receive the benefits of competition. DRA holds that local exchange carriers enjoy major cost advantages due to the ubiquity of their network, their wide deployment of switching intelligence, and more efficient routing and switching requirements, and that to promote economic efficiency these benefits should be reflected in local exchange carriers' toll prices.

DRA concludes that switched toll rate floors should include tariffed rates for only those access functions actually used plus the incremental costs of the remaining network services. Switched toll floors would be set at the sum of the originating and terminating CCLCs, the local switching rate at both the originating and terminating ends, plus the incremental cost of transporting the call between end offices. DRA would not include the local transport rate element of access charges since it covers the cost of bringing a call from the trunk side of a local exchange carrier's switch to an interexchange carrier's point of presence, a service that is not required in completing a local exchange carrier's own toll call. DRA submits that the methodology required to determine incremental costs of a local exchange carrier's interoffice network telecommunications service can be developed and adopted in the implementation phase.

Contel agrees with DRA's concept that toll price floors should be based on a combination of access charges and incremental costs, as an approach that would treat all carriers consistently. It states, however, that pricing should be based on a mix of switched and special access, since competitors can purchase special access and thereby reduce their per-minute costs and can also build their own bypass facilities.

AT&T submits that local exchange carriers should in all cases use the premium rate for intrastate switched access services in the imputation process, including a "fair share" of local exchange transport expense. It is AT&T's position that local exchange carriers' toll networks should be viewed conceptually as similar to interexchange carrier toll networks, with multiple points of presence in dense urban areas and single points of presence with connections to many end offices in less dense areas.

AT&T recognizes that imputation of transport rates is problematic due to the absence of specifically designated points of presence for the local exchange carriers. In its view, such points of presence must be designated in such a manner as to accurately separate monopoly elements (those used primarily for completing local calls) of the local exchange network and competitive elements (those used to provide toll calls), thereby identifying monopoly access transport mileage for purposes of calculating transport charges. Otherwise, it asserts, the local exchange carriers' switched toll rates would reflect local exchange access transport at rates lower than those charged competitors for the same service.

As an approximation of this approach, AT&T suggests that a local exchange carrier's local Class 5 end offices would be designated as toll points of presence when toll traffic from these offices directly connects to other Class 5 end offices. However, where the Class 5 office routes a call to a toll tandem, the toll tandem would be considered the point of presence, and the tariffed access transport rates for mileage between the end office and the

tandem would be imputed in switched toll rates. AT&T describes the studies needed to calculate the average transport access charge to be imputed.

AT&T submits that its approach would reduce a local exchange carrier's incentive to discriminate in setting local transport rates and would also increase local exchange carriers' revenue base available for use in meeting universal service goals.

MCI takes a similar view that the imputation process should include a component for local transport rates. MCI asserts that local transport is at least in part a bottleneck monopoly function, particularly for switched services, since for technical and economic reasons potential competitors cannot install their own facilities to provide local transport. Since local transport rates are allegedly well above cost, potential competitors would be caught in a price squeeze if the local exchange carrier is only required to recover its cost (however measured) for local transport in its own switched toll rates while charging competitors more than that cost. Switched toll rates would also cover the local exchange carrier's costs of the remainder of the transport of intraLATA toll calls.

In MCI's view, three approaches could be used to measure how much of toll transport should be included in the access charge imputation: (1) charge all local exchange carrier toll transport at the transport rate in the access tariff, (2) use the average distance between end offices and toll tandems, or (3) use the average transport distance charged to interexchange carriers. MCI prefers the third approach, on the basis that it comes closest to a market measure of the extent of transport that is part of the bottleneck monopoly and that it is probably the easiest approach to use since it can be computed directly from access charge billings. MCI believes the first alternative ignores the distinction between the transport that could be provided by more than one carrier and the bottleneck monopoly portion that may need to be priced above

cost to recover revenue requirement. Further, the second alternative ignores the traffic that does not use tandem switches and thus could also overstate the bottleneck monopoly part of transport.

MCI concludes that under its approach all intraLATA toll carriers would pay the same amount for access to the local exchange bottleneck and that whatever contribution is established for the combination of local exchange carrier-provided switched toll and access services would be maintained, no matter what shares of the total intraLATA toll traffic are held by various carriers.

MCI believes that it is not possible for the Commission to determine whether Pacific's cost differences in providing access and transport to interexchange carriers or alternatively as part of Pacific's own switched toll service are due to efficient operations or are the result of anticompetitive abuses. Therefore, MCI concludes that only very rarely if at all should deviations from full imputation be allowed.

Sprint submits that local exchange carriers should impute the same access charges in their own switched toll rates which they charge interexchange carriers, including switched access rates, special access rates, and billing and collections services rates charged to interexchange carriers. Sprint asserts that the intent of such imputation is to place the local exchange carrier, which controls these essential access facilities, in the same economic position as its competitors.

CWC agrees with Sprint that imputed access charges should include all charges an interexchange carrier would be required to pay, including charges for the transport rate element. By this approach, CWC argues, interexchange carriers would not be disadvantaged by local exchange carriers' refusal to permit colocation of interexchange carrier technical facilities on local exchange carrier premises.

CBCHA agrees with Pacific that relative local exchange carrier service efficiencies should be reflected in the imputation process. It submits that pure imputation without such considerations would simply transfer switching inefficiencies into local exchange carrier prices, a step which in its opinion would be unfair to Pacific's customers. At the same time, CBCHA recognizes that reflection of a local exchange carrier's unique efficiencies in its prices may well threaten the viability of competition.

Contel, MCI, Sprint, and others point out that current disparities in switched access and switched toll rate structures make rate element-by-rate element imputation problematic. MCI and Sprint suggest that imputation be on a toll service-by-toll service basis, with MCI stressing that each service choice, such as an optional calling plan or separate 800 offering, should meet the imputation standard separately. Contel submits instead that the goal should be that toll revenues cover total access costs on an aggregate statewide basis. MCI submits that it would be better for the development of competition in the long run to have consistent time-of-day structures for toll and access charges and to impute access charges on a rate element-by-rate element basis. DRA notes that some nighttime intraLATA switched toll rates fall below current interLATA access rates, but takes the position that such a disparity would be acceptable as long as total revenues for each tariffed service or calling plan cover the imputed access charges.

In reply testimony, DRA states that Pacific's imputation proposal is the most sophisticated offered in Phase III testimony. DRA asserts that its own imputation procedure is better because it is simpler and, in conjunction with what it views as its inseparable proposal that the CCLC be shifted to terminating access for outbound services or to originating access for inbound services, provides numerically similar price floors. DRA asserts that Pacific's calculations require much information which is not routinely available to regulators and may be proprietary. DRA

notes that its own approach uses incremental costs only for interoffice network services, and as a result is simpler and more understandable than Pacific's use of end-to-end incremental costs.

Pacific reports that DRA's plan is carefully reasoned with the correct fundamental economic principle that imputation should cover only the access services the local exchange carrier uses in providing its toll services. Pacific asserts that DRA's approach is not as consistent with economic theory as is Pacific's proposal, but recognizes that it may well be easier to implement. Pacific concludes that much of DRA's proposal is acceptable to Pacific, particularly if DRA's recommendation to bifurcate the CCLC is adopted. Pacific states that it is unclear how DRA's approach would work for WATS and MEGACOM-like services, and objects if DRA proposes imputation of switched access charges at both ends of a MEGACOM-like call, since interexchange carriers incur only the terminating switched access charge. Pacific recommends that, if DRA's plan is adopted, it be modified to impute originating special access in rates for large business users, as in Pacific's own proposal.

GTEC similarly states that it could support DRA's imputation formula with four amendments and additions: (1) access charges should not be imputed if a local exchange carrier introduces services similar to AT&T's Software Defined Network service; (2) the originating CCLC should not be imputed into the higher volume bands of WATS, 800, or equivalent tariffs, so such services could compete with MEGACOM-like services of interexchange carriers; (3) any incremental costs included in toll rates for billing, sales, or administration should be computed net of any similar costs included in the imputed access rate elements; and (4) a local exchange carrier should be allowed to reduce its toll rates if it can demonstrate that a competing interexchange carrier's intraLATA tariffs do not cover the same access charges

which are imputed in the local exchange carrier's rates (as long as rates are not priced below incremental costs).

Sprint takes exception to the imputation proposals of GTEC, Pacific, and DRA, stating that GTEC and Pacific fail to implement the imputation standard of D.89-10-031. Sprint asserts that, though DRA complies more closely with the standard, DRA fails to unbundle and impute some measure of the use by local exchange carriers of common or similar trunking and switching equipment for toll and access transport and also fails to impute tariffed rates for billing and collection services which local exchange carriers bill to interexchange carriers when providing billing services. Sprint also asserts that price floors should be set using direct embedded costs for the non-monopoly building blocks as directed in D.89-10-031 rather than incremental costs as proposed by the local exchange carriers and DRA, until useful company-specific incremental cost models are developed.

MCI argues similarly that the imputation proposals of Pacific, GTEC, DRA, and CBCHA all ignore, in whole or in part, the importance of nondiscriminatory access to bottleneck monopoly building blocks endorsed in D.89-10-031. MCI asserts that Pacific never acknowledges that local transport is, at least in part, a bottleneck monopoly building block and while DRA implicitly does so, it appears to ignore this fact in calling for the local transport element of access charges to be priced no lower than fully allocated cost. CBCHA's and GTEC's proposals, which do not impute access charges at all, ignore this principle entirely, with neither offering any discussion of why the public interest would be served by their approach. AT&T has similar criticisms of GTEC's proposal.

MCI submits that Pacific and DRA fail to deal with the fact that inefficiencies of providing access to interexchange carriers are at least in part under the sole control of the local exchange carriers, since they choose how to route the calls and

which facilities to use. In its view, reflection of local transport differences in toll rates would simply create incentives for the local exchange carriers to engage in inefficiencies in order to continue anticompetitive conduct and would also reduce the possibility that effective competition will develop. MCI states that the unavailability of colocation enhances the ability of local exchange carriers to enforce inefficient local transport configurations. MCI also contends that these approaches unnecessarily reduce the contribution that Pacific's toll would make.

AT&T expresses a similar opinion that Pacific's proposal for imputing access charges deviates significantly from D.89-10-031. In AT&T's view, the imputation process should only recognize cost differences arising if local exchange carriers do not provide access to other carriers, e.g., certain costs for carrier access marketing functions. AT&T argues that differences in costs because of different utilization of the network should not be recognized, except as reflected through a different mix of tariffed access elements obtained at tariffed rates.

AT&T, MCI, and CBCHA disagree with Pacific's proposal that imputation for high volume toll rates should reflect the type of access competitors might utilize. In AT&T's opinion, this approach would create endless regulatory challenges, with local exchange carriers arguing that their toll services would be competitively disadvantaged if switched access rates are imputed. AT&T submits that local exchange carriers can provide services similar to MEGACOM by utilizing high capacity dedicated access on a stand alone basis or on a shared basis with participating interexchange carriers.

MCI challenges in particular Pacific's example that its toll rate floor should be incremental cost plus terminating switched access charges for customers which might otherwise use competitors' services like MEGACOM. MCI argues that until there is

widespread geographical availability of special access substitutes from interexchange carriers, Pacific should at a minimum impute tariffed special access rates plus the incremental cost of switching to the closed end and tariffed switched access rates for the open end of any service it offers that competes with MEGACOM and similar alternatives.

CBCHA asserts that Pacific's proposal for discount calling plans would permit a local exchange carrier to reflect the efficiencies inherent in competitors' service strategies in its own prices even if the local exchange carrier does not adopt those strategies in serving its own retail customers. CCTA submits that Pacific's approach would be inconsistent with unbundling and price imputation principles adopted in Phase II.

DRA calls AT&T's imputation proposal "constructive," stating that it is similar in several ways to DRA's own proposal. DRA is concerned, however, that AT&T's approach is too complicated. DRA sees the practical effect of AT&T's proposal being the creation of a series of "virtual points of presence" just past the local exchange carrier's end office switches or at tandem switches. DRA states that in contrast its own imputation scheme implicitly places virtual points of presence in the center of end offices, thus drawing a different boundary between access and network services. DRA is concerned that AT&T's proposal would create adverse incentives for local exchange carriers to overinvest in direct interoffice transport to avoid imputation of higher access charges. DRA concludes, however, that the practical difference in its method and AT&T's method would likely prove small.

DRA criticizes MCI's proposal, stating that MCI's real intent is to ensure that local exchange carriers face a cost structure on average equal to that of the interexchange carriers. DRA submits that this has no cost basis and is inconsistent with Commission unbundling principles and ratepayer interests.

Pacific takes issue with certain portions of AT&T's proposal. Pacific asserts that AT&T does not recognize that no additional costs arise when a call does not go through a tandem. Further, AT&T would average direct and tandem connection into a single price floor; Pacific argues that this approach has no economic efficiency justification since Pacific should choose to connect its end offices in the least cost manner.

Pacific also contests MCI's assertion that, in order to discourage inefficient provision of access, cost differences should not be taken into account. Pacific asserts that the new incentive-based regulatory frameworks adopted by this Commission and under consideration by the FCC include adequate incentives to provide access in an economically efficient manner.

Pacific is concerned that MCI and AT&T do not make clear how WATS and 800-like services, with dedicated facilities at the originating or terminating end, should be handled, and takes issue with their apparent imputation of both originating and terminating switched access charges in local exchange carrier discounted toll services. Pacific also notes that AT&T's and MCI's proposals would require further work, including a study to establish average transport rates if AT&T's proposal is adopted.

Pacific disagrees with the view that billing and collection services should be treated as monopoly elements in the imputation process, since the Commission has already designated billing and collection services as Category II services. Finally, Pacific argues that Sprint's view that local exchange carriers should impute the same access charges assessed interexchange carriers would lead to economic inefficiencies, reiterating its view that cost differences should be taken into account in the imputation process.

GTEC argues similarly that MCI would impute costs the local exchange carriers do not incur, and that AT&T's proposal is unduly burdensome and would result in some of the same unnecessary

charges. GTEC states that since access charges include costs of billing, sales, and administration, MCI would require local exchange carriers to overstate these costs in toll rates. GTEC states further that imputation of switched access elements into prices for services competing with interexchange services bypassing the switched access network (such as SDN-type services or MEGACOM) would be inappropriate.

Discussion

In evaluating the various imputation proposals before us, our guiding principle is the basic goal underlying the imputation requirement adopted in Phase II: prevention of anticompetitive price squeezes. An assessment of how well each proposal is likely to perform in meeting that goal is invaluable in choosing among the proposals.

The first area of controversy we turn to is the question of whether and to what extent the local transport element of the switched access tariff should be imputed in local exchange carriers' switched toll rates and charges. Competitors fear that local exchange carriers may engage in anticompetitive price squeezes by inefficient local transport configurations and/or by charging interexchange carriers more on a per-mile basis than the comparable amount reflected in their own switched toll rates.

We affirm our earlier conclusion that imputation is an important tool by which to discourage anticompetitive conduct, and agree with AT&T and MCI for this reason that the monopoly portion of a local exchange carrier's network should be treated comparably in setting both access and switched toll rates. We find useful AT&T's depiction of local exchange carriers' toll networks as divisible into monopoly and competitive elements which can be demarcated conceptually by what DRA calls "virtual points of presence," since this comports with our own understanding of local exchange carriers' network configurations.

At the same time, we also agree with the parties which assert that efficiencies in routing and switching should be recognized, to the extent they can be ascertained, in order to promote economic efficiency and to allow ratepayers to realize resulting cost savings through lower toll rates.

Pacific, GTEC, and DRA treat the end office as the local exchange carrier's virtual point of presence by pricing all transport beyond the end office at cost rather than at tariffed local transport rates in their imputation proposals. We agree with AT&T and MCI that this approach underestimates the monopoly portion of the network and thus could create an anticompetitive price squeeze.

MCI essentially uses the average transport distance charged to interexchange carriers as a proxy for the distance that monopoly characteristics extend into local exchange carriers' networks. This approach would eliminate any advantage a local exchange carrier might attempt to gain by anticompetitive price squeezes. We do not agree, however, that MCI's approach should be adopted simply for this purpose. We note, in fact, that if uneconomic "POP proliferation" has occurred as alleged in response to high transport rates, MCI's approach might actually underestimate the monopoly portions of local exchange carriers' networks.

AT&T's proposed approach designates virtual points of presence based on whether toll traffic is routed directly between Class 5 end offices or is routed through toll tandems. Since this method relies on the actual design of local exchange carriers' networks and recognizes local exchange carrier efficiencies in routing and switching, we adopt AT&T's method of designating virtual points of presence as reasonable for purposes of the imputation calculation.

In keeping with AT&T's recommendation, we instruct Pacific and GTEC to prepare a study that measures their intraLATA

switched toll traffic directly between end offices, and between end offices and toll tandems. The weighted average length of transport between end offices and toll tandems, as determined from these actual traffic measurements, should then be used to calculate the local transport rates and charges to be imputed in local exchange carriers' switched toll rate floors. Pacific and GTEC should submit this study in the implementation phase.

We adopt in Section V.C the principle that access services should be cost-based (except for the CCLC element), and discuss in Section V.C.3 the concept that the local transport rate might be priced at direct embedded cost or incremental cost. We note that, pending possible approval of incremental pricing methodologies, direct embedded cost pricing of local transport could equalize AT&T's, Pacific's, and DRA's proposals, i.e., the entire end office-to-end office distance could be reflected in the switched toll rate floor at its direct embedded cost. Parties may also propose incremental costing methodologies which might similarly equalize these proposals.

We turn now to whether and how local exchange carriers should be allowed to reflect other than switched access charges in high volume discount toll plans aimed at competing with services such as MEGACOM. Some parties argue against recognition of any access other than tariffed switched access in the imputation process. AT&T suggests that local exchange carriers could offer special access on a stand alone basis.

Since interexchange carriers' access alternatives include special access and facilities-based bypass in addition to switched access services, it is clear to us that local exchange carriers would be at a competitive disadvantage if they were required to impute switched access rates, including the non-cost based CCLC, in all their switched toll rates. As a result, we agree with Pacific and GTEC that they should be allowed to offer high volume discount

toll services structured to compete with interexchange carriers' services based on types of access other than switched access.

Pacific suggests that special access (high speed or analog) should not be treated as monopoly building blocks in the imputation process and as a result that costs of such access rather than tariffed rates should be included in the imputation process. MCI responds that tariffed special access charges should be imputed until there is widespread geographical availability of competitive substitutes to local exchange carriers' special access services.

In D.89-10-031, we explicitly chose not to determine which functions are or are not monopoly building blocks for a given bundled service, concluding that this should be determined on a case-by-case basis. Further, contrary to Pacific's assertion, we did not find that only Category I services should be treated as monopoly building blocks in the imputation process:

> "Absent [a showing that cost differences exist], the bundled rate must be at or above the sum of tariffed rates for the bottleneck building blocks and the costs of nonbottleneck components, even if there are floors for a flexibly priced service lower than the tariffed rates." (D.89-10-031, mimeo. p. 141, emphasis added.)

Since local exchange carriers still retain significant market power in the provision of Category II services, D.89-10-031 does not preclude that a Category II service might be considered a monopoly building block in a bundled service. To guard against anticompetitive pricing, we will examine, on a case-by-case basis, whether Category II services exhibit characteristics of monopoly building blocks in the provision of specific bundled services. If so, the adopted imputation principle states that their tariffed rates and charges rather than their costs should be included in the imputation process. Because of the troubling possibility that local exchange carriers can leverage their continuing market power for Category II services through bundling them with services which

would otherwise be more competitive, we are inclined to require imputation of tariffed rates and charges for Category II services upon which bundled services are built absent strong evidence of viable competitive alternatives.

We caution that to guard against anticompetitive pricing, high volume discount toll plans should be structured carefully to comply with adopted imputation principles and should be based explicitly on the implied underlying access arrangements including any associated service terms and conditions. Parties should explore further in the implementation phase the appropriate structure and pricing of high volume discount toll plans. We stress that local exchange carriers will not be allowed to simply use this vehicle at will to avoid imputation of the CCLC or of allocated overheads in switched toll rate floors.

In its comments on the ALJ's proposed decision, GTEC requests that local exchange carriers continue to be allowed to offer present discount toll plans offered to lower volume customers, even though such rates may not necessarily cover switched access charges including the CCLC. We will not grant GTEC's request at this time, but will allow parties to address this issue in the implementation phase.

Another related issue is treatment of local exchange carriers' billing and collection services in the imputation process. In keeping with our finding that Category II services may function as monopoly building blocks for some bundled services, the answer depends on whether the service or individual components act effectively as a monopoly building block. Particularly because we decline to require presubscription, some local exchange carriers' billing and collection services such as the Billing Name and Address component may well exhibit monopoly building block characteristics. Local exchange carriers and other parties interested in this issue should address it further in the implementation phase. As some parties caution, care should be

taken to prevent double counting between monopoly building block and competitive components in the imputation process.

Parties also raise questions regarding the level of aggregation in the imputation process, in light of current disparities in switched toll and access rate structures (e.g., toll rates have time-of-day differentiation whereas access charges do not). Because of these disparities, we agree that rate element-by-rate element imputation of access charges in switched toll rate floors may not be practical. However, in order to prevent cross subsidies from switched toll services which may be less competitive to other more competitive toll offerings, we agree with MCI and Sprint that the imputation should at least be on a service-by-service basis, with access services relevant to each service choice (e.g., each discount toll plan or each separate 800 offering) fully reflected in that service's rate floors.

Further, to the extent practicable, imputation at a more detailed level would be desirable because this would further goals of economic efficiency and full utilization of the network. For example, a worthy rate design goal is that no floor for any switched toll rate element should be below the total direct embedded costs of its bundled components. However, we can envision that other factors could outweigh this goal, for example, if its application would result in rate increases in some intraLATA toll mileage bands. Parties should explore this concept further in the implementation phase.

DRA raises the treatment of intercompany calls in the imputation process. Because statewide average access charges and switched toll rate floors will be established, this issue is moot.

We agree with AT&T that only premium access rates should be reflected in imputation since local exchange carriers' connections are comparable to premium connections available to interexchange carriers.

VI. Competition for other IntraLATA Services

A. Local Services and ZUM Calling

1. General

Pacific, GTEC, Contel, Citizens, and Roseville oppose opening basic exchange services and local and ZUM calling to competition. Pacific notes the historical treatment of ZUM calling in conjunction with local services and supports the continuation of substantial discounts from toll rates. Pacific would also prohibit competition for 911, 411 and intraLATA foreign NPA 555-1212 directory assistance, and non-revenue producing 0- calling.

Pacific questions whether network efficiencies would be advanced or frustrated if local calls are handled by interexchange carriers. Contel submits that a continued local exchange monopoly (including access) would serve to protect the integrity of California's telecommunications infrastructure and ensure that the Commission's regulatory goals are maintained.

Full exchange competition raises the specter of duplicate local networks to GTEC, which argues that such competition would be inconsistent with goals of economic efficiency, universal service, and full utilization of the local exchange network and would undermine the Phase II regulatory framework. GTEC envisions that alternate providers could take advantage of social pricing policies such as rate averaging and residual pricing, and agrees with AT&T and others that such issues are too complex and the consequences too far-reaching to be considered in an expeditious manner in this proceeding. GTEC also states that ZUM services are designed to address local communities of interest in California and notes that if the Commission requires local exchange carriers to impute access charges into ZUM rates, the net result of ZUM competition would likely be higher ZUM rates.

Citizens asserts that basic exchange competition would cause local exchange carriers to lose their most profitable

business customers and, further, that Phase III was not intended to deal with issues of basic exchange competition. CP National and Roseville similarly see Phase III as an inappropriate forum for consideration of local exchange competition.

DRA opposes ZUM competition because of consumer protection concerns. Because local exchange carriers' ZUM calls will probably be priced far below interexchange carriers' services, DRA recommends that local exchange carriers block 10XXX ZUM calls. This policy would allow consumers to receive the lowest price for ZUM calls and, according to DRA, would facilitate use of simple CPE devices that prefix 10XXX to all calls.

At the same time, DRA sees no need to prevent interexchange carriers from terminating other types of ZUM calls nor, because of terminating access charges, any need for interexchange carriers to compensate local exchange carriers for such calls. DRA also sees no reason to follow imputation procedures for tariffing ZUM services.

AT&T views the local exchange network as a continued natural monopoly and submits that competition for those services or service elements which provide basic access and associated functionality to the local exchange network raises important public policy issues regarding local franchise rights and the desirability of possibly duplicating in whole or in part the local exchange network. Since in its view such issues are complex and the consequences far-reaching, AT&T asserts that expeditious treatment in this proceeding would be inappropriate and that a separate investigation could be instituted for this purpose if desired.

AT&T distinguishes ZUM calling from basic exchange services on the basis that it and other intraLATA toll services are users of the existing local network for which competition would not duplicate the network, and supports competition for extended area, special rate area, and ZUM calling.

CALTEL, ACLA, CCTA, and Mtel assert that local exchange competition should be permitted. CALTEL, while recognizing that local exchange services are often characterized as natural monopolies, is concerned that any express limitation on competition in exchange services may be construed as prohibiting competition for activities such as interconnection of end users or development of private networks. ACLA sees no logical reason to permit competition outside an arbitrary 24 mile radius around an end office while prohibiting competition within this artificial border. ACLA states that it is reasonable to assume that local exchange carriers will, for the foreseeable future, retain some form of monopoly over local loops to most residential customers and as a result appears to accept the idea of excluding competition within the local loop itself. ACLA also recognizes that local exchange carriers should probably retain their monopoly over 911 services, given the confusion that might result from having multiple emergency service providers.

CCTA expects to see little effective competition for local exchange services for some time to come, but asserts that a competition ban is not needed and would simply lead to a recycling of the controversies that have grown out of the intraLATA ban.

Mtel submits that the intraLATA framework used for end user ratemaking purposes does not necessarily bear any relationship to actual costs and argues that regulation should allow competition to configure the intraLATA market to promote economic efficiencies, wherever such efficiencies may be realized.

2. Colocation and Direct Central Office Connections

In MFS's Local Equal Access proposal, competitors could obtain direct access to local loop facilities through physical access in local exchange carrier wire centers, so that the competitor's switching and/or transmission facilities could be connected to local exchange carrier-provided local loops. MFS

asserts that absent such a requirement local exchange carriers can maximize revenues and profits through bundling local loop service with local switching and interoffice transport, thus leveraging the local loop monopoly in order to monopolize these other, potentially competitive services.

MFS does not see close scrutiny of rates for local exchange carriers' connections between their central offices and competitors' points of presence as an adequate substitute for its proposal, for two reasons: (1) the difficulty and expense in trying to pin down accurately through regulatory processes the local exchange carriers' costs of providing efficient connections, and (2) the possibility that local exchange carriers' incremental costs are greater than the cost to a competitor of constructing its own facilities.

MFS does not believe that there are any technical impediments to interconnection of competitors' facilities directly to local exchange carriers' wire centers, since technical specifications for interconnection are well established and interconnection is common in the long distance market. MFS acknowledges a legal question regarding whether mandatory interconnection would be consistent with local exchange carriers' property rights. As an alternative, it suggests that a local exchange carrier be allowed to deny a competitor physical access through a "Dutch Auction" procedure whereby the local exchange carrier agrees to construct the connecting facility itself at a price specified by the competitor.

MFS does not anticipate physical constraints arising from its proposal. MFS sees as unlikely that more than a handful of carriers would request direct connections in any given area. Further, it asserts that there is abundant empty space in many central offices due to switch conversions and replacement of copper cables with compact fiber optics. MFS suggests a waiver procedure

should central office congestion become a problem at specific sites.

Agreeing with MFS, ACLA submits that local exchange carriers should be required to permit competitors to colocate their facilities within local exchange carrier end offices and tandems. Recognizing the need for reasonable compensation to local exchange carriers for any expenses incurred, ACLA still concludes that potential savings arising from elimination of extensive links between local exchange carrier facilities and competitors' points of presence would be enormous.

Pacific, CP National, Roseville, Citizens, Contel, and DRA all oppose imposition of colocation and direct access requirements at this time, arguing this would entail more extensive physical unbundling than contemplated in the Phase II decision and that further study is needed because these issues are highly technical with profound revenue and service implications. Pacific and CP National cite D.89-10-031 as specifically relegating consideration of Bay Area Teleport's direct access and colocation proposal in Phase II to a separate proceeding. Pacific filed a motion to partially strike MFS's testimony on these grounds. Contel also notes that MFS's proposal is pending before the FCC and submits that this Commission may want to take a wait-and-see attitude and/or actively participate in the FCC proceeding.

Pacific contends that MFS's claim that physical space limitations would not be a problem is based on almost no economic analysis and is simply wrong. Pacific suggests instead that each facilities-based interexchange carrier plus each Metropolitan Area Network provider, at a minimum, would request physical colocation along dense routes.

Pacific is particularly opposed to MFS's Dutch Auction proposal on the basis that MFS would be in an incredibly strong initial bargaining position and this approach would not lead to economically efficient outcomes. Pacific also contends that MFS's

colocation proposal would have a major impact on Pacific's ability to continue to fund low basic exchange rates, since MFS contemplates that the local loop would be priced to recover only costs plus a reasonable rate of return and contribution from both toll services and switched access services would be lost. Pacific further argues that local exchange carriers would need to deaverage rates geographically, since MFS would target its offerings to high density, low cost areas. Citizens voices similar concerns.

3. Discussion

The proposals by MFS and ACLA that competitors be allowed to colocate their facilities within end offices and to connect directly to local loop facilities raise complex technical issues which cannot be resolved on a policy basis absent evidentiary hearings. We note that Teleport Communications Group filed a petition on April 16, 1990 in I.90-02-047 in which it requests consideration of issues substantially similar to those raised by MFS and ACLA. We believe it is more appropriate to consider colocation and direct access issues in I.90-02-047 than in the implementation phase of this proceeding, and as a result defer these issues to I.90-02-047. Pending findings to the contrary in that proceeding, switched and special access services will continue to be offered only on a bundled basis, with switched access remaining a Category I service.

Because it would be too difficult to isolate testimony of MFS and several other parties regarding colocation and direct access issues, Pacific's motion to strike portions of MFS's testimony should be denied.

We agree with the local exchange carriers that their basic exchange services and local and ZUM calling should remain as monopoly Category I services so that we can retain control over their pricing. Consistent with our universal service and affordable local service goals, residence exchange services and local and ZUM calling should continue to receive special pricing

treatment. Further, we determine in Section IV.F that business access services should be priced to recover their fully allocated costs.

Because we anticipate that local and ZUM rates will continue to be priced below interexchange carriers' toll rates, local exchange carriers should block 10XXX local and ZUM calls, with a recording to inform customers that such calls should be completed over their own networks. However, we agree with DRA that interexchange carriers should not be prohibited from terminating other types of ZUM and local calls and that there is no need for compensation for such calls beyond terminating access charges since local and ZUM calls will continue to receive special pricing treatment. Customers with special access or other means of accessing interexchange carriers will have the responsibility (as they do now for intraLATA calls) of determining whether to make a local exchange carrier ZUM call or use their interexchange carriers. To provide additional ratepayer protection, interexchange carriers should, however, continue to be prohibited from holding out the availability of their services for completion of local and ZUM calls.

In the ALJ's proposed decision, facilities-based competition with the local loop would have been allowed on the grounds that development of new technologies such as Personal Communications Networks should not be discouraged and that the local loop bypass potential does not appear to be significant at least in the near term. GTEC, Citizens, and Contel oppose facilities-based local loop competition in their comments on the ALJ's proposed decision, arguing that the Phase III record is inadequate to support findings regarding the bypass potential due to such competition.

Since the attractiveness of uneconomic bypass of the local loop will depend to a large extent on the level of access charges, particularly the CCLC, we agree with these parties that

potential detrimental effects of facilities-based competition with the local loop cannot be assessed adequately based on the Phase III record and thus that facilities-based local loop competition should not be authorized at this time. Parties should address this issue in the implementation phase in the context of the various access charge proposals made at that time.

As a final matter, since no party voiced opposition in their Phase III submittals to Pacific's proposal that competition continue to be prohibited for 911, 411 and intraLATA foreign NPA 555-1212 directory assistance, and non-revenue producing 0- calling, we will not allow competition for these services at this time. Parties may affirmatively propose in their testimony in the implementation phase that competition be authorized; we do not find the comments received on the ALJ's proposed decision adequate for this purpose.

B. Low Speed Private Lines

Competition for high speed private lines (with capacity of at least 1.544 megabits per second (mbps)) was authorized in D.88-09-059 in Phase I of this proceeding. Pacific, Contel, Roseville, Citizens, AT&T, MFS, and ACLA recommend that the restriction on speed (more accurately, capacity) be lifted so that competition would be authorized for both analog and digital services without regard to speed. Pacific recommends that low speed entry be authorized when a decision becomes effective following the implementation phase, except that low speed special access for intraLATA MTS and WATS-like services would not be allowed until MTS and WATs competition in stage two of its phased competition proposal. Contel suggests that competition be allowed after intraLATA access tariffs are approved. AT&T recommends a January 1, 1991 target date. MFS recommends that entry barriers for this service be lifted expeditiously.

GTEC argues against expansion of competition to include low speed private line services. It notes that in Phase II the

Commission found that low speed private line services were not competitive service offerings and placed those services in Category I for pricing purposes; GTEC states that it is unaware of any subsequent developments which would warrant revisiting this decision. If competition were permitted, GTEC asserts that a detailed audit of private line circuits would be required before it could move to a meet point billing scenario.

AT&T submits that pricing principles for competitive low speed private line services should mirror those adopted in Phase I for competitive high speed private line services: the local exchange carriers should be required to eliminate current tariff distinctions between private line and special access services for all common service elements, and services from the local exchange carrier's central office to an interexchange carrier's point of presence (the CO-to-POP link) should be priced at direct embedded cost.

MFS recommends that all private line services, including digital data services and special access services, be opened to competition at this time to allow Californians to fully benefit from this technology. In its view, this expansion would give users additional flexibility in meeting their needs for private line voice and data services, producing the benefits of competition, and would have only a minimal impact on local exchange carriers.

MFS notes that at present a customer desiring to create an intraLATA private network may purchase high capacity portions of its network from multiple vendors, but any portions using transmission below 1.544 mbps can be procured only from local exchange carriers. MFS asserts that any customer desiring to interconnect high capacity and low capacity services must either purchase central office multiplexing services from a local exchange carrier or install multiplexing equipment on its own premises, with the latter option often being inefficient because it would require back-haul of low speed circuits from the central office to the

customer's premises. MFS concludes that it would be more rational from an economic standpoint to grant all carriers the same authority to provide multiplexing and lower capacity transmission services within their networks. Customers could then choose the most economically efficient combination of services to meet their needs.

MFS believes that competition for low speed private line services should have an inconsequential impact on local exchange carrier earnings since, it asserts, low speed private line service is a low traffic density service which for most end users is most economically served through the local network. In its view, competition would initially be limited only to those customers which already use high capacity services or are located in the same buildings as customers with high capacity services. However, if MFS's Local Equal Access proposal were adopted, MFS anticipates much more significant competition for low speed services.

In MFS's view, GTEC's argument that low speed private line services should remain noncompetitive because the Commission classified them that way in Phase II is simply illogical: the Commission did that because competition had not yet been authorized. MFS, Sprint, and AT&T see the need to revise joint billing arrangements as more an implementation issue rather than a valid policy objection to competition.

WBFAA opposes competition for intraLATA low speed private line services on the basis that viable competition for these services, particularly alarm applications, does not exist and is not likely to develop. WBFAA asserts that services such as alarm transport private lines are probably the last form of communications to benefit from intraLATA competition, were such competition allowed.

WBFAA stresses a view that competition must exist among providers and not just among alternative services available from a single provider (who allegedly could manipulate the market and

create price instability), or among services that are provided primarily by a local exchange carrier with only a small portion provided by a competitor. According to WBFAA, the Commission must assess factors such as availability, reliability, cost effectiveness, compatibility, longevity, and compliance with alarm industry standards to determine if there is sufficient competition to permit intraLATA competition for private line alarm transport services. WBFAA concludes that alternatives must be present to meet competitive criteria before dealers will use them, and before the Commission can permit competition and grant pricing flexibility.

WBFAA does not see the exchange network, cable television, or radio as being competitive alternatives, for a variety of reasons. WBFAA also asserts that jointly provided (e.g., AT&T and Pacific) services are not truly competitive since the local exchange portion is provided by competitors essentially on a resale basis.

WBFAA is also concerned about Pacific's desire to raise private line rates, asserting that since private lines are not discretionary nor truly competitive, at least for the alarm industry, they should not be priced above cost or considered candidates for Category II treatment. WBFAA is concerned that categorizing low speed private lines as competitive would result in ratepayers losing regulatory protections afforded monopoly services.

API is concerned about the significant differences in Pacific's and GTEC's positions regarding low speed private lines and stresses the need for consistent regulatory treatment of the two utilities' private line services. Further, API submits that there is no evidence to support Pacific's contention that all private line services are below cost and thus must be subjected to rate increases before competition may be allowed. While recognizing that rates should be cost-based, API submits that

private line costs should be examined in the implementation phase prior to any rate changes. API also contests Pacific's continued characterization of these services as discretionary, which view API asserts was rejected in D.89-10-031.

Discussion

No party disputes the views of WBFAA and MFS that widespread competition is not likely to develop for a large proportion of low speed private line applications. At the same time, MFS and others point to significant benefits which could arise in other situations, for example, where high speed and low speed applications could be provided jointly and more efficiently.

WBFAA would have us assess the viability of low speed private line competition before allowing entry, citing a list of factors which it would have us consider. This sequence of events would run counter to our conclusions in Section IV.B that such an approach would produce a reliable factual record and that the best strategy in a partially competitive intraLATA market is to set up a regulatory structure that protects ratepayers while allowing, through level playing field conditions, a market test to determine whether competition is indeed viable.

The pricing structure adopted for a Category II service protects a service's customers from prices above fully allocated costs (or some other higher ceiling found reasonable by the Commission) while protecting competitors from prices below direct embedded (or possibly incremental) costs. The only reasons we see to not place low speed private lines in Category II and allow competition would be if we wished to control service prices either (a) below fully allocated costs to prevent rate shock or for some other public policy goals, or (b) above fully allocated costs to raise contribution. Because low speed private line revenues are relatively small, we see little to be gained from any attempts to raise contribution by pricing these services above fully allocated costs. At the same time, we see no universal service objectives

that would constrain low speed private line rates below fully allocated costs. We conclude that the only possible rationale for retaining low speed private lines in Category I would be if such a step were needed to prevent rate shock.

Because we do not have access at this time to cost data regarding low speed private line services (including low speed special access services), we defer determination of pricing flexibility and competition for these services until the implementation phase. If at that time we find that pricing these services according to Category II principles would adequately protect customers from unacceptable levels of rate shock, competition will be allowed and the services will be placed in Category II. Otherwise, we may choose to defer competitive entry for some or all low speed private line services and to phase in rate increases for these services as quickly as reasonable so that these services cover their costs rather than receive subsidies, and so that competition can develop, if viable, on a level playing field basis.

Parties should propose rate designs for low speed private line services in the implementation phase. Until cost data is available, we will not act on AT&T's request that low speed services be priced comparably to high speed private line services.

C. Operator Services and Pay Telephone Services

Pacific references the pay telephone settlement adopted in D.90-06-018[17] in stating that operator services should be among the first group of services for which intraLATA competition should

17 Pacific and other parties refer in their Phase III testimony to a settlement pending in I.88-04-029. In D.90-06-018 we adopted this settlement with minor modifications unrelated to the references made to it by the parties. For convenience we refer herein to D.90-06-018 rather than to the pending settlement, since adopted, in I.88-04-029.

be authorized. Pacific distinguishes operator services competition from intraLATA switched toll competition by stating that operator service competitors should be required to use local exchange monopoly intraLATA services to complete calls prior to the authorization of competition for intraLATA switched toll services. As with a number of other services, Pacific would condition the authorization of competition on an initial rate realignment. Pacific asserts that its "Public - non sent paid" services generated contribution of $121 million during 1988, although no breakdown of this figure is provided. In reply testimony, Pacific clarifies that it supports operator services competition under the terms of D.90-06-018 once the "subsidy recovery" included in Pacific's operator services is identified and shifted to other services through rate design.

DRA states that operator services rates should first be reduced to comparable interLATA levels with competition to follow one year later. In reply testimony, DRA reviews some of the problems with operator services that have been experienced and cites regulatory initiatives that were taken in I.88-04-029 and elsewhere to address them.

Intellicall requests that the Commission affirm that customer-owned pay telephone providers should be able to utilize automated billing and call completion services for intraLATA calls and that competition should be authorized for intraLATA services generally. Intellicall states that varying degrees of automated call completion and billing services have been inherent in the customer-owned pay telephone services the Commission has authorized since 1985. Intellicall describes its related pay telephone products in some detail and describes how expanded competition should benefit consumers through lower prices for operator services and similar products. In reply testimony, Intellicall identifies Pacific's billing and collection and validation services as items that should be imputed at tariffed rates into rates Pacific is

allowed to charge for its own operator services once competition is authorized.

AT&T places operator services among those that can be offered within the LATA readily as they do not duplicate but complement the use of the local exchange network. Barriers to entry are low and interexchange carriers stand ready to introduce operator services for intraLATA calls almost immediately. AT&T also illustrates that its credit card and operator surcharges are higher than the comparable rates Pacific now charges.

Roseville disputes AT&T's characterization of operator services as easily separable from intraLATA switched toll services, and states that operator services and intraLATA toll services should be "deregulated" at the same time.

Contel identifies intraLATA billing and collection and operator services as those for which competition could begin immediately upon the Commission's approval of local exchange access tariffs. Contel supports the framework laid out in D.90-06-018 for the introduction of competition.

Citizens believes that billing and collection services provided for message toll services should remain with the local exchange carriers, and supports an earlier settlement submitted in I.88-04-029.

CP National expresses continuing support for the small company conditions adopted in D.90-06-018, noting that it did not sign the settlement due to certain other language that it found unacceptable.

CPA echoes the call for competition in accordance with D.90-06-018, and supports the framework decided in D.89-10-031 to govern such competition.

Discussion

Notwithstanding Roseville's argument, it is apparent that there are no impediments to the authorization of operator services competition independent of the authorization of competition for intraLATA switched toll services. As parties suggest, operator services are separable in an operational and financial sense from other intraLATA services and could be provided competitively even while many other intraLATA services remained monopolies. Operator services competitors could use the local exchange network to complete calls and then collect the total charges from the customer and remit toll charges to the local exchange carrier.

Pacific asserts that contribution that is now in its operator services rates should be shifted through rate design before competition is authorized. We are unable to evaluate Pacific's contention based on the record developed thus far. AT&T points out that its operator services rates now exceed Pacific's for credit card and operator-assisted calls. Given the competitive nature of the operator services market in which AT&T participates, this is cause to doubt the need for Pacific to shift contribution prior to competitive entry. However, such conclusions will have to await our examination of the relevant costs and revenues in the implementation phase.

As discussed in Section IV.G, even if we find that Pacific's operator services are priced so as to generate contribution, we could find such price levels to be appropriate with the contribution assigned either to pay telephone services' monopoly building blocks or to the competitive portion of Pacific's service. Alternatively, we could agree with Pacific that the contribution should be shifted elsewhere through rate design. Parties should present their pay telephone rate design proposals based on cost studies in the implementation phase.

In other respects we see no reason to alter our pro-consumer policies regarding interLATA operator services, and we

would expect to apply those to intraLATA operator services absent any compelling showing to the contrary. With regard to private pay telephone providers and the nature and extent of billing and operator services that they are authorized to provide, we do not modify any of the provisions of D.90-06-018 by today's decision. We intend that full competition for operator services (beyond that authorized in D.90-06-018) will be implemented following examination of local exchange carriers' prices and costs. That authorization will toll the end of certain restrictions described in the settlement agreement adopted in D.90-06-018.

Finally, Intellicall argues that Pacific should impute a billing and collection component into the rate floor for operator services should pricing flexibility be authorized. Consistent with D.89-10-031, local exchange carriers will be granted pricing flexibility for operator services concurrently with implementation of full competition. GTEC and Pacific should propose appropriate rates, floors, and ceilings in the implementation phase and should respond to data requests from other parties with specific cost information related to cost components or imputation needs that Pacific or GTEC may not include in their testimony. We will defer until then the factual issue of which components of operator services are monopoly building blocks for which tariffed rates rather than costs should be imputed in Pacific's and GTEC's rate floors; Intellicall may renew its argument at that time.

D. Resale

It is Pacific's view that reselling intraLATA services should only be allowed when MTS and WATS competition is permitted in stage two of its proposed transition to competition. Pacific argues that allowing resale to occur before MTS and WATS price reductions occur would allow resellers to underprice those services and erode the contribution those services provide. Pacific further submits that resale of basic exchange service and local and ZUM calling should not be authorized since competition for these

services would not be authorized under its proposal, on the basis that resale is competition. Pacific also suggests that the Commission may wish to consider further limiting resale of any below-cost services such as analog private line or foreign exchange, until those services are priced to recover their cost.

DRA opposes a scenario in which only resale of local exchange carriers' services is permitted. Recognizing that it has certain surface appeal because it would encourage full utilization of the local exchange carriers' network, DRA asserts that it would be just as difficult to enforce as the intraLATA ban, stating that local exchange carriers would not be able to determine whether a reseller has any non-local exchange carrier facilities in its network.

GTEC supports Pacific and DRA, emphasizing difficulties in enforcing regulatory distinctions between facilities-based carriers and resellers.

Contel recommends that resale be allowed for all services for which competition is authorized, stating that resellers provide an alternative to facilities-based carriers and in some rural areas may provide the only competitive alternative.

Only Roseville supports competition by resellers prior to entry by facilities-based providers. In its view, an early resale provision would be beneficial because it would allow the market to develop naturally at a pace set by the participants, require no major construction or rearrangement of services or facilities, and result in no major stranded investment of local exchange carrier facilities. Roseville would delay facilities-based competition an additional 12 to 36 months, depending on the service, after resale competition is allowed.

Discussion

Parties other than Roseville are persuasive in their arguments that resale-only competition could not be enforced. Partly because we believe our regulatory efforts are better focused

on speedy completion of the implementation phase and other pressing regulatory matters, we agree that resale of intraLATA services should be allowed only when facilities-based competition is authorized.

VII. Other Competition Issues

A. Local Exchange Carrier Competition in Other Territories

Pacific, GTEC, CP National, and Roseville oppose allowing local exchange carriers to compete with each other. GTEC asserts that such competition would not be in the public interest because it would not result in cost savings to customers as long as statewide uniform rates are maintained, would create customer confusion, and would create increased cost allocation requirements. Roseville states that competition among local exchange carriers would be impractical as long as pooling continues, but suggests that competition could be permitted if pooling is abolished.

Citizens, MCI, and DOD/FEA would allow local exchange carrier competition, though Citizens and MCI attach caveats. Citizens would require structural separation of such out-of-service area activities; MCI agrees that protections would be needed against cross subsidies from a local exchange carrier's bottleneck monopoly within its franchise territory. With such protections, MCI sees the same benefits of entry arising due to local exchange carrier competition as due to entry by other potential competitors.

AT&T suggests that the Commission may wish to investigate this question in a separate proceeding, and that a proper approach might be to allow a local exchange carrier or other interested party to file applications or initiate another procedural mechanism to consider proposals on a case-by-case basis.

Discussion

Because of our determination that statewide average toll and access rates should be maintained, it is not clear to us that

there would be incentives or benefits to entry by one local exchange carrier in another's franchise territory. However, as AT&T suggests, we would entertain applications by local exchange carriers on a case-by-case basis. We would expect any such application to detail what societal benefits could be expected from any proposed competition and how the local exchange carrier's ratepayers would be protected through structural separation or other mechanisms.

B. Carrier of Last Resort

The parties almost without exception state that local exchange carriers should continue to play the role of carrier of last resort for intraLATA services, with several noting that absent presubscription the local exchange carrier, as the 1+ carrier in its territory, is automatically the carrier of last resort.

MCI does not see designation of a carrier of last resort as necessary due to the large sunk investments in route-specific facilities. If presubscription is adopted, MCI recommends that the Commission monitor whether a carrier of last resort obligation is needed, offering suggested steps if a carrier chooses to discontinue service to a community. MCI does not see this as a short term problem but one which might arise as existing plant wears out. In response, Pacific submits that the assurance that service will be available on demand should continue, and that the local exchange carrier should be the carrier of last resort in the area it services.

Noting that at least AT&T, MCI, and Sprint serve all areas of California, CALTEL expresses confidence that intraLATA competition will develop once such competition is authorized. If not, CALTEL agrees that local exchange carriers should remain the carriers of last resort in instances where no other carrier offers service.

In CENTEX's view, the obligation of local exchange carriers to offer and provide services to all customers upon demand

will remain indispensable as long as such carriers retain significant market power. CENTEX concludes that each local exchange carrier should remain the carrier of last resort within its present service area for all switched access services and any other services over which it holds significant market power.

Discussion

Because 1+ intraLATA dialing remains with local exchange carriers, there appears to be no need to address this matter further. A local exchange carrier should file an application if it wishes to abandon its current carrier of last resort obligations in the future.

C. Customer Information Requirements

DRA notes that in areas with advanced switches customers currently do not need to know whether a call is local or long distance, since the switch automatically routes a dialed seven digit number appropriately. DRA is concerned that, with the advent of intraLATA competition without presubscription, a telephone user may not know the type of call and thus would not know whether an interexchange carrier may be used. DRA asserts that this inability to know whether a dialed call is a toll call is an important impediment to a functioning competitive intraLATA market. As a result, DRA proposes that local exchange carriers be required to provide information to all customers to explain simply which exchange prefixes are not toll.

Although DRA holds that a consumer education program offers the best alternative for informing customers of when they are making an intraLATA toll call, DRA believes that reinstatement of the calling protocol in older step-by-step switches requiring that all intraLATA switched toll calls be prefixed by a 1 warrants investigation as an interim alternative to presubscription. DRA submits that this information, useless in a monopoly market structure, may give customers the information needed to make a competitive market function. Because of certain practical

impediments to its proposal, including limitations on the number of telephone number prefixes and possible conflicts with the North American Numbering Plan, DRA recognizes that careful study would be required before this protocol could be implemented.

GTEC opposes imposition of further customer education requirements, submitting that directories contain full explanation and provide examples of when calls are toll and when an area code must be dialed. GTEC further asserts that entrants can be expected to provide any additional information they believe is necessary to instruct customers as to how and when their services may be used.

GTEC also opposes DRA's 1+ toll dialing suggestion. It submits that most central offices have been converted to electronic switching and that requiring such a dialing requirement would not allow GTEC to make full use of its technical capabilities. GTEC submits that this change back to older dialing patterns would cause much customer confusion and increase costs.

Discussion

We agree with DRA that adequate availability of customer information is a necessary component of a competitive telecommunications market structure. Local exchange carriers already provide extensive customer information through requirements such as bill inserts and through their white pages telephone directories. We believe that most customers rely on their local white pages directory as the first source of information regarding their telephone service. A perusal of Pacific's San Francisco White Pages shows a clear explanation of ZUM and toll calling areas for San Francisco exchanges. We see no need to require expansion of this information, though obviously it will need certain modifications and updating to reflect the advent of intraLATA competition.

However, our decision to not require the option of presubscription for competitive intraLATA switched toll services raises issues regarding the adequacy and availability of public

information regarding 10XXX dialing. In particular, residential consumers may be unaware of this option. For example, it was widely reported that many residential customers who had presubscribed to AT&T for interLATA service believed themselves incapable of making interLATA calls via other carriers during AT&T's recent one-day network outage.

Further information about the availability of 10XXX dialing would better inform customers about their market options for all 10XXX calling, not just that within the LATA. Substantial expenditures by local telephone companies were involved in providing equal access for interexchange carriers pursuant to the Modified Final Judgment; we believe these network capabilities should be widely publicized.

We solicit parties' suggestions in the implementation phase regarding steps that could be taken to better inform and educate customers regarding 10XXX calling. While parties are encouraged to submit a range of proposals, we make the following proposal for parties' consideration.

Pacific's San Francisco White Pages contains a brief discussion of "company code" calling, but no listing of codes for particular carriers. Because the white pages are a substantial source of customer information and because we are permitting local exchange carriers to retain all 1+ dialing for intraLATA switched toll calling, we believe that it may be appropriate for local exchange carriers' white pages to provide a more explicit description of 10XXX calling along with the company codes that customers may use without having to establish a specific account with an interexchange carrier. The expense of publishing such a listing should be de minimis. As for the competitive implications of requiring a local exchange carrier to list access codes of its competitors, we believe that this is a quid pro quo that is more than justified by the market advantage offered local telephone companies by retaining 1+ dialing and by the benefit to the public

of better educating them about the choices purchased by the investments made to permit interLATA equal access.

Because this issue has yet to be addressed by the parties, our conclusions regarding it are tentative and based on the general discussion parties have provided regarding the market advantages of presubscription and the informational and other barriers that customers may face in attempting to use 10XXX codes to make calls. We wish to entertain further argument and receive testimony on this point in the implementation phase, including specific proposals for the criteria that interexchange carriers should meet to qualify for inclusion on this list (such as the absence of a monthly minimum service charge, or the willingness to accept any caller whose credit is good enough to maintain local telephone service). Parties may argue that this proposal is ill-advised or that some other means of disseminating information about 10XXX calling is preferable. Our discussion here is intended to see that the record is developed so that we can decide the issue in the implementation phase.

We agree with GTEC that DRA's 1+ toll dialing suggestion should not be pursued because it would not allow full use of switch advances while possibly causing customer confusion and increasing costs.

D. Unbundling Issues

MCI and CENTEX propose that further unbundling requirements be adopted in Phase III which in their view are needed to allow fair intraLATA competition.

MCI states that unbundling should ultimately go as far as is feasible toward offering on a separate basis each network capability so that customers and competitors alike do not have to receive services or functions they do not want or need. CENTEX asserts similarly that each primary monopoly network component must be made available as a distinct tariffed service, so customers could order and use network components to satisfy their

telecommunications needs most efficiently and most economically, without having to subscribe to additional duplicative features. In reply testimony, MFS supports the testimony of MCI and CENTEX.

These parties' arguments were all made and dealt with in Phase II. We see no need to address them further at this time.

VIII. Pooling and Geographic Rate Averaging

A. Current Procedures

Local exchange carriers currently maintain a single statewide intraLATA switched toll rate structure, and all the independent telephone companies except GTEC concur in Pacific's toll private line tariffs. The system of statewide average switched toll rates was mandated by D.74917; a comparable requirement was imposed on interexchange carriers by D.84-06-113. Local exchange carriers are allowed to maintain their own interLATA access tariffs, in accordance with D.83-12-024. GTEC and its affiliate GTE West Coast do so.

An elaborate system of intercompany revenue flows has evolved over time to sustain statewide average toll rates, as well as average access rates for those local exchange carriers which concur in Pacific's access tariff.

All California local exchange carriers except GTEC and Winterhaven Telephone Company (Winterhaven)[18] participate in an intraLATA switched toll pool and an intraLATA toll private line pool. The carriers pool their revenues and each carrier, including Pacific, receives its recorded costs of providing switched toll or toll private line service plus the switched toll or toll private

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18 Winterhaven has only one exchange and, though within California, is contained in an Arizona LATA. As the only California exchange within the Arizona LATA, Winterhaven has no California intraLATA toll tariffs.

line "pool" rate of return on its investment. Pacific and GTEC terminated their intraLATA switched toll and private line settlement agreements effective December 31, 1989. GTEC's termination and ongoing negotiations regarding cost support in 1990 and beyond are described shortly.

All California local exchange carriers except GTEC, GTE West Coast, and Winterhaven also participate in an interLATA access pool. Each local exchange carrier receives its recorded costs of providing intrastate interLATA access plus the access "pool" rate of return on its access investment.

There is also a "common pooled" surcharge applied to billings of intraLATA services of all local exchange carriers except GTEC, GTE West Coast, and Winterhaven, with the resulting revenues going to the interLATA access pool. Originated in D.85-06-115, this surcharge makes up for access settlement revenues lost due to the interLATA SPF-to-SLU transition.

Eleven local exchange carriers currently have Extended Area Service (EAS) cost recovery agreements with Pacific. Pacific pays each of the carriers the differential between the company's revenues and costs, including a return (Pacific's realized rate of return on its exchange services) on the company's EAS investment. Pacific and GTEC terminated their EAS agreement effective December 31, 1989. The fixed 1990 payment to GTEC from Pacific and negotiations for treatment subsequent to 1990 are described in later sections of this decision.

As a final piece of the settlements mechanism, the California High Cost Fund (CHCF) was first adopted in D.85-06-115 and later modified by D.88-07-022. This fund (not a pool) is funded by a uniform incremental amount (cents/minute) collected as a part of the CCLC in all interLATA switched access tariffs.

The CHCF is a mechanism by which certain local exchange carriers recover settlement revenues lost due to regulatory changes ordered by this Commission and the FCC, such as changes in

interstate high cost funding, interstate non-traffic sensitive cost assignments, changes in separations and accounting methodologies, and rate changes. To be eligible for CHCF funding, a local exchange carrier's one-party residence flat rate must equal 150 percent of Pacific's comparable rate.

D.88-07-022 excludes Pacific and GTEC from CHCF eligibility. All other local exchange carriers can receive 100 percent of their CHCF requirements for 1988 through 1990. The CHCF has a phase-down provision beginning January 1, 1991 whereby the amount of recovery from the CHCF is reduced to 80 percent of eligible levels in 1991, 50 percent in 1992, and 0 percent in 1993 for those local exchange carriers which choose not to initiate a general rate proceeding (either under General Order 96A or by a general rate case application) by December 31 of the previous year. The rationale for the phase-down provision is to ensure through a general rate review that a local exchange carrier has a genuine need for CHCF support.

B. Proposals for Modifying Current Arrangements

The November 22, 1989 Assigned Commissioner's Ruling stated a goal of finding a simpler approach (consistent with PU Code § 739.3) for assuring rate stability for high cost telephone companies which would be relatively insensitive to broader policy changes that the Commission may consider for the larger companies. To this end, CACD was instructed to convene workshops to discuss modifications or reforms to the pooling and settlements process.

The ruling also delineated related issues such as rate averaging requirements and concurrence in competitive intraLATA tariffs as within the scope of Phase III testimony and reply testimony, to be submitted in January and February of 1990. Some parties addressed settlements issues in both Phase III testimony and the workshops.

CACD scheduled and held workshops on March 29 and 30 and April 5 and 6, 1990, allowing parties to submit position statements

by March 1, 1990. DRA, TURN, and AT&T submitted such statements. Three additional submittals were made on March 15, 1990: a joint Consensus Position Statement by all California local exchange carriers, a separate Joint Position Statement by Pacific and GTEC, and a separate position statement by Pacific. The mid-sized local exchange carriers (Contel, Citizens, and Roseville) and Pacific also submitted a later Memorandum of Understanding signed April 4, 1990. In addition to these parties, MCI, Sprint, and the County of Los Angeles (LA) participated in the settlements workshop.

Following the workshops, CACD prepared a draft workshop report, participants reviewed the draft, and CACD prepared a final workshop report and filed it with the Commission with service on all parties in I.87-11-033.

In presenting the parties' proposals, the settlements workshops and related submittals are emphasized since they are more recent than Phase III testimony. Parties propose, variously, reconsideration of statewide average rate requirements, retention or modification of current pooling arrangements, replacement of pooling with either Originating Responsibility Plans or Designated Carrier Plans, elimination of the common pooled surcharge, and modification of the current high cost fund arrangements.

1. Uniform Statewide Toll and Access Rates

Most parties which address this topic support continuation of statewide uniform toll rates for local exchange carriers. In the Memorandum of Understanding, Pacific and the mid-sized companies state that statewide average toll pricing is desirable but may not be sustainable in a competitive environment. While recognizing that its rates should not differ markedly from Pacific's in order to be competitive, GTEC submits that statewide average toll rates should be an option rather than a requirement. In its view, local exchange carriers must have flexibility to establish their own toll rate structures as competition develops,

as well as the ability to implement optional calling plans to meet needs of their specific customers.

The smallest local exchange carriers assert that uniform statewide average toll rates are essential to maintain fairness and equity for rural and suburban customers, noting that rural customers make a higher percentage of toll calls and thus are more dependent on continued affordability of toll rates than are urban customers. Roseville fears that deaveraged toll rates would encourage abandonment or bypass of services where higher costs exist.

DRA notes that setting GTEC's (or smaller local exchange carriers') toll rates higher than Pacific's due to higher cost structures would stimulate such high cost companies to improve efficiency or risk competitive losses.

AT&T submits that with the introduction of intraLATA competition, it is unreasonable to compel any local exchange carrier to charge toll rates based on average costs not imposed on all competing carriers.

Few parties address or challenge the continued appropriateness in a new combined interLATA and intraLATA toll market of the current policy of allowing company-specific interLATA access tariffs. No party addresses potential imputation problems.

DRA supports company-specific cost-based access charges if feasible. CP National states that all local exchange carriers except GTEC should continue to participate in the present access pool, but that GTEC, even with a separate intraLATA access tariff, should continue to concur in Pacific's intraLATA toll schedule in a competitive intraLATA marketplace. Roseville submits that statewide average intraLATA access rates are needed to prevent what it sees as a potential tariff shopping problem.

Regarding interexchange carriers, Pacific, CP National, and Calaveras assert that all competitors should employ statewide average toll rates. Pacific submits that though competitors may

offer statewide rates, they can effectively deaverage their prices by selectively targeting their services to high-volume areas, thus disadvantaging Pacific. Roseville agrees that this requirement should be extended to competitors if it is imposed on local exchange carriers. MCI states that a geographic averaging requirement would not be harmful and in fact that such a requirement is probably not even needed, since it would be very costly to bill on a deaveraged basis. AT&T believes the Commission should encourage carrier-specific statewide average rates but allow carriers to propose deaveraged rates. CENTEX submits that regulation of interexchange carriers should be addressed in other appropriate proceedings, but suggests that if geographic deaveraging is adopted, deaveraging occur first for private line and private line-like services, especially discretionary ones.

2. Modified Pooling Arrangements

DRA recommends that the present switched toll, toll private line, and access settlement pools be maintained for the seventeen smallest local exchange carriers, but that any local exchange carrier which wishes to withdraw should be allowed to do so without any restrictions. DRA recommends that these local exchange carriers concur in Pacific's toll and access charges and either that the access pool be expanded to include intraLATA access or that a separate intraLATA access pool be created in order to distinguish access costs from switched toll costs more easily. DRA is concerned that aggregation of costs would make it difficult to effectively monitor service-specific costs and billings.

Roseville states that the toll pool should include all existing services, including operator and customer services, to ensure uniformity in services and rates for these services throughout the state. Pacific submits that when its intraLATA private line and special access tariffs are merged, costs and revenues for these services will need to be combined in a single pool.

In their Consensus Position Statement, the local exchange carriers propose that independent local exchange carriers other than GTEC retain an option to continue participation in existing pools, with local exchange carriers allowed to withdraw if they wish. Pool participants would continue to concur in Pacific's tariffs. The local exchange carriers propose placing intraLATA access in the intraLATA switched toll pool in order to avoid extensive and costly revisions to existing cost and separations study methodologies.

The local exchange carriers do not propose modifications to the toll private line pooling structure or EAS agreements in their statement but comment that changes may be proposed at a later date.

In their Memorandum of Understanding, the mid-sized companies and Pacific submit a proposal whereby funding for the mid-sized companies would be shifted from Pacific and the pooling process to a broader based funding source called the California Universal Network Access Fund (CUNAF). As one option (preferred by Roseville), each mid-sized company would be allowed to choose to remain in the current settlement pools during a transition period and concur in Pacific's toll and access tariffs. Settlement payments from the pools would be reduced over time and replaced with increasing payments from the CUNAF, with CUNAF payments fixed after the final transition year. Thereafter, the local exchange carrier could continue to receive reduced settlement payments or could choose to exit pooling entirely and rely exclusively on the CUNAF to fund its costs in excess of revenues.

In Phase III testimony, AT&T proposes that, if intraLATA switched toll competition is allowed, the intraLATA switched toll pool should be eliminated and only a unified intrastate access pool should remain. AT&T views this as a reasonable approach since it anticipates that local exchange carrier switched toll rates would be deaveraged and local exchange carriers would change rates more

often to respond to competition. It submits that an access charge pool would allow more efficient local exchange carriers to compete for toll services without the burden of providing cross subsidies to less efficient or higher cost companies. AT&T concludes that its approach would substantially reduce volatility and risk to the smaller local exchange carriers because access rates and revenues would be more stable than competitive switched toll rates.

GTEC opposes the portion of AT&T's proposal that intrastate access revenues be pooled by all local exchange carriers, stating that it does not participate in the access pool nor does it want to as a result of this proceeding.

Contel, Citizens, and Roseville oppose AT&T's proposal to eliminate the switched toll poll, arguing that this would place them at substantial risk for the contribution received from these services and for stranded investment, and would conflict with current policies to maintain statewide average toll rates and universal service. They point to proposals by Citizens and CP National in Phase III testimony, refined in the Consensus Position Statement, in which the smaller companies would be at risk for competitive price changes and for limited settlement revenue variations as a way by which pool volatility and CHCF funding requirements would be reduced. In their view, such steps would remove AT&T's major concern without eliminating the basic pooling arrangements currently in place. In workshop submittals, AT&T agrees that maintenance of switched toll pooling bears further discussion if modifications such as these were made.

3. Originating Responsibility Plans

Originating Responsibility Plans would compensate local exchange carriers involved in joint provisioning of intraLATA toll services, i.e., services originating in one local exchange carrier's territory and terminating in another carrier's territory.

Each local exchange carrier would bill on a bill-and-keep basis for originating MTS and WATS traffic and terminating 800

traffic, either concurring in Pacific's tariffs or establishing its own tariffs. The local exchange carrier would then compensate the other carriers for (1) transport and termination of jointly provided MTS and WATS traffic and (2) transport and origination of jointly provided 800 traffic, based on access tariffs.

A comparable arrangement for toll private lines is a "meet point" billing process, in which each local exchange carrier would bill the customer for that portion of the service it provides. For access services, local exchange carriers would simply bill on a bill-and-keep basis.

DRA believes the mid-sized local exchange carriers should be moved from the settlement pools to an Originating Responsibility Plan using Pacific's intrastate access charges. DRA also recommends that all EAS arrangements be replaced with Originating Responsibility Plans. DRA recommends that these changes occur on a flash cut basis and that local exchange carriers be authorized to recover any resulting incremental revenue requirement shortfalls from the CHCF.

In their Consensus Position Statement, the local exchange carriers propose that carriers not participating in the pools may file separate bill-and-keep access tariffs and may also request supplemental funding to meet their access charge revenue requirement. Additionally, individual local exchange carriers could negotiate specific arrangements with Pacific for transitional revenue support or other mechanisms as may be appropriate.

In their Joint Position Statement, Pacific and GTEC report that they are negotiating to establish an Originating Responsibility Plan based on premium access charges and to provide a transition from the fixed payment which GTEC will receive in 1990 from the switched toll pool, but have not yet agreed on the dollar amount of the transition support or the length of the transition. They are similarly negotiating an end to their intraLATA toll private line pooling and EAS cost recovery agreements.

GTEC's switched toll revenue for 1990 will be comprised of the 1990 fixed payment from the pool and end user switched toll billings, which GTEC will bill and keep. Beginning in 1991, the Originating Responsibility Plan being negotiated would apply to all intraLATA switched toll traffic between GTEC and all other local exchange carriers. During a transition period, the level of support payment that GTEC will receive from the pool would be phased down. GTEC's switched toll revenue during the transition period would be comprised of the phased-down payment, the net Originating Responsibility Plan access charge payments for jointly provided MTS, WATS, and 800 traffic, and its end user MTS, WATS, and 800 billings.

GTEC and Pacific would bill jointly provided private line services through a "meet point" billing arrangement. Because the process and procedures to implement meet point billing are complex and time consuming, GTEC's private line pooling support would remain fixed with no phase down until meet point billing can be implemented. During this period existing billing arrangements for jointly provided private lines would continue.

The framework being negotiated by Pacific and GTEC for compensation of interchanged EAS would essentially mirror an existing Originating Responsibility Plan arrangement currently effective for interchanged ZUM Zones 2 and 3 traffic. GTEC and Pacific plan to propose a modification to the ZUM agreement in the implementation phase, so that the CCLC rate element is included in the compensation calculation. Upon approval of this proposal, GTEC and Pacific would flash cut to an Originating Responsibility Plan for EAS. In the meantime, effective January 1, 1990, Pacific began paying GTEC a fixed amount to compensate for interchanged EAS traffic.

In its Phase III testimony, GTEC discusses the current negotiations. It submits that continued pooling of toll and private line revenues and costs between GTEC and Pacific is not

sustainable in a competitive environment, stating that the two companies face varying degrees of competitive entry and have differing customer needs, differing cost structures, and differing strategic objectives for responding to competition. GTEC concludes that a continuation of pooling arrangements would frustrate the companies' efforts to position themselves to react to an increasingly competitive environment. GTEC reports that its 1989 net switched toll and toll private line settlement revenues were $195 million, which equates to a contribution of $5.33 per month per GTEC customer line, and proposes a gradual phase out of the toll settlement flows so that usage growth could offset part of this impact.

GTEC wants the toll transition to last at least four years (mentioning a period as long as seven years in its Phase III testimony), and expects to recover revenues formerly coming from pooling through Z factor adjustments in its price cap index.[19] DRA is opposed to recovery of these revenues from ratepayers, on the basis that the negotiated transition payment has not been adopted by the Commission and thus may not be considered for inclusion in the Z factor. GTEC takes the opposite position that D.89-10-031 explicitly holds that revenue impacts from changes to intraLATA pooling arrangements should be reflected in price cap adjustments (D.89-10-031, mimeo. p. 182). TURN states that GTEC should recover these lost revenues not from ratepayers but from increased efficiency.

19 The Z factor is an element in the rate adjustment formula adopted for Pacific and GTEC in D.89-10-031. It is the annualized dollar effect of authorized cost changes outside a utility's control and not accounted for in either the inflation or productivity factor.

Pacific believes the payments to GTEC from the toll pool should end by 1993, and wants to target its own resulting cost reductions to lower toll rates.

In the Memorandum of Understanding, the mid-sized companies and Pacific state that each mid-sized company should be allowed to elect to exit the settlements pools. In place of intraLATA switched toll pooling, the local exchange carrier could choose either an Originating Responsibility Plan or a Designated Carrier Plan (described below). In place of intraLATA private line pooling, the carrier would establish an intraLATA special access arrangement. In place of the access pool, the local exchange carrier would bill and keep for access services, either concurring in Pacific's tariffs or establishing its own access tariffs. Settlements payments would be replaced by contract payments from Pacific, with the contract payments reduced over time and offset by increasing payments from the CUNAF. CUNAF payments would change as traffic volumes and costs change, so that reasonable rates can be maintained.

In its Phase III testimony, AT&T suggests in conjunction with its recommendation that the switched toll pool be eliminated that all local exchange carriers be required to either offer switched toll services through Originating Responsibility Plans or, alternatively, go to a Designated Carrier Plan. In AT&T's Originating Responsibility Plan proposal, each local exchange carrier would be responsible for its own switched toll costs, with no funding source such as the CHCF or the CUNAF. In reply testimony, Contel, Citizens, and Roseville oppose AT&T's proposal. Since the Memorandum of Understanding signed by these three companies contains similar Originating Responsibility Plan and Designated Carrier Plan provisions, their opposition appears to be due primarily to the mandatory aspects as well as the lack of high cost funding in AT&T's proposal.

4. Designated Carrier Plans

In their Memorandum of Understanding, the mid-sized companies and Pacific state that each mid-sized company should be allowed to elect to exit the settlement pools, participating in a Designated Carrier Plan rather than an Originating Responsibility Plan for intraLATA switched toll service.

In a Designated Carrier Plan, the local exchange carrier could pick any carrier to be the designated switched toll carrier; however, Pacific agrees to be the designated carrier of last resort. The retail relationship between the local exchange carrier and its customers would not change: the company would continue to bill its customers for service (at the designated carrier's tariffed rates). The local exchange carrier would remit all revenue to the designated carrier, would receive intraLATA access revenues at its own tariffed rates from the designated carrier, and would perform billing and collection and operator services under separate contract to the designated carrier. As in an Originating Responsibility Plan, settlements payments would be replaced by contract payments offset over time by increasing CUNAF payments.

CACD states that Contel and Citizens propose a Designated Carrier Plan arrangement. Citizens contemplates exiting from the toll pool effective January 1, 1990, with an eight-year transition from contract payments to the CUNAF. Citizens proposes to concur in Pacific's originating interLATA access tariff, but file terminating access charges that are 150 percent of Pacific's. Contel is negotiating a five-year transition beginning January 1, 1993.

In the workshops, DRA stated its willingness to accept Designated Carrier Plans in place of Originating Responsibility Plans as a way to allow companies to leave the pools. AT&T likewise sees Designated Carrier Plans as being acceptable alternatives if a local exchange carrier chooses not to provide switched toll services through an Originating Responsibility Plan.

In its view, the designated carrier would be allowed to allocate resulting switched toll expenses to the access pool.

5. Elimination of Common Pooled Surcharge

DRA believes that the common pooled surcharge should be eliminated as soon as possible, by conversion to a bill-and-keep surcharge. DRA recommends that the local exchange carriers (excluding Pacific) which participate in the common pooled surcharge be allowed to recover the revenue requirement shortfall which would result from movement to a bill-and-keep basis from the CHCF and that Pacific be required to reduce its billing surcharge commensurately.

6. Changes to High Cost Fund

The local exchange carriers propose to change the name of the CHCF to the California Universal Service Fund, to reflect its universal service objectives. The mid-sized companies and Pacific propose in the Memorandum of Understanding that an additional fund, the CUNAF, be established to replace pool funding for the mid-sized companies' excess costs of providing toll and access services.

a. Costs Eligible for High Cost Fund Support

DRA recommends that current CHCF arrangements be maintained for the seventeen smallest local exchange carriers, except for certain modifications. The CHCF would also be available to the mid-sized companies to the extent revenue requirement shortfalls exist due to movement to an Originating Responsibility Plan for switched toll and EAS and meet point billing for toll private line services, or due to elimination of the common pooled surcharge. Under DRA's proposal, a local exchange carrier which is eligible for but does not request CHCF support would be allowed to accrue its yearly CHCF support and request such CHCF entitlements in the future if the need arises, subject to the phase-down conditions.

In Phase III testimony, Roseville submits that CHCF funding should be available if local exchange carrier traffic falls

so that toll costs are not covered. It further states that separate funding should be provided, either through the CHCF or otherwise, to local exchange carriers which can document stranded investment due to intraLATA competition or above-average costs associated with carrier of last resort obligations.

In their Consensus Position Statement, the local exchange carriers state that D.89-10-031 provided that the local exchange carriers would be eligible to recover the impacts of expansion of local calling areas, elimination of Touch Tone rates, and rate design changes occurring in the implementation phase of this proceeding through the CHCF mechanism. While they envision that the impact of any Commission-authorized changes in Pacific's toll rate ceilings would likewise be covered by the CHCF, the local exchange carriers state that with competition and pricing flexibility they would be willing to absorb revenue impacts if Pacific adjusts its toll rates between the ceilings and floors (subject to reexamination if this results in substantial negative revenue impacts or if the potential for volatility is extreme). Further, they propose that impacts of other regulatory actions affecting Pacific would not qualify for CHCF recovery unless the impacts exceed $10 million in pool revenues per event or $25 million cumulative for a 12-month period preceding the October CHCF advice letter filings each year.[20] The carriers make these proposals as an avenue to reduce sensitivity of the pooling process to regulatory decisions, thus meeting stated objectives without creating a new and entirely untested alternative to the pooling process.

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20 Citizens and CP National suggested similar modifications, though with less specificity, in their January 1990 Phase III testimony.

In response to the consensus paper, DRA is concerned about the interplay between impacts of toll rate ceiling changes (proposed for CHCF funding) and rate changes between the ceilings and floors (proposed to be absorbed), and is also concerned about increased monitoring and advice letter review requirements.

In the Memorandum of Understanding, Pacific and the mid-sized companies propose that funding for the mid-sized companies' switched toll, toll private line, and access services currently received through pooling be recovered instead from a second high cost fund called the CUNAF. Citizens stated in the workshops that it assumes that settlement impacts of rate design changes resulting from the implementation phase would also be covered by the CUNAF. For mid-sized companies electing to remain in the pools, CUNAF payments would be capped after the transition period at the final year entitlement. If a local exchange carrier exits the pools, CUNAF payments would be indexed by access line growth and the Gross National Product Price Index minus a 2 percent productivity factor. LA questions the assumed 2 percent productivity level; AT&T submits that the Commission should determine whether this reflects a company's true costs.

Some smaller local exchange carriers also raise the possibility of an additional rate of return "backstop" to provide additional protection from adverse impacts of competition-related changes in the regulatory framework.

b. Funding Sources

The local exchange carriers, AT&T, and DRA agree that the CHCF funding base should be broadened, based on the view that the need for CHCF support will increase in the future due to revenue effects of pending Commission actions (ZUM expansion, expanded local calling areas, elimination of Touch Tone rates and charges, intraLATA competition and possible access and toll rate reductions, and implementation phase actions).

In Phase III testimony, AT&T recommends that CHCF funding be expanded to include all local exchange carrier and interexchange carrier end user services except lifeline, as a more equitable funding mechanism to derive support from all users that benefit from maintenance of high penetration levels in high cost areas.

Local exchange carriers propose that CHCF funds be derived from a uniform end user billing surcharge on all intraLATA and interLATA toll services (the same services subject to surcharge under the Moore Universal Telephone Service Act). In the workshops, AT&T supported this proposal. Pacific filed extensive comments following the workshops on the desirability of such a surcharge instead of the current CCLC increment approach.

DRA recommends that the CHCF funding base be expanded to include intraLATA switched toll and access services (when established), with the current method of an increment on the CCLC continued for switched access charges and imputation of the CCLC increment in local exchange carrier switched toll rates. DRA recommends that the expanded CHCF funding base not include local exchange, EAS, and ZUM Zones 2 and 3 services because, it asserts, such inclusion would defeat the aim of the CHCF to ensure that local exchange rates are maintained at reasonable levels to promote universal service. DRA states that a fee on the CCLC is easier to collect from resellers than a billing surcharge would be.

LA proposes a flat per line end user charge (e.g., $0.05 per line) to fund the CHCF.

According to the Memorandum of Understanding, the CUNAF would be funded by an increment on the CCLC element of interLATA and intraLATA switched access charges, with imputation in local exchange carrier switched toll rates.

c. Review of Companies Requesting Support

Parties disagree over the need and frequency for review of companies drawing on high cost funds.

In their consensus paper, the local exchange carriers propose a two year delay, to December 31, 1992, before the CHCF phase down would be initiated. The local exchange carriers contend that there is far too much uncertainty to be able to put together a reasonable test year, due to factors such as the upcoming implementation phase, expansion of local calling areas, elimination of Touch Tone charges, impacts of the new regulatory framework for Pacific and GTEC, and potential effects of intraLATA competition.

DRA would consider a one year delay, beginning the phase down on January 1, 1992. DRA further suggests the phase-down provision repeat on a five year cycle, in order to provide added incentive for local exchange carriers to initiate general rate proceedings and to ensure that withdrawals from the CHCF are not perpetually made by companies with excessive earnings. This concern is shared by AT&T and LA. AT&T notes that the mid-sized companies have an annual financial attrition review, but that there is nothing similar for smaller companies. AT&T suggests a mandatory continuing periodic review to determine a local exchange carrier's need to draw upon a high cost fund.

The local exchange carriers oppose reinitiation of the phase-down provision to limit future CHCF funding following a rate review, on the basis that circumstances six years in the future are not currently predictable. They submit that the Commission can take appropriate action in 1996 or later if circumstances at that time indicate the advisability of further rate filings.

The Memorandum of Understanding states that the proposed CUNAF payments would not be subject to either a phase-down or a sunset provision because the intent is to cover costs of providing toll and access services on an ongoing basis. In the workshops, Contel and Citizens asserted that this would provide them the rate stability needed to exit the pooling environment. DRA, AT&T, and LA object to the CUNAF's failure to require periodic

earnings review; DRA proposes alternatively that funding come from the CHCF, retaining the phase-down provision.

C. Discussion

To implement on a statewide basis the new framework for intraLATA competition adopted today, we need to either decide or at least lay out steps which will be undertaken to decide the following issues:

-Should local exchange carriers be required to maintain statewide average toll rates? If so, should statewide average access rates be required as well? Should interexchange carriers similarly be required to offer statewide average toll rates?

-What on-going support should be provided for the higher costs of companies other than Pacific? Should distinctions be drawn for GTEC, the mid-sized companies, and the smallest companies?

-What should be the source of that support?

-How much risk should each of the companies other than Pacific and GTEC bear regarding its costs?

-To what extent should cost support be tied to overall company profits? Should current CHCF phase-down provisions be modified in any way?

1. Statewide Average Toll and Access Rate Structures

Most parties support continuation of statewide average switched toll rates for both local exchange carriers and interexchange carriers, though some such as GTEC and AT&T submit that statewide average switched toll rates should be an option rather than a requirement.

In exploring potential ramifications of relaxing current requirements that statewide average switched toll rates be maintained, we note first that the least relaxation of current policies would be to allow each local exchange carrier to establish

separate intraLATA switched toll tariffs, while maintaining current policies which allow company-specific access tariffs and require each interexchange carrier to maintain uniform rates wherever it provides service. Let us examine that option.

Assuming for discussion purposes that GTEC's access charges and switched toll rates were set higher than Pacific's (a situation that appears likely given knowledge about GTEC's and Pacific's relative costs) and that interexchange carriers face cost structures that do not vary significantly between Pacific's and GTEC's service territories, an interexchange carrier's statewide average switched toll rates would be more competitive with GTEC's rates than with Pacific's rates and its profit margin would be less for service to customers in GTEC's territory than for service in Pacific's territory. While, as MCI notes, interexchange carriers may wish to maintain average rates due to marketing and billing considerations, such a situation would undoubtedly increase pressures to allow interexchange carriers to deaverage their own switched toll rates so that they could compete effectively in each of the local exchange carriers' territories.

A decision to allow deaveraged interexchange carrier switched toll rates would create further deaveraging pressures. Would we allow only a bifurcated interexchange carrier rate structure, with different rates for customers in Pacific's territory and in GTEC's territory? What about traffic between the two local exchange carriers' territories? We can easily see how this step would lead to broader geographic deaveraging, which would then create pressures to allow Pacific and GTEC to each deaverage its own switched toll rates.

While it may be possible to develop separate switched toll rate structures for Pacific and GTEC in a manner that would allow continuation of statewide average interexchange carrier rates and thus control this deaveraging spiral at least for a time, we must be aware of the indicated direction and the resulting erosion

in our ability to impose geographic pricing restrictions once the deaveraging barrier is breached.

It is certainly plausible that allowing Pacific and GTEC to establish separate switched toll tariffs would create a strong incentive for GTEC to lower its rates to maintain its competitive position within its own service territory. This could be done in at least two ways: cutting its costs of providing switched toll and access services, or moving a portion of the non-traffic sensitive local exchange costs currently allocated to interexchange services elsewhere. Cost cutting would be a desirable outcome.[21] Further, overall reductions in the non-traffic sensitive costs embedded in switched access and toll rates might also be a worthwhile objective. However, we prefer that such steps be taken with full regulatory control on a coordinated basis for both utilities rather than through steps initiated by Pacific or GTEC individually.

We reiterate our commitment to maintenance of affordable basic exchange and toll rates throughout California, not just in low cost areas. In the implementation phase we must grapple with a major restructuring of toll, access, basic exchange, and other rates. There and on an ongoing basis we must strike a balance between more cost-based rates, to encourage economic efficiency, and derivation of contribution to fixed network costs, to maintain universal service goals. We must also consider the administrative feasibility of providing adequate regulatory oversight of multiple geographically deaveraged toll tariffs. We are confident that, with maintenance of statewide average switched toll rates, our regulatory goals can be properly balanced. However, because of

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21 A company could also attempt to "hide" service costs through cost misallocations; hopefully our auditors would detect any such regulatory abuses.

uncertainties regarding containment of rate increases in high cost areas, we are not willing to start down the road to geographic switched toll deaveraging at this time. Just as we took a cautious approach in D.84-06-113 in choosing to limit intraLATA competition until ramifications of divestiture and interLATA competition were better known, we conclude today that statewide average intraLATA switched toll rates should be maintained for each interexchange carrier and on a coordinated basis for local exchange carriers as a whole at this time. As Roseville points out, the local exchange carriers will essentially function collectively as a single interexchange carrier. After experience is gained in a competitive intraLATA market, we may well revisit this issue.

We look now at whether the current policy of allowing local exchange carriers to maintain company-specific interLATA switched and special access charges should be extended to the intraLATA arena. It is not clear to us, and unfortunately no party addresses how such access charges would be set relative to statewide uniform switched toll rates nor in particular how the imputation requirement adopted in Phase II would be applied. No party takes issue with the current policy which has allowed GTEC and GTE West Coast to implement interLATA access tariffs which differ from Pacific's.

As Contel points out, deaveraged intraLATA access charges would bring greater pressure to deaverage switched toll rates than exists currently with competition limited to interLATA services. The current requirement that interexchange carriers maintain statewide average interLATA toll rates has the practical effect of spreading GTEC's higher access rates over interexchange carrier customers statewide. While this situation may encourage interexchange carriers to concentrate on markets in Pacific's territory, to the extent interLATA competitors market statewide they all face the same access rate structures. (This analysis applies on an interstate basis equally well.)

Such would not be the case under intraLATA competition, due to the addition of local exchange carriers as competitors. In a competitive market in which interexchange carrier rates are uniform without respect to LATA boundaries, Pacific would receive a relative competitive advantage (assuming current access charge differentials) because it, unlike the interexchange carriers, would not market in GTEC's territory and would not incur GTEC's higher access charges for services rendered in GTEC's territory.[22] Thus, all else being equal, Pacific could undercut interexchange carriers' statewide average switched toll rates while complying fully with the Phase II imputation principles. Such a situation could well trigger a deaveraging spiral extending to toll rates.

Through D.83-12-024, GTEC and GTE West Coast were allowed to establish separate switched and special access tariffs to be effective with divestiture on January 1, 1984. In that decision, the Commission recognized benefits of company-specific cost-based access charges, but also that there was insufficient time prior to divestiture to consider multiple access filings for all companies. In light of GTEC's testimony that it was similarly infeasible for GTEC to develop separate interstate and intrastate access tariffs within that time, the Commission approved the concurrence of all independent telephone companies except GTEC and GTE West Coast in Pacific's access tariffs but permitted GTEC and GTE West Coast to implement their own access tariffs. The Commission also allowed other companies to establish company-specific cost-based tariffs with two caveats: "so long as this does not disadvantage the general body of ratepayers or impose inordinate administrative burdens on our staff."

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22 As Pacific notes in its comments on the ALJ's proposed decision, Pacific would, however, pay GTEC access charges for intercompany calls terminating in GTEC's territory.

While the Commission and our staff have successfully managed oversight of access tariffs since that time, both of these earlier concerns would be magnified with intraLATA competition if local exchange carrier toll rates were deaveraged. Because of this, we do not see the policy of company-specific interLATA access tariffs as inviolable or automatically applicable on a combined intraLATA and interLATA basis.

Because we decline to allow deaveraged switched toll rates at this time and because company-specific intraLATA switched and special access charges could create competitive pressures to reverse this policy, we tentatively conclude that with the advent of intraLATA toll competition all local exchange carriers should be required to maintain unified statewide switched and special access tariffs. While Pacific and GTEC currently maintain separate toll private line tariffs, the move to consolidate toll private line and special access tariffs implies that statewide average toll private line tariffs may also be appropriate for all local exchange carriers. Parties should address the issue of statewide average switched and special access and toll private line tariffs in testimony to be submitted later this year, as described in Section VIII.C.2.

We are fully cognizant that imposition of statewide average local exchange carrier toll rates and access charges carries with it some relative competitive disadvantages for local exchange carriers: they lose some amount of pricing flexibility in responding to competition and lower cost companies might be burdened by rates not reflective of their costs. We do not take these steps lightly, and note that any negative effects are mitigated somewhat by our allowing creation of discount switched toll plans for high volume customers, as discussed in Section V.C.5 of this decision. To the extent relative competitive disadvantages remain due to statewide average rates, we see them as part of the overall regulatory package (balanced by factors such as prohibition

of presubscription at this time) adopted today which supports level playing field competition while protecting basic ratepayers.

Derivation of statewide local exchange carrier toll and access tariffs is discussed in the next subsection.

2. Cost Support for High Cost Local Exchange Carriers

There are several basic ratemaking approaches, as well as numerous permutations, by which statewide average toll and access rates can be maintained, imputation standards adopted in Phase II met, and protection afforded to high cost companies. In deciding among them, we consider potential ramifications on the competitive market, local exchange carrier risk, and efficiency incentives.

Goals should include simplicity and funding stability. A funding method which puts local exchange carriers at some risk would be desirable because it would encourage efficient operations. The funding should also come from a broad source, as long as this is consistent with goals of encouraging economic efficiency and does not adversely affect competitive markets.

As a prelude, it is helpful to examine the current subsidy systems. The following table summarizes the current system.

Service	Subsidy Recipients	Source of Subsidy
Switched toll, private line	All but Pacific, Winterhaven	Pacific's switched toll, private line rates
InterLATA access	All but Pacific, GTEC, GTE West Coast	Pacific's access, flowed through to statewide interLATA toll; all Pacific intraLATA services (through pooled surcharge)
	GTEC, GTE West Coast	InterLATA toll of customers in Pacific's territory (due to reflection of their higher access charges in statewide average interLATA toll rates)
EAS	12 carriers	Pacific

In addition, the CHCF (funded through the CCLC) is being tapped for $14.9 million in 1990 for six companies to cover settlements shortfalls due to regulatory actions.

Regarding local exchange carrier risk under the current subsidy structure, it is minimal for the independent companies participating in the pools and EAS cost recovery agreements: they see essentially cost-plus revenues, with the only uncertainty being the rates of return. Since the costs of each of these local exchange carriers are a relatively small portion of each pool, the individual local exchange carrier's actions do not materially affect the rate of return. Further, the individual local exchange carrier has no effect on the EAS rate of return. This mismatch between responsibility and risk does not provide a strong incentive to operate efficiently in providing these services.

Since GTEC receives a fixed payment in 1990 to support its toll costs, it is at risk that this amount may or may not match its actual costs. This approach should improve GTEC's efficiency incentives. Since GTEC does not participate in the interLATA access charge pool, it is similarly at risk for its access revenues.

Parties propose the following types of shifts in contribution in this proceeding.

Proposal	Subsidy Shift
Maintain pooling for smallest carriers	No shift
CUNAF	Subsidy of mid-sized carriers' toll and access shifted from Pacific's toll and access to statewide access services
Broaden CHCF funding	From interLATA access to all interexchange rates, or at least to intraLATA as well as interLATA access

Higher access charges for carriers exiting pools	Subsidy of mid-sized carriers' access shifted from Pacific's access and hence all statewide toll directly to statewide toll rates
GTEC phase out from toll pool	From Pacific's toll rates to GTEC's rates

Our first reaction is that this multitude of proposals, with one treatment for the seventeen smallest local exchange carriers, three options for the mid-sized carriers, and yet another approach for GTEC, with creation of a second high cost fund and with several of these proposals accompanied by multi-year transition periods, if adopted as a package would greatly complicate rather than simplify the settlements process. While simplification is not of sufficient importance to automatically override other important regulatory goals, we are disappointed that the settlements workshops could not produce a consensus recommendation to meet this goal.

The various proposals carry with them different risk profiles and different levels of efficiency incentives. The proposal that pooling continue for the smallest local exchange carriers would simply continue the low risk and efficiency incentives associated with the current pooling arrangements. On the other hand, fixed payments based on forecasted costs, as contemplated in proposals regarding the mid-sized companies and GTEC, would put carriers at risk in that the company would profit if costs are contained below the forecast but would bear revenue shortfalls if costs are excessive. It also increases risks due to volatility of demand and costs.

Local exchange carriers currently receive funding from the CHCF based on forecasts of eligible settlements effects. It is not entirely clear whether the local exchange carriers envision the CUNAF funding to be set on a forecasted basis or whether it would retain some of the cost-plus aspects of the current pooling arrangements. We note that high cost funding based on forecasted

costs would be more in keeping with our goal of encouraging economic efficiency.

Some of the proposals would shift contribution to a broader range of services, e.g., the local exchange carriers' proposal that CHCF funding be obtained from all interexchange services. Such proposals could run counter to goals of economic efficiency and level playing field competition, at least to the extent that local exchange carrier costs of providing competitive toll services would be allocated to other services.

We must be wary that allocating costs of providing a particular service, whether toll or access, to other services which are competitive or partially competitive could exacerbate uneconomic bypass problems for those services. (We are well aware that geographic cost averaging itself can exhibit this shortcoming. However, maintenance of statewide average rate requirements for both interexchange and local exchange carriers should significantly counteract any such problems.) We also note that moving non-traffic sensitive local exchange costs from toll and switched access services to local exchange services could enhance economic efficiency as rates become more cost based.

We look next at the suggestion that local exchange carriers might institute terminating access charges higher than Pacific's, as a way to fund a portion of their higher revenue requirements. We have already tentatively determined that company-specific access charges should not be allowed at this time, because of concerns about switched toll rate deaveraging. While the effect of the mid-sized companies' access charges (however high they might be set) on interexchange carriers' rates may be de minimis, we see no benefits to this proposal to justify granting this request.

The phase-down provision of the CHCF troubles the local exchange carriers, with the mid-sized companies emphasizing in particular that the proposed CUNAF funding, like pooling, should operate independently of overall earnings levels.

We find interesting DRA's submittal of rates of return earned by the smaller companies in 1989, ranging from about 9 percent to a high of 31.47 percent. DRA reports that, of the twenty companies (excluding Pacific and GTEC), nine earned rates of return over 15 percent in 1989; at least sixteen of the twenty earned in excess of their authorized rates of return. Many of these companies have not had rate reviews since the early 1980s.

Without detailed information on the reasons for these earnings levels, on their face the numbers imply that the current web of support, including the settlements pools, the common pooled surcharge, EAS cost recovery agreements, the CHCF, and the federal high cost fund, have overshot their intended mark, at least in 1989, which was to protect these companies' ratepayers by providing reasonable affordable telephone service in rural and high cost areas.

While we cannot reach conclusions at this time regarding reasonable profits for the smaller local exchange carriers, this information implies that support for local exchange carriers' toll and access services should not be determined independently of broader earnings issues. On this basis, it appears that the local exchange carriers' proposal for automatic CUNAF funding without a requirement of periodic earnings review is unreasonable. While the pooling process has likewise operated independently of overall earnings or operations reviews, we do not see this as sufficient reason to continue or expand such an approach.

Nor do we see any rationale for setting up two separate funds to handle two different aspects of settlements changes. The CHCF as currently constituted covers settlements revenues lost due to regulatory changes; modifications to the pooling process itself certainly fits such categorization. To add a second fund would run counter to our goal of simplifying the settlements process. Further, the issue of linkage with review of the local exchange

carriers' operations exists for all high cost funding and should be considered on that basis. The mid-sized local exchange carriers appear to draw a distinction because in their view a decision to leave the pools should strictly be voluntary; as a result, they argue, the earnings security in the proposed CUNAF is needed in order for them to voluntarily exit the pools.

We do not share these companies' apparent view that they have an inherent right to the high level of protection from risk embodied in the current pooling process; instead, these local exchange carriers, or at least California ratepayers, would likely benefit from insertion of additional risk and efficiency incentives in their regulatory frameworks since the same arguments regarding the benefits of risk in enforcing efficient operations and thus protecting ratepayers which support the new regulatory framework adopted in D.89-10-031 for Pacific and GTEC apply similarly to the smaller local exchange carriers.

In keeping with this view, we believe the time has come to consider whether the entire subsidy framework cushioning the higher cost local exchange carriers should be revamped. To this end, we propose the following system for setting statewide average local exchange carrier switched toll, toll private line, and access rates and charges and for providing contribution to GTEC and other higher cost companies. Since some aspects of this proposal have not been fully explored in the parties' Phase III testimony or in the settlements workshops and related submittals, further opportunity will be given to address this proposal through testimony and hearings. We will require by further ruling that parties submit testimony later this year presenting positions on the following proposal and any alternative proposals (including possible continuation of current procedures) they might have.

a. GTEC

Much of the package which Pacific and GTEC are negotiating appears to be acceptable, based on information they

have provided in this proceeding. However, in order to ensure that universal service goals are met, we conclude in Section IV.F that any phase-down of GTEC's cost recovery from statewide toll rates should be accomplished only with our oversight and approval. With this approach, any approved reduction in contribution would be eligible for recognition through the Z factor in GTEC's price cap indexing mechanism, as contemplated by GTEC.

We agree with the overall concept that compensation to GTEC should be determined on a forecasted basis rather than derived through cost-plus pooling. As a result, it appears reasonable that GTEC and Pacific should move to an Originating Responsibility Plan for EAS and switched toll services, and to meet point billing for private line services, with fixed payments from Pacific to GTEC for the forecasted amount by which statewide average rates will overcompensate Pacific and undercompensate GTEC.

We propose that statewide average switched access rates and toll floors and ceilings be set based on Pacific's and GTEC's costs (including anticipated pooling disbursements to other independent companies). (Whether specific rates or instead rate floors and ceilings are established for low speed special access and private line services will depend on whether competition is authorized for these services, as discussed in Section VI.B.) Parties should address this issue in their testimony and also how decisions would be made regarding pricing of flexibly priced toll and access services, e.g., by Pacific alone or by Pacific and GTEC on a coordinated basis.

In its comments on the ALJ's proposed decision, GTEC raises concerns about the method by which the statewide average toll rate structure would be set in the implementation phase and updated subsequently through application of price indices, as well as the method by which compensation between GTEC and Pacific would be determined. GTEC questions whether Pacific's or GTEC's price cap index would be applied to update toll rate caps and how any

potential revenue differences arising from differences in the company-specific price cap indices would be handled.

GTEC is also concerned about how compensation between Pacific and GTEC would be set, and suggests that the initial level of compensation should be based upon a comparison of revenues actually received by Pacific and GTEC in 1990 compared to revenue that each company would receive had the new statewide average rates been in effect in 1990. Once the payment is initially set, GTEC suggests that it be adjusted prospectively by the price cap index or through a Commission-approved rate rebalancing plan.

Parties should address GTEC's concerns in their testimony to be submitted regarding settlements issues.

b. Other Independent Local Exchange Carriers

For the twenty other local exchange carriers, we propose a two step regulatory framework. Pooling would be continued for now for all twenty companies (with GTE West Coast and Winterhaven participating in the access pool), with certain minor changes made to adapt the existing pooling process to meet current conditions. However, the emphasis would be on a complete revamping which would be phased in as soon as administratively feasible.

With the advent of intraLATA competition, placement of intraLATA access charges must be determined for pooling purposes. We propose, for administrative ease, that intraLATA access costs and revenues be included in the existing intraLATA switched toll pool, with the existing interLATA access pool continuing as currently structured. We solicit testimony on Roseville's proposed inclusion of operator services and customer services in the pooling process, as well as on Pacific's concerns regarding the private line/special access overlap between the pools if these tariffs are combined.

We see no need to change the name of the existing high cost fund as proposed by the local exchange carriers.

However, we agree with them that the settlements effects of any rate design changes authorized in the implementation phase, like changes adopted in Phase II, would be eligible for CHCF treatment, since the CHCF was established for such purposes. We propose adoption of the provisions in the Consensus Position Statement that would require the smaller local exchange carriers to absorb revenue impacts of movement within rate ceilings and floors for local exchange carrier toll services and that would set minimum thresholds on settlements revenue impacts below which CHCF funding could not be invoked, because these limitations would reduce the sensitivity of the pooling process.

The local exchange carriers have a valid point regarding timing of future rate reviews. We today lay out policies which will lead to a significant restructuring of rates in the implementation phase in this proceeding. As a result, we reluctantly agree that commencement of their rate cases before that restructuring is effected is probably impractical. As a result, we would entertain petitions for modification of D.88-07-022 to suspend the phase-down provisions of the CHCF.

While we propose that current pooling arrangements for these companies be continued on an interim basis until general rate cases (or advice letters) can be processed following the implementation phase, we propose one additional restriction to the CHCF in the interim: that funding be limited to an amount forecasted to allow the local exchange carrier to earn its authorized rate of return on overall intrastate operations, perhaps in a simplified manner consistent with that applied to Pacific and GTEC in D.89-12-048. In addition to commenting on this proposal in their testimony, parties should recommend how this restriction should be implemented, i.e., by what calculations the needed amount of CHCF funding should be determined.

We envision the current pooling process as continuing only as long as necessary until an alternative can be created and

phased in. The following is our proposal, put forward for parties' comments, regarding a replacement mechanism:

- Each local exchange carrier (other than Pacific and GTEC) shall be eligible to receive funding from the CHCF subject to the following conditions:
  - Its flat rate residential rate is at least 150 percent of Pacific's. In prepared testimony, parties should comment on whether this criterion should be modified to reflect suburban rates.
  - The Commission has found through a general rate proceeding that such funding is needed in order for the local exchange carrier to earn its authorized rate of return.
- The CHCF funding level for a local exchange carrier will not be based on service-specific rates and revenues, but rather will be determined by the Commission to be the overall contribution needed in order for the local exchange carrier to earn its authorized rate of return on intrastate services as a whole.
- The amount of funding from the CHCF will be set on a forecasted basis rather than on a recorded cost-plus-return basis. In testimony, parties should propose how this amount would change in years following a general rate review, e.g., along the lines of a price cap formula or based on anticipated growth and/or with phase-down provisions such as currently in place.
- Because the proposed CHCF will contribute to high costs on a company-wide rather than service-specific basis, the CHCF will be funded through a surcharge on all local exchange carrier end user services to which surcharges normally apply, except lifeline, and to all interexchange carrier end user services.

In their testimony, parties shall propose a method and schedule for phasing in this approach, based on an assessment of a reasonable schedule within which to process rate cases and advice filings for these companies, with priority given to companies earning significantly above their authorized rates of return and/or currently receiving CHCF funds.

The mid-sized companies' proposals contemplate a transition period between pooling arrangements and CUNAF funding. It is not clear to us why a transition period would be needed. In their testimony, parties should address whether a need exists to phase from a recorded cost-plus-return pooling process to forecasted CHCF funding after a local exchange carrier's operations have been reviewed through a general rate case or an advice letter filing. Unless parties bring forth compelling arguments otherwise, we see a flash-cut move to forecasted CHCF funding as being more consistent with our goal of simplifying the settlements process.

Parties should also address for Commission consideration whether Originating Responsibility Plans, Designated Carrier Plans, or perhaps other alternatives should replace current pooling arrangements.

c. Common Pooled Surcharge

Because of the broad rate rebalancing policies adopted today, we propose that Pacific's revenues from the current common pooled surcharge should be incorporated into its overall rate design, in a method to be determined in the implementation phase, rather than obtained through a bill-and-keep surcharge as contemplated by DRA. We tentatively agree with DRA, however, that other local exchange carriers should retain their common pooled surcharge as a bill-and-keep surcharge pending their next rate proceedings and that any revenue requirement shortfall should be eligible for CHCF recovery during that period. Parties should address this proposal in their testimony on settlements issues.

IX. Pricing and Regulation of Interexchange Carriers' IntraLATA Services

Several parties, including AT&T, MCI, CALTEL, MFS, and Mtel, are of the opinion that interexchange carriers should receive the same pricing flexibility for intraLATA services for which competition is allowed as they enjoy in their interLATA operations. CP National joins in this view, but with the caveat that the five-day advice letter notice period should be lengthened.

CENTEX sees no need for reconsideration in this proceeding of interexchange carriers' regulatory frameworks, beyond consideration of removal of intraLATA entry barriers, and recommends that all other aspects of interexchange carrier regulation be addressed in other appropriate proceedings.

Most parties, including AT&T itself as well as DRA, Citizens, CP National, MCI, CALTEL, and Mtel, envision that AT&T's current interLATA regulatory restrictions, imposed because of its position as the dominant interLATA carrier, would remain in place on an intraLATA basis. MCI suggests that AT&T could petition to change its form of regulation for a particular intraLATA offering if it can show no market power. Mtel suggests similarly that AT&T's treatment as a dominant provider could be modified if it loses its dominant position. CP National suggests if the Commission wishes to review AT&T regulatory requirements that such review take place in a separate proceeding. Only DOD/FEA has the view that AT&T should be treated as a nondominant carrier in intraLATA markets.

Only GTEC and Citizens suggest more stringent intraLATA pricing restrictions for interexchange carriers than the current interLATA rules. GTEC submits that competitors should be required to supply full cost support for their competitive toll rates as well as cost-supported rate floors based on direct embedded costs or, in the case of 800 services and optional calling plans, either embedded direct or incremental costs. Citizens is of the view that

all competitive intraLATA carriers (except for AT&T) should be limited to the Category II pricing flexibility authorized for local exchange carriers in D.89-10-031, with AT&T being subject to its current interLATA regulatory framework on an intraLATA basis as well. AT&T opposes the more stringent notice periods in D.89-10-031, though it states that it would not oppose modifying the local exchange carriers' notice requirements for flexibly priced services to equal interexchange carriers' notice requirements in the interLATA market.

DRA submits that each interexchange carrier should be required to offer service at least to all equal access converted customers in a LATA. Pacific agrees, submitting that this would be sound and fair and would expand calling options to all customers served by equal access facilities. TURN suggests that the Commission consider requiring that AT&T or possibly all interexchange carriers serve all exchanges within a LATA; as an alternative it suggests that a threshold level of subscribership be established which if exceeded would result in the carrier having to serve all exchanges. Calaveras suggests a more stringent requirement: that all intraLATA toll competitors be required to provide statewide service at averaged prices, though it also entertains the alternative of only a LATA-wide service requirement.

AT&T and MCI respond that interexchange carriers should not be hampered by requirement-to-serve restrictions. AT&T submits that if competitors enter markets where local exchange carriers' services are uneconomically priced, the proper regulatory response is to permit repricing to more competitive levels rather than to inhibit competition by imposing barriers to entry such as a LATA-wide requirement to serve. MCI complains that, particularly if presubscription is not allowed, a requirement to serve would only impose costs without providing any benefits.

CWC submits that interexchange carriers with intrastate interLATA certificates of public convenience and necessity should

receive automatic authorizations to offer intraLATA service for services for which intraLATA competition is expanded.

Discussion

In today's decision, we affirm that statewide average toll rates should be maintained for interexchange carriers as well as for local exchange carriers (Section VIII.C.1).

We see no need to reconsider at this time other aspects of interexchange carriers' current regulatory frameworks, including AT&T's treatment as a dominant carrier, or to impose requirement-to-serve restrictions. We note that notice and other regulatory requirements for nondominant interexchange carriers have been addressed recently in D.90-08-032. Because such carriers are expected to operate on a nondominant basis for intraLATA services as well, it is reasonable to extend their interLATA regulatory requirements to their provision of authorized intraLATA services. Since it is not clear what AT&T's market power will be in competitive intraLATA markets, AT&T's interLATA regulatory framework in effect today should be applied on an intraLATA basis. We note that AT&T recently filed A.90-07-015 in which it requests modifications to its regulation as a dominant interLATA provider. If it wishes us to deviate from current interLATA requirements for intraLATA services, it should bring this issue before us, either through an amendment to A.90-07-015 or by separate application.

Finally, consistent with our conclusion in D.88-09-059, CWC's request that interexchange carriers receive automatic authorization to offer competitive intraLATA services should be denied because it would run counter to PU Code § 1005. Each interexchange carrier must request Commission authorization to provide desired competitive intraLATA services, pursuant to PU Code § 1001, even if they already possess authority to offer identical services on an interLATA basis.

X. Monitoring

Parties offer several suggestions regarding expansion of the comprehensive monitoring program initiated by D.89-10-031.

Pacific lists several factors the Commission may wish to monitor to assess how competition is evolving: entry of new competitors, comparative prices and price changes of local exchange carriers and competitors, the ability of competitors to respond to price changes by other firms, and developments in other jurisdictions where competition is more advanced than in California. Pacific suggests that other information such as quantity and capacity data of competitors might also be useful.

In addition to the data cited by Pacific, MCI submits that the Commission should monitor either local exchange carriers' market shares for the various types of services or at a minimum the trend in their minutes of use. MCI stresses that trends in market shares, rather than market shares by themselves, are necessary to convey useful information.

TURN fears that customers may have to bear the burden if local exchange carriers are unable to compete and cautions that particularly for smaller local exchange carriers the transition to competition should be closely monitored. In its view the Commission should establish a regular yearly evaluation period for the review of competitive conditions, holding in reserve the reinstatement of monopoly supply as an option. TURN suggests various indicators of effective competition: market shares, ability of new entrants to provide subscribers with alternative sources of supply in terms of their geographic coverage, capacity to serve, range of service options, availability of discounts, and quality and technical characteristics of service.

Mtel supports strict reporting requirements and accounting methodologies to force local exchange carriers to clearly separate competitive from noncompetitive services.

Parties have been working with CACD to specify exactly what reports will be provided to meet Phase II monitoring requirements. In anticipation of adoption of new reporting requirements, we have continued to collect all previously-ordered monitoring information from Pacific and GTEC. Needed information from current reports will be consolidated into the ongoing requirements.

In addition to Phase II monitoring requirements, we believe that the interexchange carrier monitoring program adopted in D.88-12-091 (in conjunction with pricing flexibility for AT&T) will provide useful information in monitoring intraLATA competition. As Pacific and TURN point out, monitoring the experience of interexchange carriers within the LATA will be an important part of our ongoing oversight and evaluation of expanded intraLATA competition.

At this time we cannot devise a simple extension or combination of the Phase II and D.88-12-091 monitoring programs to provide an appropriate set of measures to monitor expanded intraLATA competition, and will need to consult further with the parties to develop specific modifications to these already-ordered programs.

To this end, we direct CACD to conduct a further workshop after Phase II monitoring requirements are finalized to consider how the intraLATA and interLATA monitoring programs should be expanded or modified to monitor expanded intraLATA competition. CACD will file a workshop report with the Commission and parties will be allowed to file comments and reply comments on the workshop report. If the workshop report and comments are sufficient to permit us to adopt needed monitoring modifications through a rulemaking decision, we shall do so. Otherwise, we will hold hearings or take whatever other procedural steps are appropriate to allow us to make a final decision on needed enhancements to our monitoring programs.

XI. The Implementation and Supplemental Rate Design Proceeding

The November 22, 1989 Assigned Commissioner's Ruling identified several issues to be addressed in the Phase III implementation and supplemental rate design phase of this proceeding. Certain modifications to the scope of the implementation phase are needed in light of today's decision on Phase III policy matters. The timing of the implementation phase will be set by further ruling to coordinate with cost studies being prepared by Pacific and GTEC.

GTEC and Pacific should present their embedded cost studies, including service-by-service direct embedded and fully allocated costs of service, and, if desired, incremental cost studies for review in the implementation phase. These costs will form the basis for implementing several policies adopted in today's decision, e.g., that overall rates for cost-based access charge elements should be based on fully allocated costs, that monopoly business access services should recover their fully allocated costs (unless to do so would cause unacceptably large sudden rate increases), and that rate floors and ceilings for local exchange carriers' switched toll rates should be based on imputed access charges or costs plus direct embedded or incremental (for floors) or fully allocated (for ceilings) costs of providing the services between the designated virtual points of presence.

Pacific and GTEC should present several possible access charge scenarios, consistent with today's decision, in addition to any alternatives they might propose. As discussed in Section IV.F, the scenarios which we particularly wish to examine include the following:

1. With uniform intraLATA and interLATA statewide access charges based on fully allocated embedded costs, the CCLC should be set to derive the same contribution as would be derived from current intraLATA

toll rates and interLATA access rates on a combined basis.

2. The CCLC should be set to derive the same contribution as would be derived in 1992 from intraLATA toll rates and interLATA access rates on a combined basis, taking into account 1991 and 1992 SPF-to-SLU shifts.

3. The CCLC should be set so that overall interLATA access charges would derive the same contribution as would be derived in 1992 from unmodified interLATA access rates (i.e., prior to redesigning the cost-based elements), taking into account 1991 and 1992 SPF-to-SLU shifts.

These scenarios should reflect revenue and rate impacts of the rate design changes currently being implemented (expansion of ZUM areas, expansion of the local calling area, and elimination of a separate charge for residence and possibly business Touch Tone service), and should highlight the effect on basic rates of modifications to access charges and intraLATA switched toll rates.

Additional detail and direction regarding the cost studies and required access charge scenarios will be provided shortly by a separate ruling.

Parties may propose other rate design scenarios, including further reductions in access charges, e.g., to reduce the CCLC and/or contribution from Pacific to GTEC, or to phase in reductions in the CCLC and/or contribution to GTEC over time. We encourage parties to submit rate design proposals which would expand the contribution to local exchange costs and targeted Category I services from sources other than access charges.

Local exchange carriers should provide information regarding total ratepayer bill impacts and distribution of bill impacts for each rate design scenario they present, and should cooperate fully with other parties which wish to obtain total bill impact and distributional information regarding alternative rate

design proposals. Interexchange carriers should provide similar information regarding interLATA bill impacts.

Parties should also address the following issues:

1. The policy adopted tentatively in Section IV.F regarding isolation of the contribution from access charges and local exchange carrier switched toll rates in the CCLC and whether there should be compensation requirements if this policy is not affirmed.

2. Whether (and if so how) the current lifeline program should be expanded if basic rate increases are proposed.

3. The policy adopted tentatively in Section IV.G regarding cost allocations and rate ceilings for Category II services.

4. How rates for Category I services and rate floors and ceilings for Category II services should be reviewed or revised in the future.

5. Whether intrastate access charges should reflect greater parity with interstate access charges, and whether structural changes should be made to intrastate access charges to bring them more in line with cost structures.

6. The proper bifurcation of the CCLC into originating and terminating components, as adopted in principle in Section V.C.3.

7. Whether (and if so how) intraLATA foreign exchange service should be modified to discourage its use by shared use providers to avoid access charges.

8. Local exchange carrier discount calling plans consistent with the imputation requirements established in Section V.C.5, and whether lower volume optional calling plans whose rates do not cover switched access charges including the CCLC should be allowed.

9. The bypass potential of facilities-based competition with the local loop, in the context of various access charge alternatives, and whether such competition should be authorized.

10. What steps should be taken to better inform and educate customers regarding 10XXX calling. Parties should comment on the proposal in Section VII.C that local exchange carriers should be required to provide in their white pages a more explicit description of 10XXX calling along with certain company codes, and should propose criteria which interexchange carriers should meet to qualify for inclusion.

Additional testimony requirements may be set by further ruling if appropriate.

Separate from and prior to the implementation phase, we provide in Section VIII.C for additional hearings on settlements, pooling, and high cost fund issues. The timing of those hearings will be set by further ruling.

Findings of Fact

1. No party disputes that there is increasing competitive activity in intraLATA markets.

2. There are strong indications that at this time natural monopoly-type conditions prevail in much of the local loop, particularly for basic exchange service; for residential and small and medium business customers' originating calling, and for all customers' call terminations for outbound switched toll services; and for all originating calling for inbound switched toll services.

3. Because of continuing indications of natural monopoly-type conditions in the local loop, it is reasonable to design rates to obtain significant contribution from switched access.

4. Allowing intraLATA competitive entry will not make markets competitive nor will prohibiting intraLATA competition prevent it entirely.

5. An accurate a priori assessment of whether intraLATA competition would be economically viable or whether monopoly conditions would prevail is not possible because it would require massive amounts of largely unavailable or unpredictable information.

6. Properly structured intraLATA competition can provide increased consumer choices, increase incentives for technological advancements and innovations, provide incentives for service providers to minimize costs, and increase utilization of the network with resulting decreases in unit costs.

7. Because of the potential benefits of properly structured intraLATA competition and because an accurate a priori assessment of the viability of intraLATA competition is not possible, a regulatory strategy aimed at creating a regulatory structure that will allow economically efficient competition to develop if viable while protecting ratepayers regardless of the extent to which competition actually develops for particular services is in the public interest.

8. A more cost-based rate design would encourage the development of economically efficient competition, to the extent such competition is viable, while discouraging uneconomic competition, and uneconomic bypass and would allow local exchange carriers to compete more effectively.

9. Continued movement in rate design to more cost-based rates, as long as universal service is protected, has merit regardless of the extent to which intraLATA competition develops because cost-based rates send more accurate price signals and provide customers more reasonable rates for low cost services.

10. Exploitation of economies of scale and scope serves to enhance economic efficiency, with overall societal benefits.

11. Leveraging of inherent market power generally results in additional societal costs and can discourage technological advancements and efficient utilization of the local network.

12. A regulatory strategy to create balanced "level playing field" competitive conditions which promote economic competition through more cost-based rate design (to the extent consistent with universal service and other regulatory goals), allow competitors to take advantage of economies of scale and scope, and discourage leveraging of market power is in the public interest, because such a strategy enhances economic efficiency.

13. An assessment of whether a given regulatory structure constitutes a "level playing field" is necessarily judgmental, because the effects of many components cannot be reliably quantified or weighed in a balance.

14. Because parties have known at least since November 1987 that the Commission planned to reconsider intraLATA competition and because it could easily be twelve months or more before the implementation proceeding is completed, parties will have adequate time to prepare for competitive entry.

15. Pacific has not presented new information to support its position that the Phase II requirement that rate floors for flexibly priced services be based on direct embedded costs should be modified prior to expansion of intraLATA competition.

16. There is no need to implement rate design changes some time prior to allowance of competition, because the rate design policies adopted in today's decision support level playing field competition, with possible phase-ins if needed to prevent rate shock, and steps are taken to ensure affordable rates for the small local exchange carriers.

17. While permitting local exchange carrier pricing flexibility before competitive entry would benefit local exchange carriers and permitting competition before pricing flexibility would benefit competitors, neither approach would provide obvious benefits to ratepayers or be consistent with the goal of a fair competitive market.

18. Rate design involves a careful balancing of competing objectives such as maintenance of universal service, prevention and/or mitigation of rate shock, and promotion of economic efficiency in addition to ensuring that overall revenue objectives are met.

19. Economic efficiency is enhanced if competition develops based on various competitors' costs rather than on divergence of local exchange carrier rates from costs.

20. Economic efficiency is enhanced if revenue needs in excess of incremental costs are met by setting prices above incremental costs for services for which demand is relatively inelastic and closer to incremental costs for services with relatively elastic demand.

21. Pricing all monopoly Category I services not explicitly targeted for support at or above their fully allocated embedded costs would allow these services to recover their total costs.

22. In current rate designs, the contribution to local exchange costs on a per-minute basis is significantly greater from local exchange carriers' intraLATA switched toll services than from access charges assessed to interexchange carriers offering interLATA switched toll services.

23. Allowance of intraLATA switched toll competition while current disparities between local exchange carriers' intraLATA switched toll rates and potential competitors' rates persist could significantly erode contribution to local exchange costs and lead to unnecessary increases in basic exchange rates.

24. Reducing the disparity between intraLATA and interLATA switched toll rates would be beneficial even if intraLATA competition is not broadened because it would reduce uneconomic bypass and tariff arbitrage.

25. The substantial surcredits currently in place on access billings have resulted in effective rates for cost-based components of access charges which may well be below costs.

26. Parties unanimously agree that if intraLATA switched toll competition is authorized access charges should be uniform for both intraLATA and interLATA access.

27. Looking at the contribution (above fully allocated embedded costs) to local exchange costs which is found reasonable from switched access charges and local exchange carriers' intraLATA switched toll rates, obtaining the biggest portion of that contribution from access rather than from local exchange carriers' switched toll rates (apart from imputed access charges) would allow local exchange carriers to compete more effectively with competitors whose only contribution requirements are through the access charge and would aid in maintenance of overall contribution levels.

28. Derivation of the amount of contribution to local exchange costs which is found reasonable in the implementation phase from both switched access charges and local exchange carriers' intraLATA toll rates through the CCLC with imputation in switched toll rates would allow local exchange carriers and their competitors to compete fairly, with success depending on factors such as relative efficiencies, the offering of desirable service options, and quality of service rather than on the ability of some carriers to take advantage of pricing disparities.

29. The CCLC component of switched access charges contributes to some extent to uneconomic bypass problems.

30. Some amount of uneconomic bypass is likely to continue to be acceptable as a tradeoff for maintenance of affordable local exchange rates.

31. Commission oversight and review of any proposed phase-down of GTEC's cost recovery from statewide toll rates is needed, in order to ensure that universal service goals are met.

32. Examination of total ratepayer bill impacts, including impacts on the bills of interexchange carriers, and distribution of bill impacts of rate design proposals is important in order to

evaluate effects on universal service and identify any potential problems with rate shock.

33. The ability to enter into special contracts for MTS, WATS, and 800 services would enable carriers to market these services on an equal basis with alternatives such as private line services.

34. Current Commission orders protect against anticompetitive behavior in contract situations.

35. In Phase II, the Commission established ceilings on rates for Category II services at existing rates since those were the earnings levels assumed in setting remaining rates in prior rate designs.

36. In Phase II, the Commission did not provide for rate rebalancing from Category II to Category I services, instead placing utilities at risk for their ability to actually recover revenues implied by the rate ceilings, either through pricing at or near the ceiling or through demand stimulation.

37. Pacific and GTEC question their ability to continue to recover revenues equal to current rates in the competitive markets developing for MTS and operator services.

38. Establishment of rate ceilings for a Category II service greater than or equal to the tariffed rates of any Category I services bundled in the service plus fully allocated costs of the remaining portions of the service would be consistent with adopted imputation principles and allow for recovery of at least the service's fully allocated costs. This would also allow reflection of market conditions and maintenance of contribution.

39. Placement of a service for which competition has been authorized in Category I in order to constrain the price, either above the Category II rate floor or below the Category II rate ceiling, would run counter to the goal of level playing field competition.

40. Because today's decision resolves issues raised as possible impediments to authorization of full intraLATA competition for all switched toll services so that ratepayers are protected and level playing field competitive conditions are promoted, it is reasonable to authorize full intraLATA competition for all switched toll services, including MTS, WATS, 800 services, transmission of information providers' 900 services, and virtual private network services, to be effective upon adoption of revised access charges in the implementation phase, so that the benefits of competition can be realized.

41. If access charge revisions which isolate local exchange contribution from access charges and switched toll rates in the CCLC are adopted in the implementation phase, consistent with the policy we adopt today, there will be no remaining need for compensation requirements.

42. In D.88-11-053 AT&T was granted interim authority to provide interLATA MEGACOM and MEGACOM 800 services, compensation arrangements were adopted on an interim basis, and A.88-07-020 was consolidated with I.87-11-033 "for final resolution of the intraLATA issue."

43. Interexchange carrier participation in local exchange carrier 800 data bases would allow customers to select among all providers without having to change 800 numbers each time they change carriers.

44. The provision by interexchange carriers of complementary, or add-on, interLATA-only switched toll services would allow local exchange carriers to market an entire intrastate service provided in combination by the local exchange carrier and the interexchange carrier in a manner somewhat transparent to the customer.

45. In general, market forces can be relied upon to guide interexchange carriers in their decisions regarding add-on services and participation in local exchange carriers' 800 data bases.

46. Current presubscription technology evidently would preclude the choice of a local exchange carrier as a customer's presubscribed intraLATA carrier and an interexchange carrier for interLATA calling.

47. Based on uncontested statements by Pacific and DRA, there is no cost basis to assess different intraLATA and interLATA access charges.

48. IntraLATA access tariffs in parity with interLATA tariffs would promote fairness in the CCLC contribution between intraLATA and interLATA switched toll users, reduce tariff arbitrage, enhance customer understanding, and promote administrative simplicity.

49. Basing overall rates for the cost-based components of access tariffs on fully allocated embedded costs, with transport rates based on direct embedded or incremental costs and rates for other elements priced residually based on factors such as elasticity and marketing considerations as long as they are above direct embedded or incremental costs, would promote economic efficiency and be consistent with an overall move toward a more cost-based rate structure.

50. Availability of intraLATA presubscription, viewed in isolation, would give interexchange carriers a distinct competitive advantage because of their ability to provide 1+ switched toll services on a combined intraLATA, interLATA, and interstate basis.

51. Unavailability of intraLATA presubscription, viewed in isolation, would advantage local exchange carriers because of the inconvenience and higher billing costs of 10XXX dialing.

52. Within the context of the overall adopted competitive regulatory framework, an intraLATA presubscription option would not be likely to promote fair competition because of the interLATA and interstate prohibitions on Pacific and GTEC and their stricter pricing requirements.

53. Any differential in interLATA and intraLATA switched access charges based on the unavailability of intraLATA presubscription would be value-based rather than cost-based and would necessarily be largely judgmental.

54. There is general agreement that institution of a differential between the originating and terminating CCLC could mitigate to some extent the uneconomic bypass incentives created by recovery of local exchange costs through the CCLC.

55. It is reasonable to discriminate between access to the switched network for local usage and access for interexchange usage in order to obtain a usage-based contribution to non-traffic sensitive costs from interexchange switched traffic, because of benefits of universal service and affordable local exchange rates.

56. It is reasonable to require that shared tenant providers and resellers as well as facilities-based interexchange carriers pay intraLATA access charges, in order to maintain contribution to non-traffic sensitive costs from interexchange switched traffic.

57. Treating the monopoly portion of a local exchange carrier's network comparably in setting both access and switched toll rates would discourage anticompetitive conduct.

58. Recognition of local exchange carrier efficiencies in routing and switching, to the extent they can be ascertained, would promote economic efficiency and allow ratepayers to realize resulting cost savings through lower toll rates.

59. It is useful to depict local exchange carriers' switched toll networks as divisible into monopoly and competitive elements demarcated by virtual points of presence.

60. Treating the end office as the local exchange carrier's virtual point of presence in the imputation process would underestimate the monopoly portion of the network and thus could create an anticompetitive price squeeze.

61. Designation of virtual points of presence based on whether toll traffic is routed directly between Class 5 end offices

or is routed through toll tandems is reasonable because it relies on the actual design of local exchange carriers' networks and recognizes local exchange carrier efficiencies in routing and switching.

62. Since interexchange carriers' access alternatives include special access and facilities-based bypass in addition to switched access services, local exchange carriers would be at a competitive disadvantage if they were required to impute switched access rates in all their switched toll rates.

63. To guard against anticompetitive pricing, bundled services which include Category II services must be examined on a case-by-case basis to determine whether the Category II services exhibit characteristics of monopoly building blocks and, as a result, whether the imputation principle adopted in Phase II provides that their tariffed rates and charges rather than their costs should be included in the imputation process.

64. Because of current disparities in switched toll and access rate structures, rate element-by-rate element imputation of access charges in switched toll rate floors may not be practical.

65. Imputation of access charges in switched toll rate floors on at least a service-by-service basis (e.g., each discount toll plan or each separate 800 offering) would prevent cross subsidies from less competitive switched toll services to other more competitive toll offerings.

66. Because local exchange carriers' central office connections are comparable to premium connections available to interexchange carriers, it is reasonable to impute premium access rates in local exchange carriers' switched toll rates.

67. The proposals by MFS and ACLA that competitors be allowed to colocate their facilities within end offices and to connect directly to local loop facilities raise complex technical issues which cannot be resolved absent evidentiary hearings.

68. Continued special pricing treatment of residence exchange service and local and ZUM calling would be consistent with universal service and affordable local service goals.

69. Because local and ZUM rates are likely to be priced below interexchange carriers' toll rates, blocking of 10XXX local and ZUM calls, with a recording to inform customers that such calls should be completed over local exchange carriers' networks, would protect ratepayers by pointing them to the lower priced services.

70. It is reasonable to allow customers with special access or other means of accessing interexchange carriers to determine whether to make a local exchange carrier ZUM call or use their interexchange carrier, since local and ZUM calls will continue to receive special pricing treatment.

71. Because local and ZUM rates are likely to be priced below interexchange carriers' toll rates, continuation of existing interexchange carrier prohibitions on holding out the availability of their services utilizing the local loop for completion of local and ZUM calls would protect ratepayers.

72. The attractiveness of uneconomic bypass of the local loop will depend to a large extent on the level of access charges, particularly the CCLC.

73. No party voiced opposition in their Phase III submittals to Pacific's proposal that competition continue to be prohibited for 911, 411 and intraLATA foreign NPA 555-1212 directory assistance, and non-revenue producing 0- calling.

74. Because low speed private line revenues are relatively small, little contribution would be gained if these services were priced above fully allocated costs.

75. Constraining low speed private line rates below costs would not contribute to universal service objectives.

76. It would be reasonable to retain low speed private line services in Category I temporarily if such a step were needed to prevent rate shock.

77. Placing intraLATA low speed private line services in Category II and allowing competition would be consistent with our preferred regulatory strategy for partially competitive intraLATA markets if to do so would not expose customers to unacceptable levels of rate shock.

78. Virtual private network services are switched toll services currently provided only by interexchange carriers.

79. Authorization of intraLATA competition for operator services would allow consumer benefits due to increased choice among alternative providers and services and potentially reduced prices.

80. Competition in operator services could be authorized prior to authorization of competition for intraLATA switched toll services by requiring operator services competitors to use local exchange carriers' intraLATA toll services.

81. Pacific asserts that its current operator services rates generate contribution.

82. There is no reason at this time to alter the regulatory practices adopted in D.90-06-018 regarding the pay telephone industry.

83. There is no reason to apply different consumer protection standards to intraLATA operator services than have been applied to interLATA operator services by prior Commission decisions, although the appropriate designation of AT&T within those standards for the intraLATA market is unclear.

84. IntraLATA operator service will be a Category II service once competition is authorized and implemented.

85. Resale-only competition could not be enforced because local exchange carriers would not be able to determine whether a reseller has any non-local exchange carrier facilities in its network.

86. It is not clear that there would be incentives or benefits to entry by one local exchange carrier in another's

franchise territory, in light of the maintenance of statewide average toll and access rates.

87. Absent presubscription the local exchange carrier, as the 1+ carrier in its territory, is automatically the carrier of last resort.

88. Further information about the availability of 10XXX dialing would better inform customers about their market options for all 10XXX calling.

89. Separate local exchange carrier switched toll rates would increase pressure to allow interexchange carriers to deaverage their own switched toll rates, which would create further deaveraging pressures.

90. Deaveraged intraLATA access charges would bring greater pressure to deaverage switched toll rates than exists currently with competition limited to interLATA services, with potential detriment to universal service and the maintenance of affordable rates in high cost areas.

91. The current policy of company-specific interLATA access tariffs is not automatically applicable on a combined intraLATA and interLATA basis.

92. Risk and efficiency incentives are minimal for independent telephone companies participating in pool and EAS cost recovery agreements.

93. DRA recommends that the common pooled surcharge should be replaced with a bill-and-keep surcharge and that local exchange carriers (except Pacific) which participate in the common pooled surcharge be allowed to recover the revenue requirement shortfall from the CHCF.

94. In the settlements workshops, parties proposed one treatment for the seventeen smallest local exchange carriers, three options for the mid-sized carriers, and yet another approach for GTEC, with creation of a second high cost fund and with several of these proposals accompanied by multi-year transition periods.

95. It appears that proposals made in the settlements workshops would greatly complicate rather than simplify the settlements process.

96. DRA reports that, of the twenty local exchange carriers excluding Pacific and GTEC, nine earned rates of return over 15 percent in 1989 and at least sixteen earned in excess of their authorized rates of return. Many of these companies have not had rate reviews since the early 1980s.

97. It appears that the current web of support for high cost companies, including the settlements pools, the common pooled surcharge, the CHCF, and the federal high cost fund, has overshot its intended mark, at least in 1989, which was to protect these companies' ratepayers by providing reasonable affordable telephone service in rural and high cost areas.

98. California ratepayers would likely benefit from insertion of additional risk and efficiency incentives in the regulatory frameworks for the independent local exchange carriers.

99. The subsidy framework cushioning the higher cost local exchange carriers should be reconsidered, in light of low risks and low efficiency incentives in the current framework.

100. Nondominant interexchange carriers are expected to operate on a nondominant basis for intraLATA services as well.

101. It is not clear what AT&T's market power will be in competitive intraLATA markets.

102. CWC's request that interexchange carriers receive automatic authorization to offer competitive intraLATA services would run counter to PU Code § 1005.

103. Comprehensive intraLATA monitoring requirements are being developed in compliance with the Phase II decision.

104. The interexchange carrier monitoring program adopted in D.88-12-091 in conjunction with pricing flexibility for AT&T will provide useful information in monitoring intraLATA competition.

105. Evidentiary hearings were not required to reach our findings on matters decided today.

Conclusions of Law

1. Because there is no need to implement adopted rate design changes some time prior to allowance of competition and because parties have been unpersuasive in their arguments that competitive entry should be delayed, competitive entry should be allowed to occur on a simultaneous basis with rate design changes following the implementation phase, so that expected benefits of expanded competition are not unnecessarily delayed.

2. Local exchange carrier pricing flexibility and competitive entry should be made effective simultaneously to promote fair competitive market conditions.

3. All Category I business access services and any other Category I services not explicitly targeted for support should be priced at or above their fully allocated embedded costs so that they recover their total costs to the extent possible while meeting other regulatory goals including prevention or mitigation of rate shock.

4. The current disparity between intraLATA and interLATA switched toll rates should be reduced or even eliminated because of the efficiency benefits to be derived from consistency between intraLATA and interLATA tariffs and because significant advantages can accrue if economic competition is allowed to develop.

5. The amount of contribution (above fully allocated embedded costs) to local exchange costs and any below-cost services which is found reasonable in the implementation phase from both switched access charges and local exchange carriers' intraLATA toll rates should be obtained through the CCLC component of switched access charges with imputation in switched toll rates, because this would allow local exchange carriers and their competitors to compete fairly, with success depending on factors such as relative efficiencies, the offering of desirable service options, and

service rather than on the ability of some carriers to advantage of pricing disparities.

6. The basic rate levels found reasonable in the implementation phase should act as a constraint on the level at which the CCLC can be set and on other potential cost-based revenue shifts, in order to maintain an appropriate balance between cost-based rate design and affordable basic exchange rates.

7. Any phase-down of GTEC's cost recovery from statewide toll rates should be accomplished only with the Commission's oversight and approval, in order to ensure that universal service goals are met.

8. Local exchange carriers should provide information regarding total ratepayer bill impacts and distribution of bill impacts for each rate design scenario they present in the implementation phase, and should cooperate fully with other parties which wish to obtain total bill impact and distributional information regarding alternative rate design proposals, so that the Commission may fully evaluate each rate design scenario. Interexchange carriers should provide similar information regarding interLATA bill impacts.

9. All carriers should be allowed to enter into contracts for MTS, WATS, and 800 services when intraLATA competitive entry is allowed for these services, so that they can be marketed on an equal basis with alternatives such as private line services.

10. Rate ceilings for each Category II service should be established equal to or greater than the tariffed rates of any Category I services bundled in the service plus fully allocated costs of the remaining portions of the service because this would be consistent with adopted imputation principles, allow for recovery of at least the service's fully allocated costs, and allow reflection of market conditions and maintenance of contribution.

11. Category II treatment should be allowed for all local exchange carrier services for which competition is authorized (with

CORRECTION

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11. Category II treatment should be allowed for all local exchange carrier services for which competition is authorized (with

the possibility of Category III treatment if the local exchange carrier has insignificant market power) in order to allow level playing field competition.

12. Because today's decision resolves issues raised as possible impediments to authorization of full intraLATA competition for all switched toll services so that ratepayers are protected and level playing field competitive conditions are promoted, full intraLATA competition for all switched toll services, including MTS, WATS, 800 services, transmission of information providers' 900 services, and virtual private network services, should be authorized to be effective upon adoption of revised access charges in the implementation phase, so that the benefits of competition can be realized.

13. If access charge revisions which isolate the local exchange contribution from access charges and switched toll rates in the CCLC are adopted in the implementation phase, consistent with the policy we adopt today, compensation requirements should not be imposed after the access charge revisions become effective.

14. Because market forces generally can be relied upon to guide interexchange carriers in their decisions regarding add-on services and participation in local exchange carriers' 800 data bases, blanket add-on and data base requirements should not be imposed at this time.

15. IntraLATA presubscription should not be required at this time because it would not be likely to promote fair competition within the context of the overall adopted competitive regulatory framework.

16. Because of the competitive importance of presubscription, a schedule should be established to revisit this issue.

17. IntraLATA access tariffs should be developed and maintained in parity with interLATA access tariffs, in order to reflect equivalent cost structures, to promote fairness in the CCLC contribution between intraLATA and interLATA toll users, reduce

tariff arbitrage, enhance customer understanding, and promote administrative simplicity.

18. Overall rates and charges for the cost-based components of access tariffs should be based on fully allocated embedded costs in order to be consistent with an overall move toward a more cost-based rate structure. Local exchange carriers should be allowed to propose in the implementation phase that local transport rates be based on direct embedded or incremental costs and that rates for other elements be priced residually as long as they are above direct embedded or incremental costs, in order to promote economic efficiency.

19. A discount in intraLATA switched access charges should not be granted based on the unavailability of intraLATA presubscription, because it would be value-based rather than cost-based and would necessarily be largely judgmental and because the relative advantage enjoyed by local exchange carriers because of the unavailability of intraLATA presubscription is balanced by other factors in the overall regulatory framework adopted for intraLATA competition.

20. The CCLC should be bifurcated into originating and terminating components with the amount of the cost recovery occurring through the originating and terminating portions of the CCLC to be determined in the implementation phase, because this structure could mitigate to some extent the uneconomic bypass incentives created by recovery of local exchange costs through the CCLC.

21. CENTEX's proposal that distinctions among classes of business customers be eliminated should be rejected because retention of a contribution to non-traffic sensitive costs from interexchange switched traffic promotes universal service and affordable local exchange rates.

22. The requirements that shared tenant providers and resellers must pay access charges should be extended to the

intraLATA market with the advent of intraLATA switched toll competition, in order to maintain contribution to non-traffic sensitive costs from interexchange traffic.

23. Virtual points of presence should be designated for use in the imputation process for setting local exchange carriers' switched toll rate floors and ceilings based on whether toll traffic is routed directly between Class 5 end offices or is routed through toll tandems, because this approach relies on the actual design of local exchange carriers' networks and recognizes local exchange carrier efficiencies in routing and switching.

24. Consistent with the prior Conclusion of Law, Pacific and GTEC should prepare a study that measures their intraLATA switched toll traffic between end offices and to and from end offices and toll tandems, should use the weighted average length of transport between end offices and toll tandems to calculate the local transport rates and charges to be imputed in local exchange carriers' switched toll rate floors and ceilings, and should submit this study in the implementation phase.

25. Local exchange carriers should be allowed to offer high volume discount toll services structured to compete with interexchange carriers' services based on types of access other than switched access in order to allow them to compete fairly with interexchange carriers whose access alternatives include special access and facilities-based bypass in addition to switched access services.

26. Imputation of access charges in switched toll rate floors should be on at least a service-by-service basis (e.g., each discount toll plan or each separate 800 offering), in order to prevent cross subsidies from less competitive switched toll services to other more competitive toll offerings.

27. Local exchange carriers should impute premium access charges in their switched toll rates.

28. The proposals by MFS and ACLA that competitors be allowed to colocate their facilities within end offices and to connect directly to local loop facilities should be considered in I.90-02-047 in the context of the Teleport Communications Group petition filed on April 16, 1990 in that investigation, because they raise complex technical issues which cannot be resolved absent evidentiary hearings.

29. Pacific's motion to strike portions of MFS's testimony should be denied because it would be too difficult to isolate testimony of MFS and several other parties regarding colocation and direct access issues.

30. Basic exchange services and local and ZUM calling should remain as monopoly Category I services so that the Commission retains control over their pricing.

31. Because local and ZUM rates are likely to be priced below interexchange carriers' toll rates, local exchange carriers should block 10XXX local and ZUM calls, with a recording to inform customers that such calls should be completed over local exchange carriers' networks.

32. Because local and ZUM rates are likely to be priced below interexchange carriers' toll rates, interexchange carriers should continue to be prohibited from holding out the availability of their services utilizing the local loop for completion of local and ZUM calls, in order to protect ratepayers.

33. Facilities-based competition with the local loop should not be authorized until potential effects of uneconomic bypass can be assessed in the implementation proceeding.

34. Since no party voiced opposition in their Phase III submittals to Pacific's proposal that competition should continue to be prohibited for 911, 411 and intraLATA foreign NPA 555-1212 directory assistance, and non-revenue producing 0- calling, competition for these services should not be authorized at this time.

35. IntraLATA low speed private line services should be placed in Category II and competition should be allowed if evaluation of cost data in the implementation phase shows that to do so would not expose customers to unacceptable levels of rate shock, since this would be consistent with our preferred regulatory strategy for partially competitive intraLATA markets.

36. Full competition (beyond that authorized in D.90-06-018) should be authorized for intraLATA operator services following an examination of local exchange carriers' rates and costs in the implementation phase.

37. Resale of intraLATA services should be allowed only when facilities-based competition is authorized, because resale-only competition could not be enforced.

38. Competition by one local exchange carrier in another's franchise territory should not be allowed at this time, because it is not clear that there would be incentives or benefits in light of the maintenance of statewide average toll and access rates.

39. Statewide average intraLATA switched toll rates should be maintained for each interexchange carrier and on a coordinated basis for local exchange carriers as a whole, in order to ensure maintenance of affordable basic exchange and switched toll rates throughout California.

40. With the advent of intraLATA switched toll competition all local exchange carriers should be required to maintain unified statewide switched and special access tariffs, to prevent pressures to reverse the policy of statewide average switched toll rates.

41. Parties should submit testimony later this year presenting positions on statewide average switched and special access and toll private line tariffs and on the proposals set forth in Section VIII.C for modifying the subsidy framework, cushioning the higher cost local exchange carriers and, if desired, presenting alternative proposals.

42. Because nondominant interexchange carriers are expected to operate on a nondominant basis for intraLATA services as well, their interLATA regulatory requirements should be extended to provision of authorized intraLATA services.

43. Since it is not clear what AT&T's market power will be in intraLATA markets, AT&T's interLATA regulatory framework in effect today should be applied on an intraLATA basis.

44. Pursuant to PU Code § 1001, each interexchange carrier must request Commission authorization to provide desired competitive intraLATA services, even if it already possesses authority to offer identical services on an interLATA basis.

45. CACD should conduct a further monitoring workshop after Phase II monitoring requirements are finalized to consider how the intraLATA and interLATA monitoring programs should be expanded or modified to monitor expanded intraLATA competition.

46. Because evidentiary hearings were not required to reach our findings on matters decided today, because issues requiring hearings have been deferred either to the implementation phase or to other proceedings, and because wide latitude has been reserved within the adopted policies to ensure that rates and charges set following evidentiary hearings will be in the public interest, today's interim Phase III decision fully preserves parties' due process rights and does not conflict with PU Code § 729.

47. In order to provide timely implementation of regulatory changes needed in the current market, this order should be effective today.

INTERIM ORDER

IT IS ORDERED that:

1. The policies regarding a competitive intraLATA regulatory framework developed in this decision and described in Conclusions

of Law 1 through 7, 10, 11, 13, 16, 17, 18, 20, 22 through 27, 29, 31, 35, 37, 40, 42, 43, and 45 are adopted.

2. An implementation phase of this proceeding shall be held, with its timing set by further ruling, to implement the policies adopted herein. Pacific Bell (Pacific) and GTE California Incorporated (GTEC) shall and the Division of Ratepayer Advocates (DRA) and other interested parties may submit prepared testimony in the implementation phase of this proceeding consistent with the requirements in Section XI and subsequent rulings. In addition, any party may file pretrial briefs and replies specifically identifying any material disputed issues of fact relevant to our adoption of the policies set forth in this order. Parties requesting hearings must explain why hearings are required and the specific facts they wish to establish. If so justified, we will hear these specific factual issues in conjunction with the implementation hearings.

3. All carriers shall be allowed to enter into contracts for Message Toll Service (MTS), Wide Area Telephone Service (WATS), and toll-free 800 service effective at the time that intraLATA competitive entry is effective for these services.

4. IntraLATA competition for all switched toll services, including MTS, WATS, 800 services, transmission of information providers' 900 services, and virtual private network services, is authorized, effective at the time that revised access charges are implemented following the implementation phase of this proceeding. Parties may file applications under § 1001 of the Public Utilities (PU) Code and in compliance with Rules 2 through 8, 15, 16, and 18 of the Commission's Rules of Practice and Procedure for a certificate of public convenience and necessity (CPC&N) to provide these services.

5. Pacific and GTEC shall file reports in Investigation (I.) 90-02-047 no later than 24 months following the effectiveness of switched intraLATA competition in which they report the status of

technical issues regarding intraLATA presubscription and provide their assessment regarding the desirability of allowing such presubscription at that time. Procedural steps by which the Commission will consider these reports shall be established by subsequent rulings.

6. The requirements that shared tenant providers and resellers must pay access charges will be applied to the intraLATA market, effective at the time that revised access charges are implemented following the implementation phase of this proceeding.

7. Pacific and GTEC shall prepare a study that measures their intraLATA switched toll traffic between end offices and to and from end offices and toll tandems, shall use the weighted average length of transport between end offices and toll tandems to calculate local transport rates and charges to be imputed in their switched toll rate floors and ceilings, and shall submit this study in the implementation phase of this proceeding.

8. The Motion of Pacific Bell to Strike Portions of the Pre-filed Direct Testimonies of Dale N. Hatfield and Douglas Bradbury and to Strike Exhibits B and C, Submitted on Behalf of Metropolitan Fiber Systems of California, Inc. is denied.

9. Full intraLATA competition (beyond that authorized in Decision (D.) 90-06-018) is authorized for operator services, effective at the time that local exchange carriers' rates and charges for these services are updated following the implementation phase of this proceeding. Parties may file applications under PU Code § 1001 and in compliance with Rules 2 through 8, 15, 16, and 18 of the Rules of Practice and Procedure for a CPC&N to provide these services.

10. All local exchange carriers shall and DRA and other interested parties may submit prepared testimony presenting positions on statewide average switched and special access and toll private line tariffs and on the proposals set forth in Section VIII.C for modifying the subsidy framework for higher cost local

exchange carriers and, if desired, presenting alternative proposals. Timing and other requirements of this testimony, related hearings, and other procedural steps shall be set by further ruling.

11. All current interLATA regulatory requirements for nondominant interexchange carriers shall apply to provision of intraLATA services for which a nondominant interexchange carrier receives a CPC&N.

12. All interLATA regulatory requirements in effect today for AT&T Communications of California (AT&T) shall apply to provision of intraLATA services for which AT&T receives a CPC&N.

13. The Commission's Advisory and Compliance Division (CACD) shall chair a workshop after Phase II monitoring requirements are finalized to provide more information to the Commission regarding expansion or modification of intraLATA and interLATA monitoring programs to monitor expanded intraLATA competition. CACD shall file an original and 12 copies of its workshop report in the Docket Office, with service by mail on all parties in I.87-11-033. Parties shall be given an opportunity to file comments and reply comments on CACD's workshop report. Parties shall file an original and 12 copies of comments and reply comments in the Docket Office. Comments and reply comments shall comply with the applicable rules in Article 2 of the Rules of Practice and Procedure and shall have a certificate showing service by mail on all parties in I.87-11-033.

14. The Executive Director is directed to cause a copy of this order to be served by mail on each party identified in D.87-08-048 in Application 83-01-022.

This order is effective today.

Dated AUG 29 1990, at San Francisco, California.

G. MITCHELL WILK
President
FREDERICK R. DUDA
STANLEY W. HULETT
PATRICIA M. ECKERT
Commissioners

Commissioner John B. Ohanian, being necessarily absent, did not participate.

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

NEAL J. SHULMAN, Executive Director

TELECOMMUNICATIONS GLOSSARY

0+	Dial "0" plus a telephone number for charge card, third-party charge, and collect calls.
1+	Dial "1" plus a telephone number for direct-dial long distance service
10XXX	A dialed access code to connect to an interexchange carrier. Each carrier has an unique three-digit code represented here as XXX.
1MB Service	Measured business service (one party).
411	Dials local directory assistance.
800 READYLINE	An AT&T custom network service that offers inward calls within the state. The service may be restricted to selected area codes and the 800 number can be moved to a different location at the customer's request. The service is targeted to small and mid-size businesses and residence customers who would not benefit from regular 800 service.
800 Service	A wide area calling service that allows receipt of incoming calls from a preset calling area at no charge to the calling party. Subscribers pay on a bulk rate basis.
900	A mass calling service that permits simultaneous connections by a large number of callers to a sponsored program or polling programs. There is a fee per call for which the utility provides billing and collection on behalf of the information provider.
Access Charges	A tariff charge imposed on either customers (end users) or interexchange carriers to compensate the local exchange company for connection to local network facilities.
BETRS	Basic Exchange Telephone Radio Service.
Centrex	A service for customers with many stations that permits station-to-station dialing, one listed directory number for the customer, direct inward dialing to a particular

	station, and station identification on outgoing calls. The switching functions are performed in a central office.
CCLC	Carrier Common Line Charge. An access charge to recover a portion of the non-traffic sensitive (non-usage sensitive) costs of the local loop, the drop, and associated equipment between end office and the end user.
CHCF	California High Cost Fund. A fund derived from an increment of the CCLC that supports high cost telephone companies (usually small rural companies) against changes in revenues due to Commission or FCC actions.
Direct Embedded Costs	Historical costs of a utility that can be attributed to a specific service on the basis of direct cost causation.
Equal Access	The MFJ requires that access to the local network provided to all carriers for interstate and interLATA services must be equal in quality and type to the access provided to AT&T. Equal access also allows presubscription by the customer to any carrier without special dialing.
First Order Efficiency Loss	According to economic theory, the loss in economic efficiency that occurs when the least cost method of production is not used. A second order efficiency loss is said to occur when prices deviate from incremental cost.
FX Service	Foreign Exchange Service, also FEX. A service that provides a circuit and dial tone between a customer's main station and a central office other than the one that normally serves the exchange area in which the customer is located.
Fully Allocated Costs	Costs that include both direct and indirect costs. (Indirect costs include the overhead costs that cannot be directly assigned to any one specific project or service, but rather apply to the company as a whole.)

Fully Allocated Embedded Costs	See Fully Allocated Costs.
High Speed Private Line	A dedicated leased circuit suitable for transmission of digital signals at relatively high speeds or capacity. For example, a common high capacity service is 1.544 Mbps; this is equivalent to 24 voice circuits.
Holding Out Restrictions	Interexchange carriers are not permitted to offer or advertise intraLATA services they are not authorized to provide, even though they may be technically able to provide the services.
IEC	Interexchange carrier. A company engaged in the provision of interLATA, interstate, or international telecommunications for hire over its own or leased facilities.
Incremental Costs	Additional costs of supplying a discrete increase in output.
IntraLATA	Within a LATA. Descriptive of the service area in which the Bell Operating Companies are permitted to operate. See LATA.
InterLATA	Between LATAs. Descriptive of the services restricted to interexchange carriers by the Modified Final Judgment. See LATA.
Kbps	Kilobits per second.
LANs	Local Area Networks. Privately owned networks offering high speed communications channels for connection of information processing equipment (and telephones) in a limited geographic area.
LATA	Local Access and Transport Area. Service or market areas of the Bell Operating Companies which were established by order of the Modified Final Judgment for the divestiture of the Bell Operating Companies from AT&T. California is divided into ten LATAs.
LEC	Local Exchange Carrier. The Bell Operating Companies or independent telephone companies which provide local exchange services.

MANs	Metropolitan Area Networks. See LANs.
Mbps	Megabits per second.
MEGACOM 800 Service	An 800 service offered by AT&T for customers receiving high volumes of incoming calls.
MFJ	Modified Final Judgment. An agreement reached between the Bell System and the Department of Justice, approved by the Federal District Court on August 24, 1982. It required that AT&T divest itself of exchange telecommmunications services.
NDIEC	Nondominant interexchange carrier. AT&T is the dominant IEC with a majority market share among the carriers. All other IECs are NDIECs.
PBX	Private Branch Exchange. A switching device, usually located on the customer's premises.
PCN	Personal Communications Network. PCNs include cellular, wireless, and cordless communication systems.
Presubscription	A process which allows an end user served by an equal access end office to select an IEC to automatically provide interLATA communications.
Private Line	A circuit leased by customers for their exclusive use. It is independent of the public switched network.
Pooling	An informal name for a settlements process in which all participating companies earn the same rate of return.
POP	Point of presence. The physical location of an interexchange carrier established to obtain access to the local exchange carrier's network.
SDN	Software Defined Network. A virtual private line service by AT&T.

Settlements	An accounting procedure to define how revenues of a single call are split among different companies involved in that connection.
SPF to SLU	A transition in cost allocation factors (from Subscriber Plant Factor to Subscriber Line Usage) that allocates fixed loop costs among local, intraLATA, and interLATA jurisdictions.
Special Access	Non-switched access provided via private lines.
Switch 56	An AT&T offering which provides 56 kilobits per second switched digital service.
Switched Toll	Toll traffic carried on the switched network i.e., not private line.
Tandems	A switching system (central office) that establishes trunk to trunk connections.
Tariffs	The published rates, regulations, and descriptions governing the provision of communications service by common carriers, which are filed with the Commission.
Toll Private Line	A dedicated line that provides long-distance communications.
Universal Service	The goal of establishing affordable and available statewide telephone service.
USF	Universal Service Fund. A "high cost fund" established at the federal level to maintain the basic service rates of high cost telephone companies at reasonable levels.
Virtual Private Line Services	A software defined network that gives the functionality of a private, dedicated network while using the switched network on an as-needed basis.
WATS	Wide Area Telephone Service. A service designed to meet the needs of customers having substantial volumes of long distance calls over a wide area. It bills on a bulk basis rather than by individual calls.

ZUM	Zone Usage Measurement. A discount toll plan especially designed for metropolitan areas. The plan includes calls within mileage bands up to 16 miles.

(END OF ATTACHMENT A)