

Decision 83 06 081 JUN 29 1983**ORIGINAL**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's own motion into the effects of competition upon local and toll exchange service, including the issues of intra and inter-LATA competition, access charges, bypass, and methods of regulating competitive markets.

OII 83-02-01  
(Filed February 24, 1983)

INTERIM OPINIONPurpose of Proceeding

On February 24, 1983 we issued an Order Instituting Investigation (OII) into the effects of competition upon basic telephone service. Competition to various services offered by public utility telephone companies is growing at a rapid rate due to various decisions of the Federal Communications Commission (FCC), and technological advances. In addition, basic structural changes in the telecommunications industry are in progress as a result of the opinion in United States v American Tel. & Tel. Co. (1983) 552 F. Supp. 131.

In the OII we raised specific questions. We received written responses from over 40 parties, including local telephone operating companies, long-distance carriers, large telecommunications customers, organizations representing consumers, and certain other interests. Most of those responding also participated in hearings on

April 27, 28, and 29, 1983 at which the Commission sat en banc.<sup>1</sup> At the hearings, the parties responding augmented their written statements with additional information. The Commission also heard statements by two independent consultants invited by the Commission and one additional consultant appearing on behalf of a consumer group.

Our basic concern in this proceeding is how to perpetuate the concept of near-universal communications service in an area that has been a regulated monopoly but is becoming a competitive business. In recent years, about 98% of residential households in California have had telephones, and it is safe to say that even the smallest business needing a telephone has been able to afford one.

#### Background

To a great extent universal service has been made increasingly possible over the last 50 years by federal and state governmental policy which permitted a monopolistic telecommunications structure, under regulation, and which established rate structures that required toll revenues to support a significant portion of the fixed costs of the local telephone network.<sup>2</sup> Among other things, intercompany toll settlement methods were established which were favorable to rural telephone companies.

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<sup>1</sup> On the first day, the members of the Commission were joined in hearing the statements by Nevada Public Service Commissioner Douglas Ponn.

<sup>2</sup> Whether such support constitutes a subsidy, and if so, how great a subsidy exists, is a subject of controversy.

Starting with the late 1950s, some point-to-point private line competition was permitted but this did not have a marked effect on toll revenues. Then in 1975, MCI Telecommunications Corporation (MCI) introduced its Execunet service, which included a foreign exchange (FX) feature. A customer could call an access code, be connected via the MCI line to a distant city, and then dial any number in the local exchange of that city.

The FCC, believing this service to be directly competitive with telephone network toll service and outside what it had in mind for point-to-point service, decided that MCI was not authorized to offer it. The FCC was reversed on appeal. (MCI Telecom. Corp. v FCC (1977) 561 F 2d 365.) Introduction of other similar services rapidly followed, precipitating price competition for toll service in the high volume commercial-industrial communications corridors, of which the toll routes between the San Francisco Bay Area and the Los Angeles-Orange County-San Diego area are a prime example. The "specialized common carriers," as MCI and similar companies are called, placed pressure on Bell System companies to offer competitive price responses to such services.

In 1974, in the midst of this climate of growing transmission competition, and with increasing controversy over the tie-in between American Telephone and Telegraph Company (AT&T) and Western Electric, its manufacturing subsidiary, the U.S. Department of Justice commenced an antitrust suit against Western Electric and AT&T. The complaint's prayer included several different requests for relief, but many regulators believed the primary thrust of the suit

to be improved terminal equipment competition by way of forcing AT&T to sell Western Electric and perhaps Bell Laboratories as well.<sup>3</sup> However, after five years of false starts, the cases were placed on a schedule designed to start trial late in 1980. More procedural maneuvering followed and a settlement was finally announced in 1982 which led to the U.S. v AT&T opinion, supra, generally referred to as the Modified Final Judgment (MFJ).

Under the MFJ, AT&T will divest its local operating companies as of January 1, 1984. Most of the Bell operating companies will be restructured but The Pacific Telephone and Telegraph Company (Pacific) will remain as the company serving most of California and Nevada.

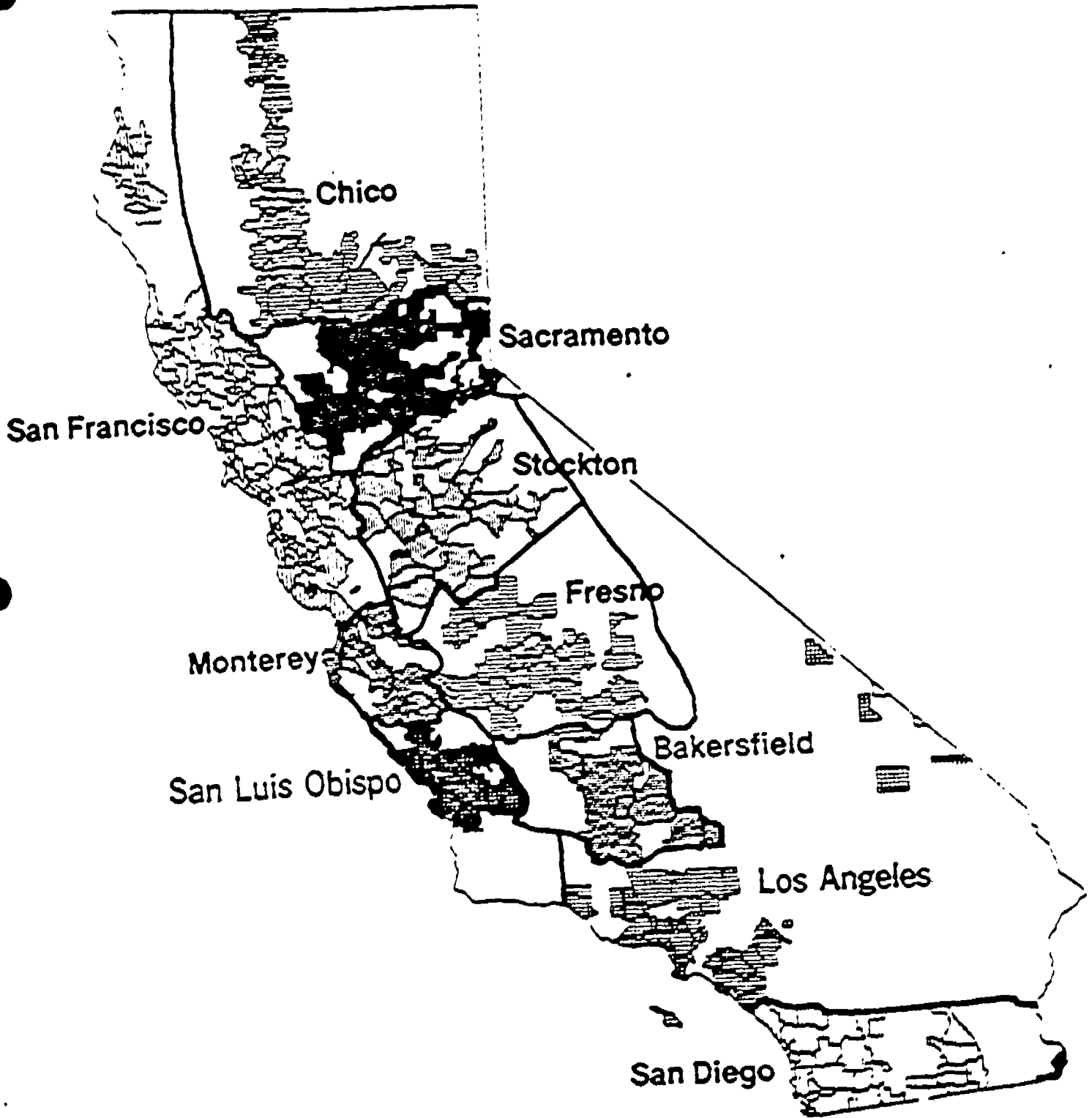
One of the MFJ's major effects in California stems from dividing the entire nation into a series of Local Access and Transport Areas (LATAs) beyond which a former Bell operating company is prohibited from transporting a call.<sup>4</sup> In California there are ten LATAs (see map on following page). Long-distance common carriers must be used for inter-LATA calls, regardless of whether they are interstate or intrastate. Thus, much of the intrastate intercity traffic formerly carried by Pacific will be lost to it upon divestiture in 1984.

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<sup>3</sup> A discussion of free competition in the terminal equipment field is beyond the scope of this decision. We have supported it, and have tried to eliminate subsidies from local telephone rates to manufacturing or manufacturing-oriented research. See Pacific Tel. & Tel. Co. (1979) 1 CPUC 2d 488 (Bell System license contract investigation).

<sup>4</sup> Independent (non-Bell) companies were not divided into LATAs but their areas are small enough that they never transported calls over distances such as were available to Pacific.

# CALIFORNIA LATAS



The MFJ also requires replacement of toll settlement agreements between telephone companies by a system of "access charges." This further reduces the funds available for support of local costs. The MFJ did not require these access charges to be placed upon the end user rather than the interexchange carriers, but the FCC in Docket 78-72,<sup>5</sup> imposes a method for interstate regulation which shifts recovery of what the FCC deems to be fixed (non-traffic sensitive) costs to the local customers. In its Third Report and Order in that docket, released February 28, 1983, the FCC concluded that recovery of fixed costs through usage (i.e. per-call) charges produces discrimination among message toll service (MTS) users resulting in interservice disparities. The FCC therefore mandated the recovery of a substantial portion of fixed exchange plant costs through flat monthly access charges upon end users. These charges cannot be less than \$2 for residential service and \$4 for business service. More of the fixed costs will be recovered in this manner over a five-year transition period, with access charges rising over that period. Since the network is not capable of blocking interstate service at a subscriber's request, all telephone customers will pay the access charge regardless of whether any interstate calls are placed. These charges take effect in January 1984.

The Third Report and Order also established a "Universal Service Fund" which is intended to "preserve universal service by enabling high cost local exchange companies to establish local exchange rates that do not substantially exceed rates charged by other local exchange companies." (Page 3.) This fund is basically directed at companies (essentially serving rural areas), which have per-station costs over a set limit.

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<sup>5</sup> The official title of this proceeding is MTS and WATS Market Structure but it has become generally known as the "access charge investigation."

With this background in mind, we initiated this investigation to present us with an overview of the problems we will encounter and suggestions for solving them. We do not intend at this point to order one or more parties to take any action, or to make any final judgment on any issue.

Intra-DATA Competition in  
Transmission Services

The issue of whether competition should be permitted in various intrastate telecommunications markets, and the ground rules for such competition, was a major issue in these proceedings. This Commission has jurisdiction over all intrastate telecommunications transmission within California, and competing carriers must receive certificate to provide service.

Nearly all parties appear to agree that competition should be permitted between LATAs, as contemplated by the MFJ. There was, however, a debate on the ground rules for such competition. The biggest dispute appeared regarding whether competition should be permitted within LATAs. Opinion here diverged significantly.

Pacific and the other local exchange telephone companies state that the local exchange company should retain toll monopoly within the LATAs. The MFJ took care not to draw the LATA boundaries too small, these companies point out, in order to leave them with some toll revenue. (See LATA map.) The local companies believe that failure to retain at least this vestige of the former toll monopoly will place a drain upon their revenues, which can only be countered by large increases in basic exchange service. Some rural companies believe that this toll revenue drain cannot be recovered by basic rates and that this will lead to their financial ruin.

The long-distance companies refer to the language of the MFJ and the later opinion filed April 20, 1983 in U.S. v AT&T which

finalizes the LATAs. These carriers point out that the Court favors such competition. They also agreed that an anticompetitive stance upon our part will increase the use of technology which bypasses the exchange network entirely. This includes not only various wireless methodologies but cable TV, which now has two-way voice and data capability.<sup>6</sup>

A few speakers at the hearing suggested that the financial health of local telephone companies and near-universal service are issues which no longer concern the Commission. In their view, if subsidies are necessary to maintain near-universal service it is up to Congress and the state legislatures to provide for such subsidies through the tax mechanism. Such legislative bodies can also enact bailout schemes for the operating companies if necessary.

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<sup>6</sup> In Television Transmission v PUC (1956) 47 Cal 2d 82, the California Supreme Court decided that we have no jurisdiction to regulate the one-way video service offered by cable TV. The Court relied upon the distinction between such service and two-way communication capability in reaching its decision (*id.* at page 87). Cal. Const. Art. XII § 3 defines as public utilities private corporations or persons that "own, operate, control, or manage a line, plant, or system for...the transmission of telephone and telegraph messages...directly or indirectly for the public." This broad language makes it clear that the Commission's jurisdiction is not limited to traditional landline telephone and telegraph systems. (Cf. Pacific Tel. & Tel. Co. v SPCC [1975] 78 CPUC 123, abstracted at 8 PUR 4th 582 and 598.) Cable TV interests in this proceeding argue that since the primary service (TV) is unregulated, ancillary services should also be unregulated. See statement by Lo-Co Cable TV in Appendix, page 43.



In this proceeding to date, we have held only legislative-type hearings to give us an overview of issues. Therefore at this point we are not going to decide what level of competition should exist within the LATAs. However, we do note that the relationship between competition and the maintenance of near-universal service is an issue that we will continue to explore, as is the relationship between near-universal service and local operating company financial health. We reject the claim that these issues are not within our preview. The second paragraph of Public Utilities Code § 451 reads:

"Every public utility shall furnish and maintain such adequate, efficient, just, and reasonable service, instrumentalities, equipment, and facilities, including telephone facilities, as defined in Section 54.1 of the Civil Code, as are necessary to promote the safety, health, comfort, and convenience of its patrons, employees, and the public."

See also § 701, conferring upon the Commission general supervisory and regulatory powers.

It is noteworthy that similar arguments were rejected by the U.S. District Court in its April 20, 1983 opinion:

"As its approval of the decree and the basic divestiture plan indicates, the Court believes not only that competition in telecommunications services and products markets is required by law but also that such competition will be healthy and will benefit the American people, including particularly the American consumer. The Court is continuing strongly to foster the objective of competition, including by such measures as the conditioning of judicial approval of exceptions from the standard provisions of the decree upon the grant by the Operating Companies of fair and equal access to carriers who wish to compete for the intra-LATA business. See pp. 31-34 *infra*. In a similar vein, the Court intends to see to it that the division of AT&T's assets will not leave the Operating Companies with outdated equipment for the access of the smaller interexchange

carriers while AT&T retains the most modern, the most efficient switches and other facilities.

"At the same time, the Court also expects to do what it legitimately can to strengthen the ability of the Operating Companies to function as viable entities, not dependent upon inordinate rate increases for their survival. Some, particularly MCI, maintain that the health of the Operating Companies is not a legitimate concern of the Court. But the Court has taken similar factors into account before, and it will do so again now. Under established legal principles, the Court is clearly free to consider the public interest in its broad sense as long as such consideration does not negate the objectives of the antitrust laws. 552 F. Supp. at 150-151.

"There can be no doubt that the continued viability of the Operating Companies is in the public interest. These companies will next January assume the responsibility of providing basic local telephone service, and it is upon them, too, that will depend the realization of the goal of universal service; i.e., the goal of providing affordable telephone service to all, including those who are not affluent or who reside in relatively isolated areas. That objective will retain all of its vitality after the reorganization of AT&T. The Court will therefore approve LATAs which tend to preserve the effectiveness and the viability of the Operating Companies." (Mimeo. pp. 11-13, footnotes omitted.)

In conclusion on this issue, we fully recognize its importance and that it is up to state regulators to come to grips with it.

We will address the issue of competition in transmission services in a new OII issued concurrently with this order, which consolidates the individual applications of carriers. Parties interested in participating in those proceedings should obtain a copy of that order.

"Dominant" and "Non-Dominant" Categories

Related to the issue of transmission competition is the recommendation by specialized common carrier interests other than the Bell Interexchange entity<sup>7</sup> that this Commission follow the FCC and designate Bell Interexchange and Pacific as "dominant" carriers, subject to full regulation (full formal applications and complete cost justifications for rate or tariff changes or new services) while the other interexchange carriers are designated "non-dominant." For the latter category there would be a simplified tariff-filing procedure with changes going into effect automatically, or at least some expedited procedure to allow the other interexchange carriers to meet competitive situations.

Pacific and Bell Interexchange claim that this is unfair and an attempt to ensnare them in regulatory red tape while their competitors are free to compete with little regulatory oversight. They deny that they will be "dominant" after divestiture and in this connection point to the rapid growth and financial health of the other carriers. They maintain that these categorizations were adopted by the FCC with the predivestiture Bell System organization in mind.

It is premature to make formal designations. We will decide what classifications are appropriate as we reach the fundamental decision on whether or not to permit competition intrastate.

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<sup>7</sup> In the predivestiture organization, interstate traffic is carried by the AT&T Long Lines Department. After divestiture, the department will become an AT&T subsidiary and will carry not only interstate calls but also intrastate inter-LATA traffic. A permanent name has not been chosen for the new company, and it is referred to hereafter as "Bell Interexchange."

The issue of how we should handle applications for intrastate certificates and rates is already before us in two applications, one by MCI (Application (A.) 82-12-21) and the other by Southern Pacific Communications Company (A.83-01-20). We will address the issue in those proceedings.

Rate Structures and Universal Service

Various parties made suggestions on how to save the lifeline category of service, or how to keep single-line residential service as cheap as possible. Virtually all parties expect significant increases in local service charges (both residential and business) regardless of what rate design is devised.

Means test. One suggestion is that any lifeline rate should be specifically targeted and not available (as it is now) to anyone who wishes it. Local operating companies generally resist this approach as raising administrative costs and as being impossible to enforce.<sup>8</sup>

Public assistance. A few parties believe that market forces should operate to the fullest and that any cross-subsidization should cease. If some people need financial relief to obtain telephone service, so this argument runs, it should be the business of Congress and the state legislatures. (See comments on this suggestion under the DATA competition discussion, above.)

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<sup>8</sup> A previously established lifeline means test was discarded by us as an undue administrative burden, after which the use of lifeline, where available, began to grow at a rate of 3% a year. A survey in evidence in a previous Pacific rate increase case showed that over half the customers on lifeline chose it because of their telephone usage patterns rather than because of their income limitations. (See Discussion, Pacific Tel. & Tel. Co. [1976] 80 CPUC 621; dissenting opinion, pp. 634-636 [15 PUR 4th 398, 410-411].)

Rate design features. The larger telephone companies prefer a measured service approach. They believe that a measured rate structure could be devised which would be strict enough so that no one would want the service if the higher grade of residential service was affordable.

This method has any number of variations, such as placing everyone on measured service, or having a premium flat rate residential category at a relatively high monthly charge.

Small telephone companies do not offer lifeline service and do not favor it because there is an insufficient revenue base to sustain it without materially increasing rates to others. Regarding measured service, some of the chief executive officers of these companies warned us not to impose it upon them under a schedule which would force them to replace central office plant (i.e. switch from mechanical to electronic equipment) ahead of normal plant retirements. They are willing to consider 100% usage-sensitive service after installing all electronic equipment, but acceleration of the process, they say, will cause significant upward pressure on local rates in their areas.<sup>9</sup> They also state that in very small exchanges, installation of equipment capable of measured local service is too expensive per customer.

The problem is aggravated by the flat access charge system (see following section) since the network cannot presently be blocked so that some users cannot make an interstate or intercity call. Under present network technology we cannot devise a lifeline rate for "local calls only" which would eliminate access charges to the intercity network.

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<sup>9</sup> These companies should by no means be thought of as backward in their technology. The statements of their presidents indicate that electronic equipment is advantageous to them and many such companies already are heavy users of it and other up-to-date products as well.

The residential rate structure problem is one of the most difficult issues we face. Because of the variety of equipment configurations we must approach the problem on a company-by-company basis in rate case proceedings.

Access Charges

The LATA system and its division of responsibilities means that revenues from long-distance traffic will no longer be shared among telephone companies by use of settlement formulas now in effect. To compensate for this loss of revenue, the FCC has ordered access charges to begin on January 1, 1984. (See discussion of FCC Docket 78-72 above under "Background.")

We have taken the position that any flat access charges (those not dependent on actual usage) should be imposed upon the long-distance carriers and not the end users. Revenues from these charges could then be used by the local operating companies to offset the revenues lost from long-lines service. We have appealed the FCC's decision to the Court of Appeals for the District of Columbia Circuit.<sup>10</sup>

In its April 21 opinion finalizing the LATAs, the U.S. District Court commented as follows on the FCC's method (mimeo. pp. 13-18, footnotes omitted):

"It may appropriately be generalized that local telephone service is relatively more relied upon by individuals and that long distance is more business-oriented. If the objective of telephone service available at reasonable rates to all is not to be jeopardized, it is therefore most important that local rates not be burdened by unnecessary increases. As the Court repeatedly pointed out in its August 11, 1982, Opinion (especially in connection with the discussion of

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<sup>10</sup> People of the State of California and the Public Utilities Commission of the State of California v Federal Communications Commission and the United States of America. No. 83-1439.

the access charge issue (see *infra*) there is no legitimate basis for using the reorganization of the Bell System as a means of undermining the universal service objective or as an excuse for raising local rates.

"The Court has therefore noted with considerable surprise and some dismay that the Federal Communications Commission, far from using the access charge tool as a means for easing the burdens on the users of local telephone service, has opted instead, in a major decision issued since the Court's approval of the consent decree, to saddle the local subscribers with the access costs of interexchange carriers. Curiously, although the FCC cites that decree and ostensibly regards its decision as assisting in its implementation, the agency's action runs directly counter to one of the decree's principal assumptions and purposes -- that the fostering of competition in the telecommunications field need not and should not be the cause of increases in local telephone rates.

"The Commission's action is undergirded by two premises: first, that long-distance revenues have been subsidizing local rates, and second, that the burden of the Operating Companies' new revenue needs to compensate for the lost 'subsidy' must for reasons of policy and economics be borne primarily by the residential subscribers. There is no basis for either of these premises.

"In the first place, it is not at all clear that the subsidy assumed by the FCC has ever existed. In its extended oversight of AT&T, and in investigations extending over many years, the Commission was never able to determine whether, in fact, local rates had been subsidized by long distance rates. In spite of that record, the FCC in its December 1982 decision simply ignored the subsidy problem and went on to decide that, subsidy or not, the telecommunications system's fixed costs (see note 37 *supra*) shall ultimately be borne by the individual subscribers. These subscribers, moreover, will bear this burden regardless of how frequently, if at all, they

make use of their instruments for long distance calls.

"Second, even if it be assumed that there was such a subsidy, it is quite clear that means other than rate increases for residential subscribers are available to make up for the lost funds. It was considered by everyone concerned, including this Court when it approved the decree, that if it were ever determined that AT&T's interstate rates had, in fact, been subsidizing local service, compliance with the law's universal service objective could and would be achieved by replacing the subsidy with access charges levied on the interexchange carriers."

\* \* \*

"During the public interest proceeding which preceded the entry of the decree [the XEJ] no one -- including the FCC -- suggested that access charges should be shifted from the interexchange carriers (which require access to the local networks to enable them to do business) to the local users (who are already paying for those local networks through their telephone rates)."

Assuming for discussion purposes that the FCC's decision stands (and is not modified by Congressional action), must we adopt a similar system? Some of the interexchange carriers and local telephone companies say "yes" because they believe that an intrastate system which loads costs onto the interexchange carriers will lead to increased use of bypass technology or to configuring equipment to



favor interstate connections.<sup>11</sup> The small telephone companies consider such statewide averaging to be essential to their economic survival. Pacific takes the position that this is not necessary because of the universal service fund established by the FCC in Docket 78-72.

These access charge issues will be resolved in Pacific's pending rate increase application (A.83-01-22) and in the associated OII 83-04-02, which includes the remaining California intrastate telephone companies as respondents.

#### Bypass Technology

In the OII we asked whether there is a threshold level for access charges at which bypass of local exchange facilities becomes economically feasible. Almost all participants answered in the negative, pointing out that bypass is an individual decision based upon analysis of costs.

It appeared to be the consensus of the participants that bypass should not be prohibited by legislation but that access charges should be set equitably to discourage it. Some parties who are large telecommunications users believe that pooling of access charges (i.e. statewide averaging) would encourage bypass by raising the charges in the high-volume communications corridors.

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<sup>11</sup> This is sometimes referred to as "rusty switch" engineering. The FCC has taken the position in some instances that jurisdiction is electronic rather than geographic; that is, a call from San Francisco to Los Angeles is an interstate call if it is routed through Nevada. We have consistently advocated that this is an unreasonable interpretation of the Federal Communications Act. We were urged at the hearings in this proceeding, by the attorney representing independent telephone companies, to seek federal legislation clarifying the Act to confirm state jurisdiction over telecommunications traffic between two locations in one state, regardless of the routing, and regardless of whether the network carrying such calls also carries interstate traffic.

The record would seem to indicate that the bypass problem is principally part of the rate structure and access charge issues.

Discussion

The preceding review is by no means an exhaustive list of issues facing state commissions on this subject. This proceeding, so far, has served as a general overview of the restructuring of the U.S. telecommunications industry and the problems involved in maintaining near-universal service. The participants have provided thoughtful and useful information which will provide guidance in resolving the major policy issues facing the Commission in regulating intrastate telecommunications service.

This OII will remain open for future use by the Commission in investigating particular issues in more detail.

INTERIM ORDER

IT IS ORDERED that this OII shall remain open for use by the Commission in investigating specific issues related to the restructuring of, and the introduction of competition into, the telecommunications industry.

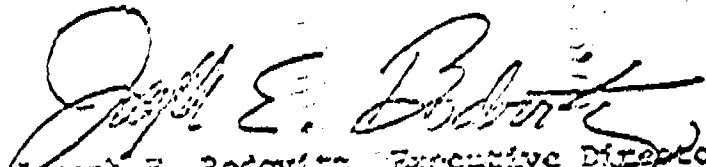
This order becomes effective 30 days from today.

Dated JUN 29 1983, at San Francisco, California.

LEONARD M. GRIMES, JR.  
President

VICTOR CALVO  
PRISCILLA C. CREW  
DONALD VIAL  
WILLIAM T. BAGLEY  
Commissioners

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

  
Joseph E. Bodovitz, Executive Director

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This appendix reviews highlights of the written statements sent to the Commission prior to the hearing, and incorporates certain selected material from the hearings on April 27, 28, and 29, 1983 (principally the presentations of three telecommunications consultants invited to participate who did not file written statements). No significance is intended by the particular order in which the statements are reviewed. Local operating telephone companies and their representatives have been grouped at the beginning. No speaker's name appears where written material only was submitted.

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The Commission should not authorize competition within the DATAs after divestiture. Certain competitive carriers may be competing on an intrastate basis presently without certificated authority. All carriers should submit billing tapes for Commission's analysis to determine the extent of this.

Pacific opposes authorization of intra-DATA competition because it will force rapid increases in rates.

Present policies have resulted in affordable service for all classes of customers, subsidies for special customer classes, rate averaging across all geographic areas regardless of costs, service upon demand and rapid restoration, efficient utilization of existing utility plant, and financial viability of utilities.

The present rate structure is a complex system of cross-subsidies. These include subsidies from one class of service to others, from one class of users to others, those arising from rate averaging across geography, and subsidies caused by postponing the recovery of plant investment costs to the future. Such subsidies cannot be maintained in a competitive environment. Markets and services where Pacific's rates have been held artificially high are targets for competitive entry. In California, the communications market is concentrated in high traffic corridors and geographic centers, facilitating competition in those areas.

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Toll service today is the principal source of subsidy flowing within Pacific's rate structure. This includes:

Local access	1.54 billion
Local usage	700 million
Private line	580 million
Service connections	350 million
Coin service	<u>100 million</u>
 Total	 3.27 billion

High-volume toll users tend to support low-volume users and business customers as a class support residence customers.

Rate averaging means the same rates statewide regardless of cost differences in servicing certain areas. Customers in high-cost rural areas benefit from rate averaging. The cost of residential access in some rural areas can be as high as four times the cost in the more populous areas. Introduction of competitive carriers will erode Pacific's ability to average across geographic areas. Some rural service might go as high as \$50 a month.

The Commission's historical policy of capitalizing and amortizing rather than expensing costs that might have been expensed has a similar impact in deferring the burden of cost recovery to the future. Future ratepayers subsidize present ratepayers.

Pacific's overall depreciation reserve has declined to 18%, less than the 22% to 59% range of principal competitors. Pacific's ability to deploy new technology depends on its ability to recover its full costs over the economic lives of the assets. The lives prescribed for Pacific's plant equate to an average of 19 years. Pacific's principal competitors are recovering their costs over a period of between 6 to 17 years. Authorizing intra-LATA competition now would impair Pacific's ability to recover its invested capital and attain depreciation rates and depreciation reserve levels comparable to competitive firms operating within the industry.

Entry of competitors into the intra-LATA market at the present time will drive rates toward actual costs and undermine the Commission's ability to oversee the subsidy flows that have served the public interest. This is particularly true in California where the market has high density traffic corridors and concentrated clusters of originating and terminating traffic. At present, for

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example, the Commission has set Pacific's toll rates at levels in excess of costs in order to subsidize other services. A call of 70 miles is priced at about four times cost, a call of 15 miles is priced about five times cost, and a call of 245 miles is priced at about six times cost. Authorizing competition in the intra-LATA market will allow entrance to achieve their objective by the following means, which have already succeeded interstate:

1. Focusing on high density corridors and major clusters.
2. Leasing and reselling of Pacific's network facilities in order to increase market coverage at little cost.
3. Concentrating on technologies and facility arrangements with low-entry and exit costs (satellite- and radio-based terrestrial) reducing risk exposure.
4. The use of bypass technology.
5. Demanding favorable terms for interconnection to the existing carrier network to achieve broad market access at little cost.
6. Using the regulatory process to handicap the established carrier (Pacific) in making any moves toward competitive repricing of services.

The following chart shows how sudden loss of subsidies could affect selected service rates:

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	<u>Current Rates</u>	<u>Averaged Rates Priced at Cost</u>	<u>Percent Change</u>
<b>INTRA-DATA ACCESS</b>			
(Subsidy: \$1,540,000)			
Residence Flat Rate (IFR)	\$7.00*	\$ 29*	414%
Residence Access (IMR)	\$3.75	\$ 23	513%
Business Access (IMB)	\$7.00	\$ 20	186%
<b>LOCAL USAGE</b>			
(Subsidy: \$700,000,000)			
5-minute call			
For example,			
a 0-8 mile call	\$ .07**	\$.10***	N/A
<b>PRIVATE LINE</b>			
(Subsidy: \$580,000,000)			
Typical Service			
(27 loops, 2 channels, 15 miles)			
	\$ 260	\$500	92%
<b>SERVICE CONNECTIONS</b>			
(Subsidy: \$350,000,000)			
Residence	\$ 23	\$145	530%
Business	\$ 35	\$175	400%
<b>COIN SERVICE</b>			
(Subsidy: \$100,000,000)			
Local Coin Call	10c	25c	150%

\*Includes local calls (0-8 miles).  
 \*\*Only applied to measured service local calls.  
 \*\*\*Applied to all local calls.

Bypass systems are also affecting subsidy flows. A large number of business customers have already begun bypassing the public-switched network in favor of various private systems. Pacific is vulnerable to this because of high concentration of revenues generated by its largest business customers. Only 1.3% of customer locations generate 36% of total business usage revenues. At the end of 1982 there were 258 licensed telecommunications satellites, 4,255 nonutility microwave channels licensed in California, and 56,272 other common carrier private lines in service in California as well as 18,700 ENPIA lines diverting traffic from the public-switched network.



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Pacific proposes the following regulatory policy:

1. Deny petitions for competitive entry into the toll markets of California including intra-LATA markets after Pacific's divestiture.
2. Stop unauthorized and illegal provision of intrastate services.
3. Develop a new regulatory framework to restructure rates.

Intra-LATA competition can only take place if the Commission allows telephone companies to be relieved of public service obligations, which include the common carrier obligation, a subsidy cost, and the rate averaging disadvantage for rate of return restrictions on competitive services not shared by competitors. "We simply cannot continue to act as a sole provider public utility if, in fact, we are not."

No distinction should be made between competitors on the basis of the Federal Communications Commission's (FCC) use of the terms "dominant" and "non-dominant" carriers. This was intended to encourage new carriers to move into the interstate market which is characterized by relatively high entry costs. The low-cost and relative ease of entry for exit into the intra-LATA market make these one-sided restrictions inappropriate.

If the Commission after divestiture authorizes inter-LATA as opposed to intra-LATA competition, competitors either should be required to block their networks to preclude ability of customers to obtain unauthorized services between points within a LATA or should forfeit their certificates. Within the LATAs all services should be treated under a common regulatory philosophy.

The ongoing effect of competition will be to drive rates to costs. The more competition introduced, the less flexibility there will be to generate subsidies. Additional (intra-LATA) competition will jeopardize support of universal access. A vicious circle is created in which loss of high-volume users is followed by reduced revenues, while fixed costs remain. Rates must be increased which invite additional competition, etc.

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<sup>1</sup> On May 12, 1983, Pacific filed a complaint (Case 83-05-05) against MCI, SPCC, and Western Union alleging that the defendants are offering "unauthorized intrastate message service."

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In response to the Commission's inquiry on what are the implications for California if it follows the FCC policy in Docket 78-72 (commonly called access docket), the effect will be twofold: to raise the rate for basic access to the network, and to lower the rate for inter-LATA calls. Over the next five to seven years this will result in an approximately \$11 per intrastate increase on residence customers being added to the rate for basic access to the network. According to Pacific's estimates it should also result in rates charged for inter-LATA services being approximately 30 to 40% lower than they otherwise would have been. The overall effect is to spread the cost of network access more uniformly across all customers.

In applying the principles of the FCC's case, the Commission should avoid inviting heavy users to leave Pacific's network due to artificial pricing policies.

Regarding the use of flat rates, usage sensitive rates, or a combination, the principles set forth in Docket 78-72 should apply. Charges for use of traffic sensitive costs should be assessed on a usage basis, while charges for the use of non-traffic sensitive (NTS) plant should be assessed on a flat basis.

A threshold level for access charges at which bypass is economically feasible cannot be established. There is no single threshold. Bypass is a customer decision based upon individual circumstances and economics.

There are actually three kinds of bypass. The first involves a customer's building its own facilities. Another form, more readily available, is the use of telephone company private-line services, encouraged by existing private-line rate levels which are substantially below costs. A third form involves use of alternate carrier facilities between the customer's premises and the carrier's point of presence. Restructuring rates is necessary.

Forced pooling between Pacific and other California companies to reduce rates in high-cost areas should not be established. The "universal service fund" established by Docket 78-72 is the appropriate way to provide relief.

Universal service is the goal but an exact level of what is "affordable" is hard to establish. In the Minneapolis-St. Paul area single-line monthly rate is \$11.71 with a two-party \$5.40 lifeline service. These rates are substantially above Pacific's flat rate of \$7 and lifeline rate of \$2.50. Nevertheless, over 98% of the households in Minneapolis, St. Paul have service. That is 3% higher than the average for California, where for Pacific's ratepayers, the real cost has actually declined. The following table shows San Francisco's rate history:

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	<u>1950</u>	<u>1960</u>	<u>1970</u>	<u>1980</u>	<u>1982</u>
Actual charges	\$4.75	\$5.05	\$4.65	\$ 7.00	\$ 7.00
Charges in 1950 constant dollars	4.75	3.96	2.80	1.90	1.64
1950 charges increased at same rate as CPI	4.75	6.10	7.90	17.15	20.25
Average hours worked per month to pay for service*	3.0	2.0	1.3	1.0	0.8

\*Average California manufacturing worker.

Evaluating basic rate history from 1950 shows that average hours worked per month to pay for basic service actually declines from 3.0 to 0.8 from 1950 to 1982. (Actual charges went from \$4.75 to \$7, but charges in 1950 constant dollars would show a decline from \$4.75 to \$1.64).

No customer means test should be established for a lifeline. This would be administratively impossible.

Optional measured service can contribute to universal service. To do this, basic access should be unbundled from usage so that customers can make individual decisions regarding the usage package best meeting their needs. By January 1985 97% of the main stations in the ZUM will have measurement capability (ZUM areas exist at present in San Francisco and Los Angeles and Pacific is being required to file a plan in its present rate increase case for Orange, San Diego, and Sacramento Counties. ZUM plans allow customers in large metropolitan areas to make calls on a local basis to the customer's own exchange plus one or more additional exchanges which, on the average, encompass the area of interest as far as work, shopping, and other needs are concerned).

Citizens Utilities (Donald L. Oesterreicher)

California interstate toll markets are already open to selective competition because of FCC decisions. Competition in intrasrate toll markets would appear to be inevitable. The unanswered question concerns competition in the local exchange markets. Citizens encourages the Commission to continue regulation of local exchange service as a natural monopoly.

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In California, the effects on settlements of Pacific's change in depreciation methods from remaining life to equal life group depreciation will cause an increase in local exchange rate for Citizens customers of between \$2 and \$3 per access line, if the total amount of the additional depreciation expense is recovered through local exchange rates.

Additional upward pressures are caused by the access charges (FCC Docket 78-72) and changes in accounting procedures to expense rather than capitalize costs related to the installation and removal of inside wire and telephone apparatus, ordered by the FCC in 1981. In California the impact of this latter change for Citizens was an increase of \$186,000 in service connection charges, and annual increase in local service rates of \$406,000, plus an increase in intrastate toll rates.

Citizens does not agree that competition stimulates modernization of plant, because in an effort to maintain high quality service at an affordable price, the telephone industry has always pursued a high level of technological innovation, for example, fiber optic technology. Citizens has not seen a demonstration of a positive effect which competition has on the development of new technology or the efficiency of the telephone system. The introduction of competition may even have slowed technological advances because of the negative impact competition has on the earnings telephone companies.

Citizens recommends that the Commission develop an access charge structure based on the approach proposed by USITA in FCC Docket 78-72. This includes:

1. A uniform nationwide and statewide average access charge rate structure.
2. A relatively low per-line charge which would not be an additional threat to universal service.
3. An interexchange carrier charge based on minutes of use, which could include all local switching costs plus other transitional costs such as customer-provided equipment.

In Citizens' opinion access charges are best assessed against the interexchange carrier. The recovery of costs allocated to interexchange jurisdictions is more appropriately recovered through those deriving the economic benefit from access to the local network. Citizens realizes that the FCC, in Docket 78-72, has

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established restrictions limiting the California Commission's ability to set alternative access charge rate structures. It may therefore be necessary to assess a portion of the charges directly from the local customer. If this is necessary a limit must be set so as not to threaten the goal of universal service.

Regarding bypass, rather than restricting it, Citizens recommends access charges be assessed equitably to all carriers and services using the exchange network, including bypass technologies. The FCC's position on bypass will make restrictions difficult. That agency has indicated it will not try to use its statutory authority to restrict bypass.

Citizens believes that intrastate access charges in California should be averaged over all companies and that the revenues should be pooled and distributed to each company based on its cost of providing access. Without such a system some subscribers of small, independent telephone companies will pay access charges significantly higher than subscribers in large cities. When it adopted a universal service fund the FCC endorsed, at least to a degree, a pooling of access charges. The jurisdictional separations formula developed by the FCC's Joint Board includes as one element "a high cost factor" designed to provide for telephone companies in high-cost service areas. In a pooled environment, the high-cost factor could be incorporated into the access charge and distributed in a manner similar to existing settlement arrangements.

Minimum telephone service should provide access equivalent to basic service, but should include a very limited amount of access to the network with rates structures to increase rapidly above this minimum.

Optional measured service could contribute to the goal of universal service, but because of the cost of implementing local measured service Citizens does not recommend that measured service be optional. Also, in many cases, particularly in small exchanges, local measured service may not be cost-effective. Citizens currently has the capability to provide measured service in three of its 28 offices. To equip the rest of them would cause substantial additional cost in the short run. In addition to the switching equipment costs, a sizable additional amount could be required for increased data processing and other support services.

The only restriction which should be imposed on toll competition or bypass is the requirement that all services pay equally for access to the network. Since the FCC is unwilling to impose its authority on bypass, restriction of intrastate bypass may

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not be an alternative available to the Commission. The goal of universal service justifies some restriction if bypass occurs at the local exchange level.

Citizens continues to believe that the traditional method of achieving universal service via the toll settlement pool is the appropriate mechanism when used in conjunction with the nationwide pooling of averaged interstate access charges. Any other mechanism needlessly penalizes areas where it is more expensive to build and maintain local facilities. Citizens has presented evidence in Docket 78-72 showing the undue rate increase impacts which would result from access charges deaveraged on a state-by-state basis. A further deaveraging to the company level would result in an extreme variation of access charges between different service areas.

General Telephone Company (David E. Anderson)

There are three basic markets: local calls, intra-LATA calls, and inter-LATA calls. There is, or will be, some competition even locally from cellular mobile radio, radial paging, dial mobile service, and private networks.

The goal of universal service has been supported by price averaging. As interexchange carriers and new suppliers enter the California market on a selective basis (in the low-cost, high-call volume urban areas) they can attract the greatest number of subscribers with the least possible investment at the lowest monthly rate. When such users abandon telephone company service, the company is left with investment in idle switching equipment and local cable facilities which cannot be immediately reused for other customers. The remaining customers have to pay for such facilities. This will increase the rates for basic telephone service, making the service offered by other carriers even more attractive. This process is already occurring to a limited degree in California. Some competition in the bypass form already exists.

The ideal approach would be for the Commission to disallow competition in the local and intramarket areas and order discontinuance of present unauthorized competition.

The Commission must decide, however, whether or not it is feasible in today's environment in California to establish such restrictions. If they are not feasible, then a pricing philosophy must be developed that will minimize the effects of competition and keep local exchange rates as low as possible.

If there is more than one provider of services, all providers should have equal regulatory burdens, such as:

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1. Filing tariffs with the PUC.
2. Paying local telephone companies a fair share of the costs for access, switching, and transport of traffic.
3. Ability to obtain approval for rate changes from the PUC on a timely basis.
4. Providing equal access to all carriers.
5. Providing service on equal service levels.

If the Commission deems a particular service is being provided under conditions of effective competition, the Commission should withdraw its regulation. Telephone companies should not be regulated in providing a service in a market where unregulated or lightly regulated effective competitors are providing the same or like service.

Rate design flexibility of telephone companies will be attenuated as opportunities to cross-subsidize local telephone service from other products or services are eliminated.

If the Commission follows the FCC policy in Docket 78-72, state toll rates will gradually be reduced with corresponding gradual increases in basic monthly telephone service. For customers who utilize the toll network, this could result for some customers in a monthly bill reduction.

In deciding whether certain charges or costs should be assigned to end users or interexchange carriers, it is important to remember that all of the charges are eventually paid for by end users. California should follow the plan adopted by the FCC for interstate purposes in Docket 78-72. The same mechanisms must be used for recovering traffic sensitive and NIS costs over the same five-to-seven-year transition period. If the states do not have a mirror image of the FCC plan, any perceived price advantage will be exploited by carriers and customers to obtain the lowest possible carrier charge.

Carriers should pay General for use of local switching, and transport of calls through a usage pricing system identical to that established by FCC. If intrastate pricing is higher, some carriers will have an incentive to misrepresent intrastate calls as interstate.

End users should pay for basic local service using usage-sensitive concepts which will result in each user paying full costs for a local access and usage charges for the use of local of

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interexchange switched network. Universally applied measured service offers the best combination of benefits to customers.

Total elimination of bypass is not possible since it would require reversal of policies set over the last 15 years by state and federal regulators and legislators. Bypass can be controlled to a certain extent through rational local pricing systems and mandatory carrier charge structure which allocates costs equitably to the parties receiving services.

General believes that universally affordable service can only be achieved with nonoptional usage sensitive service with local access lines priced to cover NIS costs, and a per call and minute charge for originated usage. This is a fair pay-as-you-go rate structure.

Lifeline service, currently available from General, should be maintained until General converts to nonoptional usage sensitive service. If the Commission deems subsidized service necessary, then the service must be properly structured so that it requires the least possible subsidy from other users. Desirable elements of subsidized service are:

1. Access line rate which recovers as much of the local loop costs as possible.
2. Low or zero call allowance.
3. A per call or permitted charge high enough to encourage conservation and conversion to usage sensitive service.

Continental Telephone Company (Del C. Williams)

The Commission should not permit competition within the LATAs. These were established as a "safe harbor" for the Bell operating companies as a means of assisting universal service. The state toll market should provide universal service support until more is known about the impact of major price increases on universal service.

Competition in any segment of the industry requires cost-based pricing in that segment. If the industry is forced to cost-based pricing extensively, a substantial portion of customers will be without telephone service. Competition will severely restrict ability to design rates to promote universal service for other social programs.

Because competition will assure aggressive development of new technology, realistic depreciation lives must be implemented and revenue to cover depreciation expense must be granted.



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Continental customers paid an average of \$16.13 per main station per month in 1981. After phase-in of FCC Docket 78-72 subscribers will pay, based on 1981 costs, an additional \$4.79 per month for interstate access. If Docket 78-72 were applied to intrastate toll, Continental's subscribers would be charged an additional \$14.43 per month.

Fair compensation to local carriers is any mechanism which satisfies two primary concerns: the maintenance of universal service, and the recovery of a revenue requirement. It must be recognized that interexchange carriers receive economic benefit from the use of a local carrier's exchange facilities.

A task force should be established to conduct a study which will determine a threshold level for access charges at which bypass of local exchange facilities becomes economically feasible. The results of this study could provide invaluable information for this Commission. Setting arbitrary restrictions to limit or prevent bypass is a nightmare. The task force should determine whether bypass should be restricted.

Access charges should be on a pooled basis to the extent needed to insure that universal service is maintained. Included in universal service should be a fair toll price on high-cost routes.

Regarding universal service, the minimum level of service that should be universally affordable includes the ability to access the telephone network. This should be pure measured service. Lifeline service would contribute to continuance of universal service but the cross-subsidization resulting from it increases the problem of setting local service rates for other users. With the ability of measured service, an economical class of service will be available to those customers qualifying for lifeline.

If lifeline service is required, a customer means test is appropriate. However, the test should not require judgment by the utility.

In 1983 only 3.3% of Continental's customers will have measured service and by 1986 this will increase to 25.3%. In some areas the cost of converting to measured service is substantial. Under today's technology the preferred approach is conversion to electronic switching. Even with this, it is necessary to have call recording or ticketing capabilities. For offices with a small number of customers the additional incremental fixed cost will be excessive, as much as \$1,000 per customer.

Urban customers, as well as rural, benefit from universal service. If rural Americans are forced off the network, urban areas

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no longer may communicate with them. Without some subsidy mechanism, most of the communities in this Sierra would not have telephone service today. Safety considerations are also a concern.

Roseville Telephone Company (Robert L. Doyle)

Commission policy on competition should differ from local exchange and long-distance market to the extent it recognizes the natural monopoly characteristic of local exchange service.

If this natural monopoly is no longer believed to exist, policy should be consistent and all competitors should be treated alike. In a competitive environment the Commission should no longer be responsible for considerations such as rates of return. Service standards should be applied equally.

The FCC in Docket 79-105 preempted the state's authority to prescribe intrastate depreciation rates conflicting with the FCC's. Change in depreciation methods from remaining life to equal life group depreciation will cause an increase in local exchange rates for Roseville customers of between \$2 and \$3 per access line. Regarding access charges, the FCC in Docket 78-72 prescribed a rate of \$4 per subscriber beginning in 1984 and this will increase over a five-year transition period resulting in further increases to local rates.

Other upward pressures on local rates result from FCC requirements regarding expensing rather than capitalizing station connection costs, and deregulation of terminal equipment.

Concerning the restriction of competition on the development of new technology, Roseville does not advocate restriction of competition in this regard although there is little to indicate that recent technological developments were related to the introduction of competition to the industry. Fiber optic technology, for example, was at least in the planning stages prior to the Execunet decision. Digital switching is evolving without relation to competition. Competition, in fact, may have slowed technological development because of the negative impact on earnings for a portion of the industry.

If the Commission follows FCC policy in Docket 78-72, there are uncertainties which make it difficult to determine potential impact on local service rates.

Utilizing 1979 cost data adjusted for estimated inflation, flat rate access charges above present local rates to be assessed at the end of the transition period would be:

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	<u>Interstate Toll Access</u>	<u>Intrastate Toll Access</u>	<u>Total Toll Access</u>
7% inflation	\$4.49	\$ 9.52	\$14.01
10% inflation	5.91	12.55	18.46

Roseville recommends the Commission develop an access charge structure proposed by USITA in FCC Docket 78-72. This consists of:

1. A uniform nationwide (and statewide) average access charge rate structure.
2. A relatively low-per line charge which would not be an additional threat to universal service.
3. An interexchange carrier charge based on minutes of use, which could include all local switching costs plus other transitional costs, such as customer-provided equipment.

The charges are best assessed against the interexchange carrier, which derives the economic benefit from access to the local exchange network. The FCC in Docket 78-72 may have limited the Commission's ability to set alternate access charges. It may therefore be necessary to assess a portion of them directly to the local customer. If that is necessary a limit must be set so as not to threaten universal service.

Roseville does not know whether a threshold level for access charges can be established to reduce the possibility of bypass. Roseville recommends that rather than a restriction on bypass, the Commission set access charges equitably for all carriers using the exchange network including bypass technologies, and favors the averaging of access charges ("pooling") on a statewide basis. Without this subscribers to smaller companies will pay significantly higher charges than customers in large cities. Through the adoption of the universal service fund and the transitional pool for residual customer-provided equipment, the FCC has endorsed at least a certain degree of pooling of access charges.

Minimum service should provide access equivalent to basic service but a very limited amount of access to the network with rate structures to increase rapidly above this minimum to a level consistent with full recovery of costs.

If structured to provide a minimum service offering, measured service could contribute to the goal of universal service.

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However, because of the considerable cost of implementing local measured service, it should not be optional. In small exchanges it may not be cost-effective and flat rates may be necessary. Cost-effectiveness of converting exchanges to provide measured rate capability can only be answered on an exchange-by-exchange basis.

CP National Corporation (George Stros)

Considerable competition already exists in interstate toll markets. Therefore, the Commission should address issues of permitting competition in local exchange and intrastate toll markets. If competition is permitted, all entrants should be bound by the same rules. If the Commission allows splitting of local exchange market, local telephone companies should be relieved as being provider of last resort and potential competitors should be required to provide telephone service equal and consistent with the goals of universal service. Without requiring competitors to provide for universal service, telephone service will not be maintained in areas of low profitability.

Another problem with local exchange competition is the utilization of capital resources. Allowing competition to enter an already developed local distribution market will lead to duplication of facilities, increase in administrative costs, and result in the increase of rates to the consumer.

Recovery of access charges must be achieved by pooling revenue and distributing the revenues among the pooling participants on a relative cost basis in order to insure continuance of service in high-cost areas.

Elements of minimum service should include access to the local exchange and the ability to receive incoming calls. Eligibility for lifeline rate should be based on usage and not on an income test which would be too burdensome administratively.

CP National does not believe that universal service can be maintained through optional measured service rates. Either a flat rate or a measured service rate is appropriate. CP National is reviewing the potential of instituting measured service in several of its local exchanges. Initial investigation shows it is too expensive to convert where there is no digital office capability. As digital equipment is installed (on a normal basis) its capability will be present. Any attempt by the Commission to accelerate this process will lead to costs to the customer that exceed the benefit received.

Rate subsidies provided by large telephone users should continue to residential customers. Commercial businesses rely

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heavily on the telephone service in their normal operations. Telephone companies must design facilities to meet this anticipated demand. For this reason CP National believes that rates should be designed to recover a greater portion of costs from the business customer whose demand is relatively inelastic, while at the same time flow to the benefit of residential customers whose demand tends to be relatively elastic.

Alvin E. Pelavin, Attorney at Law)

(Mr. Pelavin represents 17 small independent California telephone companies.)

These telephone companies are generally rural and family-owned. They have experienced growth in the last 30 years and some of them have equipment which is more modern than Bell System. One facet of the growth is expansion beyond the small towns where they are located and into the more rural areas.

The largest part of the revenue requirement of these companies is derived from toll revenues which in some cases constitute 80% of the total company revenues. These have been paid pursuant to separations and settlement procedures which have been in effect. Toll revenues of operating telephone companies have been pooled and then paid to the companies in amounts that meet their established toll revenue requirement. Administratively this is accomplished under contracts with Pacific. While this has been referred to as a subsidy of local rates, it is more accurate to recognize that there has been a precise and complex system of accounting processes allocating toll revenue to those elements of plant and operating expense which were considered dedicated to toll under governing accounting principles.

Under the FCC's new access charge system there will be a true toll subsidy because other common carriers are given access to the network at bargain rates. The local ratepayer will now subsidize the toll carriers.

Developments of the last 30 years have increased revenue requirements of the small companies but most have not initiated rate proceedings because they have met their increased expenses through toll revenue from the settlement process. The exchange rates have remained almost constant since the 1950s. Recent adverse developments in the toll revenue pool have reduced revenues to the point that some of these companies have lost money during their most recent accounting period.

As a result of this development, placing access charges into effect is only half the task. The other half is to establish rates meeting the balance of the revenue requirement. Most rural areas are low-income areas. Establishing high local rates will cause

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many customers to discontinue service. This development will require still higher local rates for the remaining customers. This cycle potentially can reach a point at which the survival of the telephone company becomes questionable.

The FCC's access charge plan includes flat monthly charges assessed equally against each telephone subscriber for the cost of that portion of the interstate plan which the FCC designates as "not traffic sensitive." The FCC decision in Docket 78-72 promises some system of additional high-cost revenue but the details of this system are not specified.

The FCC's access charge plan is logic run amok. It treats a system of definitions as gospel. Over the years, there have been changing definitions of "traffic sensitive" and "non-traffic sensitive" plant. The FCC seizes upon these terms which equate traffic with the pattern followed by electrons during the course of a single telephone conversation. It assigns the cost of the local loop to the subscriber on a flat rate basis essentially on the theory that the cost of the loop does not vary depending on the number of hours per month that messages are carried on the loop. This electronic analysis may suit the purpose of an engineer trying to trouble-shoot a bad circuit, but it is not a definition well suited to the question of cost allocation among different telephone uses.

Each time a telephone call is placed, the caller uses the network. There is no reason to attempt to isolate the existence of a single communications channel between the caller and the recipient of the call as opposed to treating the caller as making use of the entire available network. With the exception of the true dedicated private line, every telephone call placed anywhere in the system makes use of the system. Those who purport to furnish a competitive communications service without maintaining an entirely separate system skim the cream off the top of telephone revenues without bearing the burden of maintaining the system and its universal service.

True equality in competition would be to allow each competitor to establish an independent system of telephones, lines, etc. but to forbid interconnection with the existing system. The long-distance market has seen the entry of competitors who offer low-cost service by avoiding the necessity of compensating fully the exchange carriers for the expense of the system. Access charges offer the potential of requiring all of the long-distance carriers to bear the cost of access to the system, a cost which, heretofore, has only been borne by the regulated long-line carrier.

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The FCC's access charge plan takes the lion's share of the interstate plant and allocates the cost of it to each telephone subscriber by a flat rate charge that bears no relationship to the extent to which that subscriber makes use of the network. The system fixes upon each subscriber the cost of that subscriber's connection to the network and ignores the fact that the telephone user gains the benefit of the existence of the network each time a call is made. Such a nonusage sensitive charge must be recognized as a matter of philosophical choice rather than immutable economic law. It is equally valid and much more consistent with common sense to assume that the existence of the network itself is of great value to the high-volume telephone user and to charge such a user a greater share of the cost of maintaining the network.

If the Commission adopts an access charge plan based upon the FCC model without pooling, the effect upon rural areas would be the end of universal service. Such a plan would threaten the ability of many companies to continue to exist even if their more affluent subscribers desire to continue. A plan of this sort requires the revenue requirement to be distributed on a flat rate monthly basis among the customers, which would result in increases from the present neighborhood of \$5 to \$10 to charges in the neighborhood of \$50 to \$80 a month. Most subscribers simply cannot afford such rates.

Some aspect of pooling must be a feature of any access charge policy accepted by the Commission. The telephone network has developed due to policies which have allocated over 3/4 of the cost of most rural telephone companies to combined interstate and intrastate toll revenues through a pooling system.

California Independent Telephone Association

This association represents 24 independent telephone companies doing business in the State of California. Most are the providers of telephone service to the hundreds of small communities and vast rural areas within California. Together they serve nearly 50% of the inhabited geographical area of the State.

Competition should not be allowed within the LATA or within a market area. It should be allowed inter-LATA or intermarket so long as nondiscriminatory access charges are established.

The FCC policy in Docket 78-72 will result in cost pricing with a significant portion of the interstate revenue requirement assigned to the end user as a flat rate charge. If the California Commission follows this policy a greater portion of the intrastate revenue requirement would be assigned to the end user as a flat rate

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charge. Such charges should be assigned to both the interexchange carrier and the local customer. As a general rule traffic sensitive costs should be assessed against the interexchange carrier while NTS costs should be assessed against the end user.

The FCC has established a transition plan that recognizes the characteristics of NTS costs and the existence of high-cost companies and the need for a mandatory pool for interstate services. The same characteristics exist for intrastate toll services and a comparable transition plan should be considered.

In the long run, usage sensitive pricing offers the best opportunity for a minimum level of service that would be affordable. If lifeline service is deemed to be in the public interest, a customer means test should be required. Optional measured service priced on a cost-causative basis can contribute to universal service. Affordable toll service is a worthwhile objective with or without universal service considerations.

Small Independent Telephone Companies (Summary)

The small independent telephone companies serving small towns and rural areas also filed responses which are reviewed here collectively.

The primary thrust of these responses was that competition should not be allowed within local exchange areas and that elsewhere competitors should be treated equally. The statements pointed out that competitors are not going to serve low-volume, high-cost areas and that if local service rates are going to support themselves in such areas, there will be substantial basic service rate increases.

At the hearing, the chief executive officers of these companies said that the companies were very small (and in some cases ill-equipped) after World War II, and had grown rapidly because toll revenues were sufficient. Some of the officers predicted eventual bankruptcy if access charges are not averaged on a statewide basis and if wide-open intra-LATA competition is permitted. They said that dwindling revenues would make it impossible to install progressively the most modern equipment.



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Dowden and Barker, Accountants (Roger Barker)

Located in Stockton, the company provides services to 17 small local telephone companies. The firm prepared a study of flat-rate access charges necessary to recover NTS costs from the end user. (See following page.) Toll represents 70% to 87% of the small companies' revenues.

If the Commission follows FCC policy, intrastate NTS, for example, to a Company #1 customer would be an additional \$45 per month, and total (intrastate plus interstate) charges would be \$61 a month, in addition to the customer's exchange service billing.

At these rates, a majority of the small independent telephone company customers will not be able to afford telephone service.

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Access Charges  
Revenue Requirement  
Non-Traffic Sensitive (NTS) Costs

<u>Company</u>	<u>NTS - Annual Revenue Requirement</u>			<u>NTS - Monthly Requirement per Customer</u>		
	<u>Total</u>	<u>Interstate</u>	<u>Intrastate</u>	<u>Total</u>	<u>Interstate</u>	<u>Intrastate</u>
1.	\$ 557,081	\$ 147,106	\$ 409,975	\$ 61	\$ 16	\$ 45
2.	106,742	32,856	73,886	25	8	17
3.	278,601	159,931	118,670	28	16	12
4.	201,297	44,318	156,979	42	9	33
5.	503,076	94,283	408,793	17	3	14
6.	173,365	51,528	121,837	13	4	9
7.	282,564	43,556	239,008	15	2	13
8.	92,498	26,114	66,384	33	9	24
9.	592,535	106,409	486,126	18	3	15
10.	32,467	16,608	15,859	34	17	17
11.	1,974,878	406,580	1,568,298	53	11	42

APPENDIX  
Page 24Southern Pacific Communications Company (Dale E. Pilz)

SPCC is a specialized common carrier offering interstate and private line switched telecommunications services under FCC authority. SPCC also offers certain California intrastate private line services under tariffs filed with the Commission. SPCC has filed Application 83-01-02 to provide switched intercity telecommunications services in California.

The Commission should definitely permit competition both inter-LATA and within the LATAs. The modified final judgment in United States v AT&T envisions the competitive provision of all inter-LATA services irrespective of whether they are physically interstate or intrastate.

Competition will serve to promote efficiency and keep basic rates low. It will serve to encourage local exchange companies to be more innovative and efficient.

The LATAs proposed in California embrace numerous exchanges and include much of what has been considered to be intrastate toll traffic. Competition for intra-LATA toll traffic will provide the public with the same benefits as for interexchange competition. Therefore, the Commission should authorize full competition, intra-LATA, with nondiscriminatory cost-justified access tariffs that provide all interexchange carriers with equal intra-LATA access while fairly compensating Pacific and other exchange carriers for use of local distribution facilities.

If the Commission decides to preclude intra-LATA competition and thereby create a monopoly for the local exchange companies, that prohibition should apply uniformly to all interexchange carriers including AT&T. The Commission should allow competition within the local exchanges. Bypass technologies exist and can be cost-effective for some customers. Such technology is an incentive for local exchange companies to use price and construct their own facilities in a more efficient manner.

The Commission should employ the "dominant" and "non-dominant" theories adopted by the FCC in its proceeding Competitive Carrier Rulemaking (85 FCC 2d 1, 1980).

AT&T, its subsidiaries, and independent telephone companies were found to be dominant carriers because of their huge market share. The FCC found that they should be subject to traditional public utility regulation. Other common carriers, such as SPCC, were held to be non-dominant because of their lack of market power and subject to sufficient competitive pressure so that their performance

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will be in the public interest without detailed governmental intervention. The FCC provides streamlined procedures for these carriers, allowing ease of entry and exit to markets and a minimum of report filing. The divested AT&T interexchange affiliate will be overwhelmingly dominant in terms of market share and the ability to control prices in California. This entity and Pacific, as well as independent local exchange companies, should be subject to full public utility regulation. Other common carriers will possess minimum market share and will have no power to control market prices.

Competition in California markets is likely to cause rates to be aligned closely with costs but need not threaten universal service. Rather, the Commission will be able to determine how service costs are to be developed and assigned for purposes of the development of local access tariff rates which are to be paid by carriers using the local distribution plant of the various exchange companies.

SPCC believes that telephone service should be available to all who desire or need it. The Federal State Joint Board in FCC Docket 80-86 has adopted a high-cost factor mechanism which will determine the size of the universal service fund implemented pursuant to the FCC's local access charge decision in Docket 78-72. The issue of further subsidy for local ratepayers is one which involves use of the taxing authority and thus is for the Legislature to resolve. In no event should the matter of further subsidy be left by default to the local exchange carriers to decide.

If the Commission follows the FCC access charge policy, customers will pay a flat rate which will be \$10 at the end of the phase-in period plus a usage charge up to a maximum level equal to the cost of a dedicated access line. As the portion of costs borne by the carriers decreases over a five-to-seven-year-transition, the portion paid by the customer increases. The decrease in the costs allocated on a usage basis to the interexchange carriers will be reflected in lower toll rates.

Consistency between state and federal policy on access charges is desirable. Inconsistent policies could lead to long-distance interstate rates becoming significant lower than shorter-length intrastate rates which would lead to customer dissatisfaction. Two different policies would produce confusion in billing.

The most important principle supported by interexchange competitors is that access charges should be cost-based. Access

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arrangements should be priced so that price relationships between them are nondiscriminatory and reflective of underlying cost relationships. Determination of the appropriate prices for exchange access service requires unbundling of exchange access tariffs by local carriers. The incentive to bypass local facilities will be reduced only if charges are incurred for those components actually selected and utilized.

To provide local exchange carriers with incentive to furnish the most efficient methods of transport for a given type and quality of exchange access service, charges should be based upon a usage sensitive system varying by time of day, day of week, and the distance between the point of connection and the end office.

Differences in the quality of access services provided should be reflected by appropriate differences in access rates. As long as equal signal quality cannot be provided by other common carriers due to the integration of AT&T's equipment into the local exchange network, AT&T's superior access arrangements should be reflected by a premium surcharge. A premium charge was adopted in the FCC's Docket 78-72. SPCC's position is that it does not reflect the full difference in the quality of service between AT&T and the other common carriers.

If the Commission determines it is in the public interest to subsidize low-income customers, the amount of such additional charges on carriers should be kept small, relative to the costs of exchange access.

Whether access charges should be on a pooled basis to take care of high-cost companies is a problem that should be separated into two parts: that is, the non-traffic sensitive (NTS), and traffic sensitive elements. The NTS costs should be incurred by the customer. Therefore, rates intended to recover NTS costs should be cost-based. If a subsidy is required for high-cost areas it should be clearly identified and separately treated. That would be consistent with the FCC's order in Docket 78-72 (see paragraph 314). With traffic sensitive elements, rates should also be cost-based. To be consistent with Docket 78-72 traffic sensitive elements could be averaged by study area. If, however, costs are determined by local companies on a LATA-wide basis, SPCC would support LATA averaging on a subzone basis. The equal access provisions of the modified final judgment in U.S. v AT&T contemplate that LATAs may be divided into reasonable subzones.

SPCC believes that the goal of universal service is being transformed into support for high-cost local exchange companies rather than for needy customers. Any subsidy to require lifeline

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service should be directed at the particular group of customers who might otherwise not be able to afford the service. The best method is to design lifeline to provide only a minimal service rather than providing a financial means test. The latter approach would probably be expensive to administer and could not be continually monitored.

Optional measured service may both help and hinder universal service goals. It may lower some customers' costs for basic exchange service but may increase the cost for lifeline and other forms of service for customers in need of subsidization. In response to the Commission's question on whether telephone service justifies the provision of subsidies that assist in maintaining universal service, SPCC's opinion is that the Commission could only impose a subsidy requirement on the large users located in California. This would put such users at a disadvantage in relation to other users calling California residents from out of state. The subsidy would encourage large users to bypass the local network. It would be difficult to define the class of large users who should pay for a subsidy and those who should not. The sort of subsidy envisioned by the question is impossible.

Only those people who cannot otherwise afford service should be subsidized and the subsidy should be primarily for costs of access to network services rather than usage-based toll services. If the Commission follows the FCC's Docket 78-72, each customer would pay the cost of NTS plant. Under Docket 78-72 a substantial portion of costs would be moved from interexchange carriers who will therefore be able to lower toll rates. Those rates will probably not require subsidization.

MCI Telecommunications Corporation (William M. McGowan)

Competition is superior to monopoly. It spurs technological innovation and keeps consumer costs down. It has already proven itself in the interstate toll market. Regulation is required principally to monitor actions of carriers with dominant market positions. Rate regulation when required for dominant carriers should set cost-based rates and charges. Such rates insure maximum efficient use of the telephone system. When rates charged any user group exceed the costs that group imposes on the system, uneconomic bypass is encouraged. Any subsidy required to maintain universal service should be carefully targeted to reach only those who need it. Taxes or fees imposed to raise funds for subsidies should be divorced from the telephone ratemaking structure.

MCI supports a fair division of assets and liabilities between AT&T and the regional Bell operating companies. It is unfair that the regional operating companies should be required to accept

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the bulk of Bell System assets, which may be improperly valued, while receiving less than one-third of its revenues with which to support amortization of those assets and required returns on them. It is unfair that they should be saddled with a disproportionate share of AT&T's obsolete plant. The Commission has correctly urged that the Bell System inside wiring be transferred to AT&T as inherently related to customer-premises equipment.

MCI will originate and terminate its own long-distance service through the local exchange companies so long as their rates for exchange access are competitive. MCI will consider purchasing a broad range of valuable services that Pacific will be able to offer, such as competitively priced billing services. MCI will seek approval to expand its services to provide the great majority of California consumers with low-cost intercity calling. More than 60% of the total monthly phone bill for the average Californian, including a high percentage of low-income customers, consists of toll charges. Availability of cheaper toll calling should help offset the net effect of other increases in local access charges.

MCI would support a subsidy funded through an excise tax on terminal equipment such as proposed in Assembly Bill 1348.

Competition should be encouraged within the DATAs as well as among them. There is no inherent technological reason for treating interstate toll calls different than intrastate. The local exchange transmission and switch equipment that allows a call to be originated or terminated is used interchangeably.

The DATAs do not represent appropriate technical or economic boundaries for restricting interexchange competition. The technology is already there and consists of four basic sources:

1. FCC-regulated providers, such as digital termination service, multiple access radio service, and local area networks using certain technologies.
2. Public providers not extensively regulated, such as CATV.
3. Private networks outside the jurisdiction of this Commission, single user networks using microwave satellite, etc.
4. Providers regulated jointly by the FCC and this Commission such as cellular radio in

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which Pacific itself will be offering intra-DATA interexchange and even local exchange competition.

The Commission does not have the authority or ability to put these technological genie's back into the regulatory bottle.

The "cream-skimming" argument is not valid because evidence shows that demand for toll calling is price-sensitive. Allowing lower cost competitors to enter the market raises consumer demand.

It may be useful for the Commission to adopt standards and procedures that distinguish dominant and non-dominant carriers. The Commission might properly conclude that firms with a share of the total intrastate intercity market in excess of 50% should be strictly regulated, but market dominance should not be based only on market share but on such other features as the number and size of competitors, the presence and extent of barriers to entry, control of bottleneck facilities, and opportunities for cross-subsidies. (See Competitive Carrier Rulemaking, 85 FCC 2d 1, pp. 20-22 [1980]). Non-dominant carriers could be certified under a more flexible Commission procedure.

Policy distinctions between competitive and noncompetitive markets should not be based on artificial boundaries like LAMAs. Traditional boundaries are being blurred. No longer is there a clear line between communications and data processing, telephones and computers, or terminal and transmission equipment. Rather than drawing Maginot Lines around particular segments of the industry, the Commission should base its competitive policies on objective technological and economic considerations.

Since MCI hopes to originate and terminate most of its interexchange calls through the regional operating companies (such as Pacific), it also has a stake in insuring that they be left in a financially healthy technologically sound condition.

There has been much short-range fear of the financial health of the regional operating companies but they will have substantial opportunities to expand revenues and cut operating costs. After divestiture each of the seven regional companies will become an economic giant. Pacific will remain the overwhelmingly dominant company in California.

Pacific will have several highly lucrative businesses available apart from dominance of local exchange market places. A brief partial summary includes:



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1. Yellow pages.
2. Marketing of customer-premises equipment.
3. Customer-premises equipment servicing.
4. Customer-billing services.
5. Local exchange access services (new access services such as the private alarm and fast response services or home energy and lighting management).
6. Intra-LATA cellular video.
7. Other ventures such as home banking and merchandizing services.

In U.S. v AT&T, the modified final judgment also allows the companies such as Pacific the option to request court permission to enter nontraditional businesses upon demonstration that such entry would foster pro-competitive policies.

To prevent unfair treatment of ratepayers the Commission should ensure that income derived from business opportunities open to Pacific is treated as utility revenue.

Pacific should also be relieved of certain regulatory or financial burdens. Disallowances for the Bell System license contract will no longer be necessary. Shifting from comprehensive services included in one flat fee to service-by-service, cost-based pricing should create new revenue sources for services previously provided below cost. Pacific will also be able to shop for the most cost-effective equipment without being tied to Western Electric. Pacific's debt burden should be substantially relieved as a consequence of divestiture when its debt-equity ratio drops from 58/42 to 50/50.

Basic local monthly rates will increase regardless of whether state PUCs allow intrastate competition on an unrestricted basis because of FCC Docket 78-72, which mandates a transitional shift to flat rate access charges imposed on end users to cover the costs of NTS plant used in interstate long-distance services. They will also increase because of accelerated depreciation practices sought by the Bell System. Finally, unless Judge Greene rules otherwise in U.S. v AT&T, they will increase because the plan favored by AT&T loads a large share of high-cost, low-revenue assets upon companies such as Pacific.

MCI has proposed the following to protect ratepayers against disruptive rate increases in the short term:

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1. Aggressive efforts to improve the fairness of the divestiture with regard to division of assets between the regional operating companies and AT&T. MCI shares the concerns of many state commissions regarding AT&T's proposed division.
2. Rigorous scrutiny of proposed adjustments of intrastate toll and local exchange rates to ensure they are cost-based and to prevent uneconomic bypass.
3. Immediate imposition of a premium access charge on AT&T to reflect the fair value of its superior intrastate toll access connections.
4. If necessary, creation of a subsidy funded by an excise tax on terminal equipment or a uniformly applied access fee surcharge on all end users to preserve basic affordable phone service to the most needy customers.

Cost-based rates will make telephone service affordable in the post-divestiture world. Rate averaging discourages adoption of the most efficient technology for providing service to each market. Even in high-cost service areas the social objective should be to provide help in the form of subsidies only to persons of limited means. Providing rate subsidies to the wealthy owner of a mountaintop resort is neither fair nor efficient.

The Commission must proceed with great care in attempting to design rate structures to preserve the state's current high level of households with telephone service. MCI endorses the Commission's existing approach to lifeline rates. Concerning access charge policy, not all of the policies adopted by the FCC in Docket 78-72 are appropriate for the Commission but a policy similar to that (recovery of NTS costs through flat charges on end users) is essential if uneconomic bypass of the local exchange system is to be avoided.

Any Commission decision changing the basis on which access charges are identified and assessed should address two transitional issues: the need to protect users from sudden sharp increases in access charges by phasing them in over a short period, and the need to protect other common carriers from discriminatory access charges so long as they are receiving interconnection access inferior to AT&T's.

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Because a relatively small group of large users accounts for a very substantial portion of telephone company revenues, the loss of even a small number of substantial users would have a large effect on subscriber rates. It is also possible to design networks to avoid intrastate charges. Such "jurisdiction shopping" will take place if the Commission fails to coordinate its access charges with those of the FCC.

Fair consideration for the use of exchange facilities depends on accurate cost identification and appropriate cost allocation to cost-causative parties. This does not imply that end users should pay for all NTS plant while the interexchange carriers pay all traffic sensitive costs. Each user should pay only those fixed and variable costs that it causes. Thus, end users would pay a flat fee for access, including the costs of such facilities as drop wires, local loops, and central office connections. Similarly, usage-sensitive costs, including those incurred for trunk facilities, originating and terminal central office equipment should be apportioned to end users and interexchange carriers respectively to the extent that each causes such costs.

If the Commission mandated a rate structure providing for the recovery of NTS costs in a manner that varied with usage, heavy users would pay a portion of the costs caused by lighter users. They will thus face charges that exceed their costs, creating incentives to remove their communications traffic from the local exchange system, thus increasing the rates paid by the light users.

The NTS portion of access charges is best assessed against the local customers because those costs are largely attributable to end users.

It has been argued that it is more equitable to impose access charges on the interexchange carriers which would allow exchange subscribers not using interexchange services to avoid paying for such services. This argument is flawed. Access charges are for access to, and not the use of, the interexchange network and should be paid by all who use it. It would be equitable to allow subscribers to avoid paying the access charge only if they were willing to forego access to the interexchange system, but the cost of creating that option would be staggering.

Additionally, carrier collection of access charges could force subscribers to two interexchange carriers to pay more than their share of NTS costs. This would discourage subscribers from purchasing services from two or one interexchange carriers, thereby crippling competitors of the present dominant carrier.

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Other carriers should pay business line rates until they are provided with trunk connections. The modified final judgment orders equal interconnection by September 1, 1986; but until that occurs, the other carriers should pay only the rate commensurate with their service.

The Commission's ability to control bypass is limited, first, because many of the technologies are pervasively regulated by the FCC, and second, because the California Supreme Court has held that even if a company's services otherwise fit the statutory definition of a utility, a company is not a public utility unless it holds itself out as willing to serve the public and dedicates its property to public use. (Richfield Oil Corporation v PUC [1960] 54 Cal 2d 419.)

Pooling of access charges should be minimized. Pooling is a means of arranging for subscribers whose local access carriers NIS costs are relatively low (generally urban users) to subsidize subscribers of other companies whose costs are high (generally independent companies serving rural areas), but this can result in untargeted subsidies such as an urban high density but low-income area subsidizing high-income low-density areas.

Subsidy mechanisms should be chosen to provide assistance to individuals on a targeted basis by income class or need, rather than merely on the basis of rural or urban residents. The means of raising revenues to finance a subsidiary program should be divorced from the telephone rate structure. General tax revenues would be the best source of a subsidy fund. If some association with telephone use is deemed desirable, an excise tax on telephone instruments or a flat surcharge on every access line, as with provision for certain services for the hearing-impaired in California, would be preferable to a pooling system.

Lifeline should be a no-frills service offering access to both local exchange and long-distance networks, and affordable rates for both local and toll calling. Such service might include:

1. Basic no-frills telephone instrument for a household.
2. A local phone book and yellow pages.
3. A minimal number of flat rate local calls per month.
4. Additional optional local calling availability at higher prices.
5. Accessibility to competitive short- and long-distance toll calling services.

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Before predicting any particular level of subscriber decline from projected rate interests, it should be kept in mind that local monthly phone rates are currently lower in California than elsewhere.

Concerning whether optional measured service can contribute to universal service goal, the costs of introducing optional measured service and its benefits have not been well documented. The Commission should approach optional service cautiously until such information is available, to protect consumers and prevent discrimination against competing carriers.

Beyond imposing subsidy programs to support a carefully designed lifeline rate, subsidies supported by large users will worsen current bypass incentives and therefore will not contribute to universal service goals but will threaten preservation of existing household telephone service levels.

The Commission should remember that universal service includes not only access to the local exchange but also economical toll service. Affordable toll service should be available throughout California. Toll rate averaging is not the best means to achieve that objective.

Bell System California Interexchange Organization  
(William Woods; Lawrence Garfinkel)

Both MCI and SPCC are already in operation in California and are formidable competitors. Other competitors such as United States Transmission Systems can be expected to offer intrastate services. In order to meet changing market circumstances, all participants will need the ability to change prices rapidly and to reconfigure service packages and introduce new offerings. The Commission should institute a policy of flexible regulation of interexchange carriers, telling them to respond promptly to customer needs. This could include procedures for allowing price changes on shorter notice than additionally required and without voluminous and unnecessarily detailed costs support.

In at least some instances the Commission might establish price floors, allowing carriers to set rates above such floors without further Commission action.

The Commission might determine that in specific submarkets competition is not yet sufficiently developed to permit significantly reduced regulation. The Commission could then continue traditional forms of utility regulation. In other submarkets the Commission might find competition sufficiently vigorous to permit "deregulatory" approach.

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The important point is that the Commission should avoid approaches based on such misleading factors as statewide gross market share. In particular, the Commission should not adopt any regulatory scheme which classifies specific carriers as "dominant" or non-dominant." Handicapping the so-called dominant carriers will not benefit the public but rather only the nonhandicapped carriers. Federal regulatory policy which currently follows a dual system of regulation is not binding on state commissions. It results in artificially forcing up the prices of Bell System services and allowing its competitors the benefit of competing under a price umbrella. This results in market allocation and denies to the public generally, particularly residents and small business customers, the full benefits of competition. Competitors of the Bell System have designed their pricing structures to appeal to businesses and large residential users. Average and small usage customers are disadvantaged by the federal approach. Furthermore, the so-called non-dominant carriers include large and well-established businesses which do not require that protection.

Significant differences in the levels of intrastate and interstate access charges should be avoided to prevent configurations which take advantage of the lower interstate rates.

Regarding rate averaging, the Commission should be aware that the intrastate carrier access charges will constitute the largest single item of Bell interexchange's cost in providing service in California. Local carrier access charges vary significantly among areas within the state. These will be reflected in charges for service. Otherwise, customers on low-cost routes subsidize customers on high-cost routes. Rate averaging in such a situation would invite competitors to skim the cream of the overpriced low-cost routes, while avoiding high-cost routes.

Western Union Telegraph Company (Alexander J. Chisholm)

The Commission should encourage competition both between and within the LATAs. In no event should the rules for competitive carriers be more restrictive than the rules governing AT&T or Pacific. The Commission should adopt a flexible approach in regulating competitive services. Western Union knows of no carrier that plans to compete in the provision of basic wireline exchange service and such service should remain closely regulated to help prevent undesired cross-subsidization. The Commission should recognize that certain calls within the largest of the LATAs may closely resemble toll calls and for such calls competition should result in lower service charges.

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The Commission should take no action in this proceeding which might preclude competitive offerings of cellular mobile service.

Competition in toll markets should stimulate overall system efficiency and cause increased use of local exchange facilities, thereby lowering unit costs. In any event, regardless of the effect of toll competition on local rates, the Commission will have sufficient flexibility to approve local rates and to structure local service options to promote universal local exchange service. Such flexibility could include the use of measured rate pricing and the provision of lifeline to qualified subscribers.

Access charges should be cost-related. Where the local exchange subscriber is directly responsible for costs such as NTS loop, that customer should be assessed the charges. Costs directly attributed to interexchange carriers should be assessed against them. Such charges must be adjusted to reflect the inferior type of access service that is provided by local exchange carriers to interexchange carriers other than AT&T.

Lifeline service should be available only to the truly needy and a means test should be adopted.

Satellite Business System (Gerald Engel)

SBS is a domestic and international carrier using primarily satellite transmission to provide voice, data, and image transmission systems. These include private systems for large customers and dial-up long-distance services for residential and commercial subscribers.

SBS fully supports the trend toward competition. SBS urges the Commission to adopt an approach consistent with, but not limited by, FCC policy. This should include competition within the LATAs.

SBS generally supports the FCC's access charge plan but there are deficiencies with it which must be addressed in the future.

It is most difficult to determine a "threshold level" of access charge rates at which bypass becomes economically feasible. The economics of bypass vary with location, traffic, transmission speed, or type, and other factors. Today it is generally agreed that bypass is a relatively limited phenomenon and of little near-term importance to the ordinary switched voice market. (See MTS and WATS Market Structure, FCC 82-579, February 28, 1983 which concludes that bypass will not threaten the viability of local telephone companies under conditions of cost-based access.) Bypass should not

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be restricted and need not be if sensible access charges are put in place.

Bypass should be considered as two types. The first occurs because a type of local interconnection is not available; for example, high-speed digital services. Such bypass encourages the local carrier to innovate and provide new services.

The second type occurs when customers obtain interconnection services from other than the local exchange carriers for purely financial reasons. As long as telephone company access is not priced above its true cost no such bypass will occur that is truly undesirable.

SBS questions, in any event, whether bypass restrictions could be sensibly and practically enforced. Such restrictions would chill innovation in telecommunications, an undesirable result.

(Note: Attached to the SBS statement is an extensive appendix concerning equal access. This describes SBS' opinion of voice and data service quality differences between AT&T and other carriers.)

United States Transmission Systems, Inc.

USTS furnishes private line and switched-voice service and is a subsidiary of International Telephone and Telegraph. It competes in a marketplace inhabited by competitors which possess monopoly control over facilities which are crucial to the provision of USTS' services.

FCC methodology recognizes the difference between the type of interconnection provided to the interexchange carrier of the Bell System as compared with that provided to other carriers. The method imposes a premium on the interexchange carrier.

The FCC's method also recognizes the necessity to disaggregate service offerings so that subscribing customers can choose among offerings more adequately and specifically to meet particular telecommunication needs.

With some exceptions USTS subscribes to the approach of the FCC. All of the interstate problems are equally applicable in California and USTS urges the Commission to follow the lead of the FCC.

The Commission should permit competition in local exchange and toll markets in California. Rules should be different for established carriers such as the independent telephone companies, the



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operating companies of the Bell System, and Bell interexchange. USFS and other nonestablished carriers must be free to compete outside the requirements applied to the telephone companies because they do not possess the market power of those companies.

The Commission should require that any established carrier must provide competitive services through a separate subsidiary and not just "enhanced" services. This should be decided not on basis of types of service but on the market in which the service is offered. For instance, if the Commission determines competition should not exist in the local exchange market but should exist in the interexchange market, an independent telephone company which is permitted to operate in both markets could subsidize below-cost rates in the competitive market with the revenues received from the monopoly local exchange market. While USFS offers that as a solution, USFS believes that either a firm which possesses monopoly power should not be allowed to compete in a competitive marketplace, or the monopoly market in which that firm operates should be open to competition. If the Commission decides that local exchange carriers should not be subject to competition, then local exchange carriers should not be permitted to compete in a market which the Commission has decided to open to competition.

Closed entry into local exchange market will serve no useful purpose. If an interexchange carrier decides local access facilities charges are prohibitive, the carrier may decide to construct its own facilities by which to originate and terminate interstate calls.

If the Commission does permit competition in local exchange areas, then it should use the "dominant" and "non-dominant" dichotomy that the FCC employs. This will assist growth of markets on an equitable basis.

Competition should reduce telephone rates. A carrier whose costs are high and who must charge high rates will not survive in a marketplace whose participants make every attempt to reduce costs and rates. That carrier will then seek ways to reduce its own costs and rates in order to meet the competition, or fail.

The problem of universal service is targeted to specific consumer groups and to specific geographical areas. The FCC has permitted competition in the interstate marketplace but has established a so-called universal service fund to meet objectives of universality.

The traffic sensitive costs should be allocated to the end user. Averaging or pooling should not be allowed. Pooling assumes

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there are high-cost companies in order to solve the problem of universal service, where actually the target should be the particular individuals who need a subsidy. Furthermore, high-cost companies should be looked at to determine the reasons for the high cost. It is possible that this could be the result of improper cost management and not the location of the company.

It is not even necessary to pay for high-cost companies through pooling arrangements. It is possible to obtain payments through a transfer from another industry or for that matter from general tax revenues.

Even within the telecommunications industry it is possible to impose a relatively small surcharge on the end users to meet the costs of high-cost companies.

Universal service does not include the provision of affordable toll service in high-cost areas. Universal service may be necessary to allow the end user access to certain vital functions such as police and fire protection. It is not necessary for toll usage. It is difficult to conceive why toll service in the framework of universal service is a necessity requiring the imposition of subsidies or other transfer payments.

U.S. Telephone, Inc. (Kerry Fox)

U.S. Telephone is a competitive, long-distance company which does not own its own facilities. It leases facilities on a long-term basis and resells services purchased from underlying common carriers.

U.S. Telephone believes that regulatory efforts to restrict competition will retard development of new technologies. In Texas, where competition in the intrastate market is unrestricted, industries have developed to service the competitors to the ultimate benefit of the Texas state economy.

Competition should be permitted within the LATA as well as inter-LATA. Existence of intra-LATA long-distance competition provides self-policing mechanism for insuring that inter-LATA carriers will not be subjected to unreasonable charges for intra-LATA carriage. In the absence of intra-LATA long-distance competition, inter-LATA long-distance competition could be undermined through the denial of equal access to local exchange facilities.

After divestiture, Bell interexchange will simply replace Pacific as the overwhelmingly dominant common carrier in California. In the long-distance telephone business AT&T's Bell System toll revenues, when combined with those of its independent telephone company partners with whom it does not compete, accounted for a 99%

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market share of metered toll revenues in 1980. The November 1981 report of the Subcommittee on Energy and Commerce of the House of Representatives pointed out that while new carriers have grown in absolute terms, their growth appears to have been from a portion of large overall expansion of the interexchange market.

Bell interexchange will dominate the market and if not regulated can drive its competition out of business only to increase rates after the competitors are gone. Bell interexchange should be subject to the same regulation as Pacific. There is no need to have the Commission serve as a substitute for competition regarding competitive long-distance carriers since they are already competing with the Bell System and each other. This is not to say there should be no regulation. U.S. Telephone recommends a modified regulatory scheme as more appropriate to allow development of AT&T's competitors. This modified form should consist of certification, tariffs, and consumer complaints.

After divestiture the Commission's critical function will be designing appropriate access charges. The Commission must recognize that AT&T stands apart from its competitors with its dominant marketing share and superior access to local exchanges. U.S. Telephone supports a combination of flat and usage sensitive rates which promote the most efficient use of the system while eliminating the inherent advantages to AT&T provided by the current rate structure. The local customers and the interexchange carrier should both bear a portion of the costs.

Quality of service should be considered. Pacific and General should be required by the Commission to file access charge tariffs which adequately reflect the difference in the quality of interconnection provided. The FCC has determined that access charges should be adjusted to take into account technical differences. For example, AT&T's customers can obtain access to its long-distance network by dialing one digit, while most customers of other common carriers must dial seven digits plus an authorization code.

The goal of universal service is laudable but U.S. Telephone is concerned about the potential rate mechanisms which may be used to ensure it. Premium access charges for the AT&T entity will be available from AT&T to assist Pacific in maintaining affordable local service.

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Interexchange Carriers (Melvyn Goodman)

(This statement was submitted jointly by Combined Network Incorporated and Teleshare Network.)

These carriers provide an enhanced value intercity service principally through resale of foreign exchange (FX), private line, and wide area telephone service (WATS) facilities. Interexchange Carriers do not generally own transmission facilities but lease them from operating companies. The carriers submitting these comments have a total combined sales revenue substantially in excess of \$300 million. They have offices and switching facilities in more than 50 U.S. cities.

Pacific need not be perceived as having been relegated to the least profitable services. If Pacific upgrades its network it can provide superior quality for all and the interexchange carriers' volume of business will serve to enhance revenues available to local supporting companies.

AT&T has never proved that local telephone service is subsidized by intercity service and that claim is now widely disputed. During U.S. v AT&T, the Department of Justice took the opposite position and supported its view by expert testimony.

Competing interexchange carriers cannot attract business if they receive local access service inferior to that afforded the AT&T interexchange entity.

Interexchange Carriers believe that legal and financial qualifications of such carriers should be reviewed and approved. California should initiate its own limited certification procedures. No such certification should be required for interexchange carriers who have already applied for and received certification from the FCC since these carriers' legal and financial qualifications will have been thoroughly reviewed by an expert agency. This approach has been successfully followed in Texas and New York.

Interexchange carriers should file limited tariffs with the Commission evidencing the interexchange carriers' service and charges. The rates would automatically become effective after a reasonable waiting period to be determined by this Commission.

California should also establish procedures to resolve consumer complaints.

Lexitel Corporation (William O'Reilly)

Lexitel is a relatively new specialized common carrier incorporated in July 1980. Its headquarters is in Michigan.

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The Commission should permit competition in toll markets in California, meaning all interexchange telecommunications not categorized as local exchange services. Because of the large size of the DATAs proposed, a toll market exists within them. The Commission should adopt the dominant and non-dominant categorization of toll carriers developed by the FCC.

The Commission's policy on competition should not differ for local exchange markets and long-distance markets but the Commission does have a responsibility to ensure that basic lifeline telephone service is available to as many citizens of California as need it. A greater degree of care is warranted in determining the extent of beneficial competition for local exchange service.

The long-run effect of allowing competition in telecommunications will be to reduce the cost of services to the public across the board. This is already proved on the interstate level.

Fair competition to local carriers for use of their exchange facilities is a complex question which is answered by stating that the rates should be based upon a fair determination of the cost of such use. Since AT&T receives superior interconnection, rates between AT&T and the other carriers should not be equal. The FCC has adopted numerous distinctions between the compensation paid by AT&T for local exchange use and that paid by the other carriers.

Pooling of access charges should be restricted to the minimum amount necessary to protect true high-cost local carriers. This assumes that such carriers are efficient. This does carry a danger to the extent that lower-cost areas are charged higher prices that costs warrant, bypass is encouraged. Pooling which goes beyond the minimal amount absolutely necessary carries the possibility of loss of high-volume customers to the lower-cost exchanges, making the problem worse.

Lifeline service should not include anything other than the ability to make emergency local telephone calls in addition to receiving calls. To the extent that lifeline is subsidized it should be restricted to the narrowest definition possible in order to accomplish the Commission's statutory responsibilities. Such lifeline service should not, for instance, include access to toll service without additional charge, such as through payment of a customer access charge for toll similar to what the FCC has adopted in Docket 78-72.

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Lo-Co Cable Television Company (Nicholas Selby)

Lo-Co Cable is a small cable television network serving over 250 residential and business customers in Emeryville through approximately four miles of Coaxial cable. Lo-Co Cable provides a range of video and entertainment offerings on a 35-channel network. In the near future it will begin two-wave video coverage of live news events.

Lo-Co Cable looks forward to the time when it can offer two-way interactive voice and data services. Its intent in this proceeding is to preserve the opportunity to offer that service. Cable television companies may reach an \$11 billion market by 1990 for business customers alone.

Coaxial cable permits the transmission of information over broader band widths than copper wire, which means that cable can carry 130,000 times more information at 100 times the speed of copper telephone lines. The technology and the products for building or retrofitting a two-way interactive capability exist today. A cable television network can be engineered to do everything a telephone network can do and much more.

Any effort by the Commission to regulate use of cable networks for telecommunications' purposes are likely to be futile. Some cities are requiring as a minimum condition of winning a municipal franchise that cable television system operators build or retrofit the cable network with two-way interactive capability. In other words, a potential competitor to local telephone companies is fast taking shape as a result of municipal government decisions. Many cities in California are in this category.

According to MCI chairman William McGowan, there will be a total long-distance market by 1986 of \$72 billion. McGowan predicted that the direct cable link between customers and MCI would help market cable television services.

Cable television operators are also beginning to offer direct institutional loops. One company has installed a cable network in Pittsburgh, Pennsylvania to link three Westinghouse Electric facilities. Cable television networks are also being used for home banking. They can be used to supplant use of telephone networks for traffic control. A sophisticated device can provide two-way traffic control between a master computer and an individual intersection control unit. Up to 256 intersections can be monitored. The savings from not using telephone lines can amount to the cost of the entire traffic control system. One example is in Palo Alto, California where the city plans to take advantage of the

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cable network for automation of other services such as aspects of the city's water and gas systems.

The Commission does not have jurisdiction to prevent cable television networks from being constructed. Is it therefore appropriate for the Commission, as a means of preserving universal telephone service, to try to prevent efficient utilization of the capabilities inherent in cable networks? What evidence shows that preventing cable television networks from realizing their inherent efficiencies will help maintain universal telephone service better than adopting a new rate design based on low-lifeline telephone rates coupled with measured service? Cable television companies are not public utilities under California law Television Transmission Incorporated v PUC (1956) 47 Cal 2d 82. Where the Commission lacks jurisdiction to regulate the primary service (video transmissions) of cable television companies, it should not attempt to regulate their ancillary telecommunications services, since it would be quite difficult to detect cross-subsidies between different services offered over the same multichannel cable. However, to the extent the Commission desires to regulate telecommunications services of cable TV companies, it could permit a form of controlled competition between telephone companies and regulated subsidiaries of cable telephone companies, such as the FCC permitted MCI and SPCC to compete with AT&T in long-distance service.

Integrated Communications Systems, Inc.

ICS is dedicated to solutions of universal energy management problems faced by utilities and consumers through implementation of advanced communications networks. If a means could be found for universally monitoring and controlling energy consumption at load sites, increases in economic efficiency would be available and in the distribution of power. Until now, such monitoring has been out of economic reach.

ICS is on the way to overcoming that barrier. ICS techniques are dependent on the availability of local telecommunications transport supplied by established carriers at nonprohibitive rates with no artificial restrictions.

The provision of universal local telephone service is not inimical to the concept of locally delivered competitive value added information services. ICS does not propose to permit subscriber-to-subscriber direct voice message services on systems it facilitates. Basic telephone service will not be threatened.

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Local area competition starts just above the provision of basic switched telephone services provided by the telephone common carrier. To the extent permitted by federal regulatory and judicial rulings, the value added offerings should be open to all customers operating on an equal footing.

California Farm Bureau Federation (Charlotte Adams)

California Farm Bureau Federation is a voluntary, nonprofit corporation. Its primary purpose is to protect and foster agricultural interests in California. Its members consist of 52 county farm bureaus with a combined membership at the close of 1982 of over 99,000 families. The membership represents over 85% of California's commercial farmers.

The overriding concern is universal service with a high level of dependability at affordable rates.

Competition between local exchanges should be governed by an economics of scale. Universal service is best protected by a policy which limits competition for local exchange markets to allow only cost-efficient local exchanges to enter the field and operate.

Every interexchange service which uses local facilities should compensate the local company for the costs incurred in providing interexchange services whereby the local company will receive its proper share of revenue generated by its customers.

Statewide averaging of costs of exchange access and the pooling of access charge revenues are necessary to maintain universal availability of telephone service.

Access charges are best assessed on the basis of a combination of flat rate and usage sensitive rates, as well as including a high-cost exchange factor in the allocation of the access costs to the local exchange service.

Regarding universal service, central offices with step equipment do not have the capacity to offer measured service. Replacing these merely to offer measured service would not be cost-effective and would merely increase the temptation to bypass the network.

Communications Workers of America

The California Commission and NARUC have properly questioned the FCC's interpreting its jurisdiction in such a way as



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to deprive the states of a portion of their historically exclusive authority over local telephone rates.

The California Commission has no choice but to permit competition in the local exchange and toll markets in California.

Unbundling of rates harms the user of ordinary basic service because the previous method of assigning revenues legally provided numerous subsidies which helped offset the costs of providing local service. This is particularly true in rural and high-cost areas.

All toll (inter-DATA) carriers should be required to pay equal state-imposed tariffs for use of local exchange facilities. Each inter-DATA toll common carrier which requires upgrading of local exchange facilities to achieve parity should be required to pay toward the cost of that upgrading. Unless the Commission is most insistent on this point, the ratepayers of California will be subsidizing toll carriers which until now have been receiving local exchange access at substantial discounts below normal tariffs.

Concerning access charges, flat rate and usage rate charges (combination) appears to have the greatest degree of equity. A flat rate should be considered as a demand charge such as that imposed by electrical and gas utilities on their major customers to recover the high costs of energy purchased from outside sources.

Access charge funds should be pooled to provide funds necessary to offset the costs of basic telephone service in rural, remote, and depressed areas. A means test to determine eligibility for a lifeline is discriminatory on its face. Utility commissions have historically taken the position that they are unequipped to administer social policy.

Regarding what constitutes lifeline service, the commonly accepted idea is the local exchange. It is the local service area where residential subscribers telephone emergency, medical, and other health services, retail merchants, and other necessities. The Commission does not need to act to hold down toll rates. These rates may prove too low to the detriment of local exchange carriers which no longer will receive the subsidies from separations and settlements.

Hughes Aircraft Company

A strong communication base for residents and businesses is necessary and recommended. A profit tax on communications companies, both regulated and nonregulated, could provide subsidies for a leased lifeline-type resident telephones. Competitors in the local exchange

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should be required to subsidize local residents and small business in some specific situations. Lifeline service should be available. This should be a limited service to telephone for emergency. It could be a party line and heavy usage should not be permitted at the low rate.

Continuing of toll rate averaging makes calls affordable in the high-cost areas. A tax on all carriers of long distance such as AT&T and MCI could support low-usage areas.

California Public Interest Research Group (Harvey Rosenfield)

California Public Interest Research Group is a group consisting of over 40,000 individuals in California and is a nonprofit consumer and environmental organization.

Public understanding of the complex issues involved in the proceeding is essential. Public acceptance of the restructuring of the industry will depend on the degree to which the Commission exercises care in the use of its process.

This proceeding should be kept open and the opportunity for submission of materials for comments by the public continued until Judge Greene renders a final decision in U.S. v AT&T. The four weeks allowed to submit comments is insufficient.

The Commission in consultation with telephone companies and private consumer organizations should provide for funding of independent comprehensive consumer representation to adduce expert testimony in this and other proceedings on the subject.

While the Department of Justice, Judge Greene, and Congress all affirmed the goal of universal service, there is little empirical data to support the assertion that universal service will continue under the current access charge and divestiture plans. The Commission should define the term universal service in a manner which incorporates quality of service, cost, and population indexes. The Commission should also design a rate structure which reflects the historic contribution made by residential phone users to a telephone network that is currently built and operated to accommodate even the largest user, and the less easily quantifiable "externalities" that are nevertheless critical to large and small users alike. It is the near universal service upon which users depend that would make any future competition meaningful.

The Commission should take the lead in encouraging other states to agree on equal regulatory application of social and economic policies upon the telecommunications industry. Resolution of bypass and competition issues by California in accordance with the

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principle of universal service must not be imperiled by our opportunities for arbitraging or a "beggar thy neighbor" climate fostered by inconsistent treatment from state to state.

The Commission should declare a moratorium of local measured service or other significant rate design changes for a period of two years during which time the more profound effects of divestiture and access charges upon telecommunications may be clearly judged in comparison with historical trends or measures.

The Commission should allow OII 88, its investigation into quality of service indexes, to remain open so that the indexes already under consideration may be supplemented by additional standards which might become relevant as the Commission acts upon access, competition, and other issues.

Regents of the University of California

Statewide expenditure by the University for telecommunications services exceeds \$23 million. Decisions by the Commission will have a significant impact on these costs.

Provision of local exchange and toll service need not be limited to existing carriers but entry of others should include certain public responsibilities which the Commission should regulate, among them:

1. Minimum criteria for establishment and maintenance of service.
2. Contribution to a universal service fund.
3. Submission of cost data with applications whether or not the competitor is a dominant carrier. This will minimize the possibility of predatory pricing.

Competition in local markets should be monitored more carefully than long-distance competition. Local services are essential for emergency situations.

If the Commission follows FCC policy in its Docket 78-72 and requires telephone subscribers to pay costs of exchange facilities with increasingly high-access rates over the next five-to-seven years while reducing toll rates:

1. There would be a loss of residential customers who may find access charges too costly.

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2. Business customers could find it necessary to reduce the number of lines to which they subscribe.

Access charges are best assessed on a combination of flat and usage sensitive rates. The flat rate should be as low as possible. The charges are best assessed against the interexchange carriers. Customers using those carriers will pay the charges indirectly in their rates. Customers not using interexchange carriers will not pay for services which they do not use.

Notice of intent to bypass the network could be required by the Commission in order to gather enough information to determine at what point bypass is becoming economically feasible. Without such information a threshold level cannot be reliably determined. Restriction of bypass is not feasible but common carriers can be required to contribute to an intrastate universal service fund when they bypass local utility facilities.

Lifeline service can contribute to universal service but the cost administering a customer means test would probably outweigh the benefits.

Concerning the provision of subsidies in maintaining universal service, some of the largest telephone users in California are government agencies. Tax-supported institutions should not be assigned the responsibility for provision of universal service subsidies.

Some toll rate averaging is necessary to keep service in high-cost area within reasonable limits.

Western Burglar and Fire Alarm Association (Alan L. Pepper)

Providing basic telecommunication services, particularly in the local exchange but also in the toll market, is a beneficial natural monopoly. Its erosion can only result in higher basic telephone rates and lowering the quality of service. The telephone utilities should be allowed to retain their monopoly on the transmission of telecommunication signals.

Telephone utilities should not be permitted to engage in businesses other than the basic provision of telecommunication signals. If California utilities are permitted into noncommunication ventures, they must do so under rules and regulations of the Commission similar to those in the FCC's second computer inquiry decision.

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AT&T's and Pacific's recent repricing of private lines resulting in substantial increases was driven by their own marketing goals and not solely by cost considerations. Rates for alarm industry private line have increased dramatically in recent years.

Bank of America (James J. Sobczak)

The bank is one of the largest consumers of telecommunications services in California. In 1982 the bank spent approximately \$100 million for telecommunications worldwide. Domestically it spent over \$73 million. Of that figure about \$10 million was for AT&T equipment and services, and \$45 million for Pacific's offerings.

The bank endorsed the principles of the U.S. v AT&T settlement. Competition should be promoted in telecommunications services and equipment markets to spur development of new technologies.

Competition in the local exchanges should be allowed where economically efficient. Alternatives are currently evolving such as interactive cable television, cellular mobile radio, and digital termination service.

A transitional period is necessary. Bank of America has supported the transitional mechanisms before the FCC.

Access charges should be a device for the recovery of actual costs and not to raise revenues. It appears that the FCC's plan would eventually result in cost-based pricing for access. Therefore, adoption of the FCC methodology by the Commission should offer the same result in California.

Users should pay directly for the NTS cost of access. If the carrier is assessed, the cost will get passed on to the user. By billing the user directly the consumer knows the cost and can plan accordingly.

Artificial regulatory restrictions should not be imposed upon bypass because this stifles innovation and may lead to the regular telephone system becoming outmoded and technically inefficient.

All users and not just those with deep-pocket financing should contribute to supporting high-cost basic service.

Cities of San Diego and San Francisco (Leonard Snaider)

Policies of the federal government will reduce opportunities of individuals to have telephone service. The

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theoretical benefits of competition may be outweighed by the real need of all Californians to have available phone service.

Present lifeline service provides the basic elements of universal service. The present lifeline service which permits one local call a day at a reasonable monthly rate must be maintained. The enforcement of a means test is beyond the scope of the telephone company and might be more costly than the lifeline subsidy itself.

If competition conflicts with universal service, competition must be restricted. Although the Justice Department would apparently rather cut off phone service for the poor and reduce rates to large corporations, there is no justification for such action. The need for universal service could, under the proper factual setting, justify restrictions on toll, bypass, and local exchange competition. Limitation of competition should only arise upon a showing that the competition would restrict universal service.

The cities do not view toll service in the same respect as universal service. There can be a different competition policy for intracity markets and intercity markets. Toll rate averaging is not a necessary component of universal service.

North American Telephone Association

This association represents manufacturers, distributors, retailers, and installers of customer-premise equipment (CPE).

(This statement appears to be directed to the FCC's policies and the court's policies in U.S. v AT&T on the deregulation of CPE rather than to this Commission's problems concerning transmission competition).

California Bankers Clearing House Association and Tele-Communications Association (Lee L. Selwyn, Ph.D.)

California Bankers Clearing House Association is an organization of eight of the larger banks doing business in California. Tele-Communications Association consists of more than 500 industrial, commercial, and institutional entities which need high-quality, efficient telecommunications.

Competition should be permitted in all services and markets where it is economically efficient and not inconsistent with other public policy goals. But it should be recognized that under the modified final judgment in U.S. v AT&T, inter-LATA services are presumed to be competitive while intra-LATA services are presumed to exhibit properties of natural monopoly. In the near-term, intra-LATA

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services should be subject to regulation as natural monopoly, but regulatory policies should be sufficiently flexible so that opportunities for efficient competition are not precluded.

There is no longer justification for interservice cross-subsidies but under certain circumstances broadly averaged pricing plans may be in the public interest.

The effect upon individual customers' telephone bills will depend entirely upon the mix of access and usage services for the customer. Low-use customers will generally experience some overall rate increases while higher use customers may experience little or no overall increases and may in many instances experience rate reductions. California intrastate policy modeled after the FCC's Docket 78-72 is in the public interest because it promotes efficient use of both access usage services.

Users of exchange facilities should pay rates to local carriers based on the cost they engender by using the facilities. Individual customers should pay a flat rate designed to recover the NST costs of furnishing access to the network. Interexchange carriers should pay only to the extent that their use of exchange facilities introduces usage sensitive costs for the local exchange telephone system.

Flat rate charges designed to recover NTS costs should be assessed to the local customer. Usage-sensitive charges to recover traffic sensitive costs engendered by services furnished to interexchange carriers may be assessed either to the local customer or the interexchange carrier which can recover them from the end user. From the standpoint of billing efficiency it is probably most desirable for such usage-sensitive charges to be assessed to the interexchange carrier. If they are billed to the local customer directly, a duplication of billing effort may be required, introducing additional costs.

Regarding pooling of access charges to take care of high-cost companies, it is important first that the source of the apparent high cost of a given telephone company be determined. High costs may be a legitimate result of unusual operating conditions or, alternatively, as a result of poor management. An access charge pool should legitimately furnish assistance to telephone companies in the first category.

Universal access can, and should, be achieved through a rate plan based upon targeted subsidies which assure that only those individuals who could not otherwise have access to the network pay

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rates which fall below the full cost of furnishing their service. A more modern view of the "universal service" objective requires that as a policy goal, the broadest possible cross-section of customers be assured efficient availability of a variety of access, local, and long-distance usage, and other special services furnished in the most efficient manner at cost-based prices which reflect these efficiencies. Attention must thus be focused not solely upon the "entry fee" but upon the total cost of satisfying the customers' full range of demands for telecommunication services. This view does not preclude the offering of a minimum lifeline type of access to the households which genuinely cannot afford even the most minimal package of services if priced at full cost.

Continuation of the longstanding policy of providing subsidized access to the local and long-distance networks to all residential subscribers actually inhibits universal service when viewed in the broader sense. In order to support that subsidy, other telecommunication services must be priced artificially high relative to cost to generate the revenues necessary to support the access line subsidy.

A means test could be used. As a preferred alternative, a service could be constructed with features sufficiently restrictive so as to be unattractive to any customer who could afford to pay more. Such features would include:

1. Very low monthly usage allowance with very high charges for usage beyond the allowance.
2. A restriction on the level of toll use which if exceeded causes the customer to be reclassified as the "standard" residential customer when a penalty at the time of such reclassification.
3. A limitation on additional features such as touch tone, custom-calling service, etc.
4. A strict prohibition on the provision of such service in a household with any other telephone service, so that it could not be used as a "second line" within the same legal dwelling unit.

Expansion of measured local service runs counter to universal service because it tends to increase the overall cost of providing local telephone service, making it most costly to all customers.



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Optional service plans often foster rate increases in the "standard" flat rate service offering resulting in gradual migration of customers from the flat rate to the measured rate service. Measurement costs constitute a substantial portion of the total costs of furnishing local service when message rate pricing plans are in effect. Data provided by New York Telephone in its current general rate increase shows that such costs may be as high as \$1.25 per measured rate local service. Since in California measured service pricing plans involve the preparation of detail per call billing (unlike New York), the measurement costs in California are probably even higher.

Walter Bolter, Ph.D.

(Doctor Bolter is a consultant with offices in Washington, D.C. and was invited to address the Commission by Toward Utility Rate Normalization.)

In recent years problems have arisen because of competitive entry market adjustments and bypass. The FCC, in its various decisions, has not considered the impact on local service of these changes. Neither has there been national guidance by way of legislation, such as revisions to the Federal Communications Act. The marketplace approach is in force. Mechanisms of state regulation that have been used historically in a pure monopoly environment must be changed.

Universal service has to be realized at the state level. It is not being dealt with by the FCC. Federally, the approach is let the buyer beware; let the buyer who can afford telephone service get it and those who cannot, not have telephone service.

In addition, the Commission has a problem of limited time. By January 1, 1984, new state policies must be set into motion to deal with this new environment.

The local exchange basic voice grade service users are those who most need regulatory protection in the new environment. These are the customers who are least likely to benefit from competition, at least in the short term. The Commission should avoid adopting any policies where these inelastic customers end up paying for a transfusion or changeover in the plant of the existing carriers, particularly Pacific, in order to permit those carriers to offer other services to other customers through competitive services, deregulated services any nonbasic voice grade service.

The debate in this proceeding so far has been misdirected into the question of which state toll areas can be opened to

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competition. MCI, Pacific, and others take the position that charges for voice grade use should be held down at all costs, without considering what level those charges should be but simply that they should be lower than they could be in a purely competitive environment.

This approach will lead to voice grade users paying for all costs that other services do not pay for. In other words, voice grade users are going to act as guarantors for full recovery of any costs that other services don't pick up. This is what we have seen at the federal level. Deregulated areas are going to need only to make a minimal contribution above their direct costs. The difference between those direct costs and full costs is going to be picked up by the basic voice grade users. Such users are going to pick up the costs of implementing new technologies, the overhead, and anything that new ventures into deregulated areas don't cover.

That approach should be precisely reversed. The benefits of new ventures should flow to basic service.

Basic voice grade services should have a wall built around them. They should be treated separately from other services, in terms of the plant and the costs that those services accrue. Two groups of services are needed. The first group would be voice grade, paying only for the plant operating costs that the service directly accrues, plus some share of overhead. The second group, high-speed data, enhanced toll access, and whatever other services exist, will have responsibility for remaining costs. Separate rates of return will be generated for those two major groups in accordance with the different risks of providing service to those groups.

Access capacity plant for future needs then should be capitalized. All costs including carrying costs should be charged to growing services or new services as these particular offerings come on line.

The funds that are generated by voice services should be earmarked for construction of facilities that serve basic local exchange services. Funds from directly related services, such as yellow pages, ought to be set aside to serve this basic group. There should be constraints, absent a showing, to prohibit use of funds generated by basic services for ventures into deregulated areas.

The rate structure within the basic group of services need not be dictated by the separate subsidiary concept. There is no need to interfere with the existing structure of flat rate, measured service, or other designs that are in place. It is a separate proposal. However, the proposal can be used to consolidate new

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pricing options that have been developed, for example, in the context of the FCC access charge proceeding. Within the voice grade service category it is possible to mirror the FCC, that is, use a flat rate design for recovering NIS costs. Alternatively, you could reflect separate designs within that category, such as the need for access as distinguished from the need for usage, in accordance with the basic characteristics of local costs.

What happens if plant is jointly used?

If there is such plant in place, all services should bear their full share of costs. No service should be the marginal customer; no service should be considered residual.

The other area is new common plant. What if a company states that there are economies of scale in combining the demands of basic services with other services, and constructing plant to serve both needs in common?

Voice grade users should be charged no more under the common plant approach than they would be charged if the plant were designed strictly to serve their needs. That sets the upper boundary. If there are economies in joint plant construction, the Commission should ensure that those economies accrue not only to the deregulated or competitive services but to the basic service category which has an equal right to such economies.

Leland L. Johnson, Ph.D.

(Doctor Johnson appeared at the hearing at the invitation of the Commission. He is a telecommunications consultant with the Rand Corporation.)

Today's patchwork of subsidy is unfair and economically inefficient. We need a system which sends correct signals to people so they can purchase telephone service as they purchase other things such as food, shelter, and clothing in appropriate quantities. It is difficult to define universal service because it does not necessarily mean single-line service. It is possible to argue that two- or even four-party lines in high-cost areas is sufficient.

Revolutionary advances in technology drastically reduce the cost of providing information to many people. This erodes the monopoly of local telephone company. There are many groups now that can provide services to some people at lower prices, not necessarily cost, but lower prices than telephone companies are now charging. This has been called bypass. With it the FCC decisions have attempted to readjust rates in a way to reduce the possibilities of at least uneconomic bypass, that is, where the cost to the bypassers

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exceeds the cost to the telephone companies in providing access, but there because of distortions in rates, the rates charged by the telephone company are higher than the rates of the bypassers.

Bypass is not something just for private entities. The California state government is actively concerned with how to reduce its telecommunications costs by using new technologies that do not necessarily employ the facilities of the telephone company, such reductions benefiting the taxpayers.

It is true that with the erosion of the local telephone company monopoly, local rates will rise, especially to residential subscribers because they have been the primary beneficiaries of the present system. Toll rates will fall and residential subscribers as a class will benefit from that aspect, depending on usage level. We should permit the use of new technology wherever it is cost-effective for the benefit of society and in ways which would increase productivity. Do not prohibit the use of new technology or competition in order to benefit those few who will be worse off. If universal service is deemed an important goal (a working definition would be, for example, 95% of residences with easy access to a telephone) the solution must be in the form of some kind of targeted subsidy.

The problem with the lifeline rate is that it benefits those who don't need it. It is an untargeted subsidy. Why should not such people pay their full cost? This is first and foremost a problem for the Federal Government, not for the state commissions. The Commission's goal should not be to ensure universal service but to assure that rates track costs, that new technologies are encouraged in the marketplace in a way that will benefit society, and that rates do not cause excessive profits.

If we are going to talk about universal service it should be national universal service and Congress and the FCC should primarily deal with that issue. If Congress decides that universal telephone service is as important as food, it could expand the food stamp program to include purchases of telephone service. This may not be politically feasible because it is hard to have explicit subsidies. These appear as line items on budgets. It is easier if one can devise some sort of hidden subsidy, if one can provide a rate structure where people are paying a subsidy but they don't really know it, like businesses and school districts and even state governments.

Suppose that the Federal Government does not do such a thing and it leaves the responsibility to the states? If that

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happens, the problem is for the state legislatures. To avoid large administrative costs the program should be part of the existing welfare structure.

If the state legislatures do not deal with the problem it is possible to have a targeted lifeline rate. It would be necessary to institute some kind of a qualifications test, which would be a burden. This means the telephone companies presumably would give service only to low-income groups but it would have to figure out some way of enforcing the system. Perhaps this would be by deciding that only those who qualify for food stamps would qualify for the lifeline rate. In any event the key has to be a carefully targeted subsidy. The current system is unfair and unsustainable with competition.

Bruce Carruthers

(Mr. Carruthers is a consultant in Washington, D.C. and appeared at the hearing at the Commission's invitation.)

Recently in North Carolina there was a study under the sponsorship of the state government regarding the effects of federal policy changes and possible state policy changes on telephone users in North Carolina, and in their rates.

The operating telephone companies in that state participated. The study attempted to model the effects over a 10-year period of several key policy changes initiated by the FCC.

Taking into account all of the changes and assuming adoption of FCC methodology for access charges by the state for intrastate access, the study found the revenue requirements per subscriber line increased on the order of \$9.50 to \$10 per month, on the basis of the overall local revenue requirement per line of roughly \$25 including business and residence service.

That number varied by specific company. For selected small rural independents the projected increase per customer was dramatic and much higher than the \$9.50.

Selecting demand elasticity used in certain studies, it was estimated that the increase would cause an average of 4.55% dropoff of residential customers. For the small rural independents, the dropoff would be much greater. It was assumed that in certain areas that are generally poor, the price elasticity would be higher than average.

If the situation of rural independents in California is anything like that in North Carolina, the concerns expressed by those

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companies here are by no means overstated. There will continue to be a need for subsidies to rural companies to assure their survival and their ability to provide universal service.

The North Carolina study then considered different rate solutions. The first was usage-based rather than flat rate customer access charges for intrastate NTS access costs. In studying this there are the following problems: bypass, arbitrage potential between interstate and intrastate access charges, and the current private line rate structure which is lower than exchange rate.

A second alternative was maintaining a business-residential rate differential for the NTS access costs. During the seven-year transition of the FCC's access plan, the FCC allowed a rate differential of 2 to 1. This concept can be carried over to intrastate, possibly with a greater differential and one which need not terminate at the end of the transition period. Such a differential would be intended to subsidize residential users as a class.

A third possibility, probably not appropriate in California, is increasing the inter-LATA intrastate toll rates to offset flat rate subscriber charges for access. This was principally to benefit independent companies in North Carolina.

Another approach considered was possible increases in intra-LATA toll rates to offset high subscriber access charges. What constrains this is the relatively high price elasticity of toll service which could cause repression of traffic if rate increases are substantial.

Another method is assigning, at least on a transitional basis, some share of the intrastate subscriber NTS costs to the carrier access charges. This is consistent with FCC Docket 78-72.

Implementing measured use pricing for the local exchange service has much to be said for it and has been covered by other speakers. Not only might this be a mechanism to distribute the burden for access charges among users fairly, but it may also alleviate some of the need for capital investment in local exchange. The public must be educated as to the benefits of this approach, which will take time.

We also considered a ban on competitive intrastate toll and exchange services. In our opinion this is not sustainable. Distinctions between interstate and intrastate service are not clear. Also many private network systems are beyond the jurisdiction of the Commission. Lastly, such a ban might result in federal preemption.

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We also researched introducing an intrastate high-cost factor paralleling that of the Joint Board, and pooling arrangements which would distribute the benefits among small rural independents. This would be reasonable.

Various external publicly administered subsidy mechanisms were also studied in regard to universal telephone usage. These would call for some sort of taxation and transfer of funds. The political realities in North Carolina precluded such considerations, and at the federal level it is even more unlikely.

We reviewed bypass technology and concluded that it is a real problem. We found that in North Carolina users were highly concentrated in certain areas. There were traffic levels which could justify access bypass, and potential users were sophisticated and resourceful enough to take advantage of it.

The study also considered ambiguities in the law which blurred distinctions between federal and state jurisdiction. Some evolving jurisdictional conflicts were seen in the future.

Consumers' Coalition of California (Carol Robbins and Ralph Lao)

The Commission should proceed with extreme caution regarding any deregulation of the telephone industry. Much more research should be done before this is implemented. Hearings should be conducted on this subject in various parts of the state.

This country has benefited from competition and while there may have been problems with monopoly telephone regulation, the effect on small communities must be considered. Telephone regulation should not go to the other extreme just because there have been mistakes in the past.

(END OF APPENDIX)

April 27, 28, and 29, 1983 at which the Commission sat en banc.<sup>1</sup> At the hearings, the parties responding augmented their written statements with additional information. The Commission also heard statements by two independent consultants invited by the Commission and one additional consultant appearing on behalf of a consumer group. A summary of the written statements, augmented by selected excerpts from the hearings, appears as an appendix to this decision.

Our basic concern in this proceeding is how to perpetuate the concept of near-universal communications service in an area that has been a regulated monopoly but is becoming a competitive business. In recent years, about 98% of residential households in California have had telephones, and it is safe to say that even the smallest business needing a telephone has been able to afford one.

#### Background

To a great extent universal service has been made increasingly possible over the last 50 years by federal and state governmental policy which permitted a monopolistic telecommunications structure, under regulation, and which established rate structures that required toll revenues to support a significant portion of the fixed costs of the local telephone network.<sup>2</sup> Among other things, intercompany toll settlement methods were established which were favorable to rural telephone companies.

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<sup>1</sup> On the first day, the members of the Commission were joined in hearing the statements by Nevada Public Service Commissioner Douglas Ponn.

<sup>2</sup> Whether such support constitutes a subsidy, and if so, how great a subsidy exists, is a subject of controversy.



With this background in mind, we initiated this investigation to present us with an overview of the problems we will encounter and suggestions for solving them. We do not intend at this point to order one or more parties to take any action, or to make any final judgment on any issue.

Intra-LATA Competition

Competition in Transmission Services

The issue of whether competition should be permitted in various intrastate telecommunications markets, and the ground rules for such competition, was a major issue in these proceedings. This Commission has jurisdiction over all intrastate telecommunications transmission within California, and competing carriers must receive certificate to provide service.

Nearly all parties appear to agree that competition should be permitted between LATAs, as contemplated by the MFJ. There was a debate on the ground rules for such competition, however, which we will address in the following section. The biggest dispute appeared regarding whether competition should be permitted within LATAs. Opinion here diverged significantly.

Pacific and the other local exchange telephone companies state that the local exchange company should retain toll monopoly within the LATAs. The MFJ took care not to draw the LATA boundaries too small, these companies point out, in order to leave them with some toll revenue. (See LATA map.) The local companies believe that failure to retain at least this vestige of the former toll monopoly will place even a worse financial drain upon them, which can only be countered by large increases in basic exchange service. Some rural companies frankly predict bankruptcy if there is no difference between inter-LATA and intra-LATA competition.

The long-distance companies refer to the language of the MFJ and the later opinion filed April 20, 1983 in U.S. v AT&T which

finalizes the LATAs. These carriers point out that the Court favors such competition. They also agreed that an anticompetitive stance upon our part will increase the use of technology which bypasses the exchange network entirely. This includes not only various wireless methodologies but cable TV, which now has two-way voice and data capability.<sup>6</sup>

A few speakers at the hearing suggested that the financial health of local telephone companies and near-universal service are issues which no longer concern the Commission. In their view, if subsidies are necessary to maintain near-universal service it is up to Congress and the state legislatures to provide for such subsidies through the tax mechanism. Such legislative bodies can also enact bailout schemes for the operating companies if necessary.

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<sup>6</sup> In Television Transmission v PUC (1956) 47 Cal 2d 82, the California Supreme Court decided that we have no jurisdiction to regulate the one-way video service offered by cable TV. The Court relied upon the distinction between such service and two-way communication capability in reaching its decision (*id.* at page 87). Cal. Const. Art. XII § 3 defines as public utilities private corporations or persons that "own, operate, control, or manage a line, plant, or system for...the transmission of telephone and telegraph messages...directly or indirectly for the public." This broad language makes it clear that the Commission's jurisdiction is not limited to traditional landline telephone and telegraph systems. (Cf. Pacific Tel. & Tel. Co. v SPCC [1975] 78 CPUC 123, abstracted at 8 PUR 4th 582 and 598.) Cable TV interests in this proceeding do not challenge PUC jurisdiction over two-way communications they offer but argue that since the primary service (TV) is unregulated, ancillary services should also be unregulated. See statement by Lo-Co Cable TV in Appendix, page 43.

finalizes the LATAs. These carriers point out that the Court favors such competition. It is also agreed that an anticompetitive stance upon our part will increase the use of technology which bypasses the exchange network entirely. This includes not only various wireless methodologies but cable TV, which now has two-way voice and data capability.<sup>6</sup>

A few speakers at the hearing suggested that the financial health of local telephone companies and near-universal service are issues which no longer concern the Commission, and that if, under competition, local exchange telephone companies become financial liabilities, it is up to Congress and the state legislatures to act by enacting new tax laws or by inventing some of other bailout scheme.

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In this proceeding to date, we have held only legislative-type hearings to give us an overview of issues. Therefore at this point we are not going to decide what level of competition should exist within the IATAs. But it seems only reasonable to regard the problems of financial health of the local companies and near-universal service as interrelated, and we emphatically reject the notion that maintaining near-universal service is not a matter for our concern. The second paragraph of Public Utilities Code § 451 reads:

"Every public utility shall furnish and maintain such adequate, efficient, just, and reasonable service, instrumentalities, equipment, and facilities, including telephone facilities, as defined in Section 54.1 of the Civil Code, as are necessary to promote the safety, health, comfort, and convenience of its patrons, employees, and the public."

See also § 701, conferring upon the Commission general supervisory and regulatory powers.

It is noteworthy that similar arguments were rejected by the U.S. District Court in its April 20, 1983 opinion:

"As its approval of the decree and the basic divestiture plan indicates, the Court believes not only that competition in telecommunications services and products markets is required by law but also that such competition will be healthy and will benefit the American people, including particularly the American consumer. The Court is continuing strongly to foster the objective of competition, including by such measures as the conditioning of judicial approval of exceptions from the standard provisions of the decree upon the grant by the Operating Companies of fair and equal access to carriers who wish to compete for the intra-IATA business. See pp. 31-34 infra. In a similar vein, the Court intends to see to it that the division of AT&T's assets will not leave the Operating Companies with outdated equipment for the access of the smaller interexchange

carriers while AT&T retains the most modern, the most efficient switches and other facilities.

"At the same time, the Court also expects to do what it legitimately can to strengthen the ability of the Operating Companies to function as viable entities, not dependent upon inordinate rate increases for their survival. Some, particularly MCI, maintain that the health of the Operating Companies is not a legitimate concern of the Court. But the Court has taken similar factors into account before, and it will do so again now. Under established legal principles, the Court is clearly free to consider the public interest in its broad sense as long as such consideration does not negate the objectives of the antitrust laws. 552 F. Supp. at 150-151.

"There can be no doubt that the continued viability of the Operating Companies is in the public interest. These companies will next January assume the responsibility of providing basic local telephone service, and it is upon them, too, that will depend the realization of the goal of universal service; i.e., the goal of providing affordable telephone service to all, including those who are not affluent or who reside in relatively isolated areas. That objective will retain all of its vitality after the reorganization of AT&T. The Court will therefore approve LATAs which tend to preserve the effectiveness and the viability of the Operating Companies." (Mimeo. pp. 11-13, footnotes omitted, emphasis added.)

In conclusion on this issue, we fully recognize its importance and that it is up to state regulators to come to grips with it.

We will address the issue of competition in transmission services in a new OII issued concurrently with this order, which consolidates the individual applications of carriers. Parties interested in participating in those proceedings should obtain a copy of that order.

"Dominant" and "Non-Dominant" Categories

Somewhat connected to the issue of intra-LATA competition is the recommendation by specialized common carrier interests other than the Bell Interexchange entity<sup>7</sup> that this Commission follow the FCC and designate Bell Interexchange and Pacific as "dominant" carriers, subject to full regulation (full formal applications and complete cost justifications for rate or tariff changes or new services) while the other interexchange carriers are designated "non-dominant." For the latter category there would be a simplified tariff-filing procedure with changes going into effect automatically, or at least some expedited procedure to allow the other interexchange carriers to meet competitive situations.

Pacific and Bell Interexchange claim that this is unfair and an attempt to ensnare them in regulatory red tape while their competitors are free to compete with little regulatory oversight. They deny that they will be "dominant" after divestiture and in this connection point to the rapid growth and financial health of the other carriers. They maintain that these categorizations were adopted by the FCC with the predivestiture Bell System organization in mind.

It is premature to make formal designations. We will decide what classifications are appropriate as we read the fundamental decision on whether or not to permit competition intrastate.

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<sup>7</sup> In the predivestiture organization, interstate traffic is carried by the AT&T Long Lines Department. After divestiture, the department will become an AT&T subsidiary and will carry not only interstate calls but also intrastate inter-LATA traffic. A permanent name has not been chosen for the new company, and it is referred to hereafter as "Bell Interexchange."

Rate design features. The larger telephone companies prefer a measured service approach. They believe that a measured rate structure could be devised which would be strict enough so that no one would want the service if the higher grade of residential service was affordable.

This method has any number of variations, such as placing everyone on measured service, or having a premium flat rate residential category at a relatively high monthly charge.

Small telephone companies do not offer lifeline service and do not favor it because there is an insufficient revenue base to sustain it without materially increasing rates to others. Regarding measured service, some of the chief executive officers of these companies warned us not to impose it upon them under a schedule which would force them to replace central office plant (i.e. switch from mechanical to electronic equipment) ahead of normal plant retirements. They are willing to consider 100% usage-sensitive service after installing all electronic equipment, but acceleration of the process, they say, will cause significant upward pressure on local rates in their areas.<sup>9</sup> They also state that in very small exchanges, installation of equipment capable of measured local service is too expensive per customer.

The problem is aggravated by the flat access charge system (see following section) since the network cannot presently be blocked so that some users cannot make an interstate or intercity call. Under present network technology we cannot devise a lifeline rate for "local calls only" which would eliminate access charges to the intercity network. (It may be possible to design a lifeline rate

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<sup>9</sup> These companies should by no means be thought of as backward in their technology. The statements of their presidents indicate that electronic equipment is advantageous to them and many such companies already are heavy users of it and other up-to-date products as well.

which does not include a "blocking" feature but which would include "premium" access charges if intercity calls are placed.)

The residential rate structure problem is one of the most difficult issues we face. Because of the variety of equipment configurations we must approach the problem on a company-by-company basis. We regard a means test as a last resort because of its attendant administrative difficulties.

#### Access Charges

The LATA system and its division of responsibilities means that revenues from long-distance traffic will no longer be shared among telephone companies by use of settlement formulas now in effect. To compensate for this loss of revenue, the FCC has ordered access charges to begin on January 1, 1984. (See discussion of FCC Docket 78-72 above under "Background.")

We have taken the position that any flat access charges (those not dependent on actual usage) should be imposed upon the long-distance carriers and not the end users. We have appealed the FCC's decision to the Court of Appeals for the District of Columbia Circuit.<sup>10</sup>

In its April 21 opinion finalizing the LATAs, the U.S. District Court commented as follows on the FCC's method (mimeo. pp. 13-18, footnotes omitted):

"It may appropriately be generalized that local telephone service is relatively more relied upon by individuals and that long distance is more business-oriented. If the objective of telephone service available at reasonable rates to all is not to be jeopardized, it is therefore most important that local rates not be burdened by unnecessary increases. As the Court repeatedly pointed out in its August 11, 1982, Opinion (especially in connection with the discussion of

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<sup>10</sup> People of the State of California and the Public Utilities Commission of the State of California v Federal Communications Commission and the United States of America, No. 83-1459.