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Decision No. 89580 OCT 31 1978

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, Complainant, vs. SOUTHERN PACIFIC COMMUNICATIONS COMPANY, Defendant.	Case No. 9728 (Filed May 1, 1974)
And Related Matters.	Case No. 9731 (Filed May 17, 1974) Application No. 55284 (Filed October 31, 1974) Application No. 55344 (Filed November 26, 1974)
THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, Complainant, vs. SOUTHERN PACIFIC COMMUNICATIONS COMPANY, Defendant.	Case No. 9929 (Filed June 6, 1975)
And Related Matters.	Case No. 9933 (Filed June 24, 1975) Case No. 9971 (Filed September 16, 1975)

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Timothy E. Treacy, Attorney at Law, and Paul Popenoe, Jr., for the Commission staff.

FINAL OPINION

Cases Nos. 9728 and 9731, and Applications Nos. 55284 and 55344 were the subject of an extensive interim opinion (Decision No. 84167 dated March 4, 1975, 78 CPUC 123) in which we found that Southern Pacific Communications Company (SPCC) should be issued a certificate of public convenience and necessity to operate a point-to-point intrastate microwave telecommunications system between San Francisco and Los Angeles.[1/]

In that opinion we also determined that interim rates for SPCC should be the same or similar to the rates of The Pacific Telephone and Telegraph Company (Pacific) for equivalent services. Our order in that decision imposed the following restrictions on SPCC's operations (78 CPUC 156):

> "7. Any direct connection of private line circuits to the exchange network is prohibited. This includes any connection similar to foreign exchange service.
>
> "8. Any tie-line connections to PBX switchboards shall be arranged to prevent through calls from being made to or from the exchange network at either or both ends."

1/ SPCC had already been licensed by the Federal Communications Commission as a common carrier of interstate microwave communications in 1972.

We left for further decision the subject of final rates, and whether rate differentials in favor of SPCC should be introduced.

Subsequent events interfered with our determining the final rates.

Two weeks after the effective date of our interim order, SPCC requested Pacific to connect an SPCC private line circuit carrying both interstate and intrastate traffic between Los Angeles and San Diego to Pacific's San Diego telephone exchange network. (This request was made on behalf of American Airlines, which has a private line system carrying both interstate and California intrastate traffic.)

Pacific, concerned about its responsibilities to fulfill such a request under our interim order, filed with us on May 16, 1975 a petition for instruction with respect to Decision No. 84167. The petition stated that the connection requested by SPCC for American Airlines' interstate calls would allow the same connection for intrastate calls, and that the service requested was similar to foreign exchange (FX) service, prohibited by Ordering Paragraph 7 of Decision No. 84167 (quoted above).

On June 6, 1975, Pacific withdrew this petition for instructions and filed a complaint against SPCC (Case No. 9929) alleging that Ordering Paragraph 7 of Decision No. 84167 prohibits the connection requested by SPCC.

Only days later, on June 16, 1975, SPCC filed with the Federal Communications Commission (FCC) a petition entitled "Petition for Declaratory Rulings and for Enforcement of Cease and Desist Orders". SPCC requested the FCC to issue a declaratory ruling that it has exclusive authority over interconnection by specialized communications common carriers into the local exchange facilities of the Bell System companies for the purpose of furnishing interstate FX service or for insertion into Bell System common control switching arrangements (CCSAs) for the purpose of providing interstate or mixed interstate and intrastate service.

Further procedural developments followed, but, in brief, the upshot of the FCC filing was an opinion by the FCC[2/] which declared that the FCC, and not this Commission, possesses exclusive jurisdiction over all controversies relating to interconnection between the Bell System and competing carriers when such interconnections are capable of completing interstate communications through switching equipment (such as CCSAs).

This Commission, Pacific, and the National Association of Regulatory Utility Commissioners (NARUC) challenged the FCC's ruling. The U.S. District Court of Appeals for the District of Columbia Circuit affirmed the FCC's decision (June 20, 1977; 567 F. 2d 84) and the U.S. Supreme Court denied a petition for certiorari on January 9, 1978.

During this interval (which turned out to be much longer than we anticipated) our own proceedings on this subject remained off calendar. Further prehearing conferences on the cases and applications in this proceeding were held in San Francisco before Administrative Law Judge Meaney on August 8, 1975. At these prehearing conferences the parties were invited to discuss how to proceed with the various matters and what issues remained. Memoranda on these subjects were filed, subsequent to the conferences.

The issues we must now consider are (1) whether the operating restrictions against SPCC contained in Ordering Paragraphs 7 and 8 of our interim order should be continued, (2) whether the appropriate cases and applications should remain active so that we can set final rates for SPCC, and (3) regardless of the answer to (2), whether there are proceedings which can be terminated as moot or as having been completed.

2/ Memorandum opinion and order, adopted October 9, 1975, released October 16, 1975, FCC 75-1146/37267 (56 FCC 2d 14).

Operating Restrictions

As mentioned, Ordering Paragraph 7 of our interim decision prohibits direct connection of private line circuits to the exchange network, including any connection similar to FX service.

FX service is an option enabling a customer to maintain, in effect, a local telephone in a location outside his own local calling area. Under FX service, for example, the subscriber in San Francisco may place a local exchange call in Los Angeles, paying the FX mileage charge on a monthly basis rather than the message toll rate for each call made.

The above-quoted restrictions were placed in our interim decision for the same reason that we set SPCC's rates at the same approximate rates as Pacific's - to control excessive diversion of revenues from the public toll and private line services of the operating telephone companies (i.e., Pacific and other similar companies which accept an obligation to serve the entire general public throughout the State). We chose to encourage SPCC to expand its business by concentrating on its innovative services to its potential customers rather than by allowing SPCC to compete for the private line customer through lower rates on the highest-density, most-lucrative routes.

Regarding both restrictions, SPCC argues that they were originally recommended by the staff since the staff first believed that long-haul and high-density private line routes of Pacific furnish cost support for short-haul and low-density routes, but the staff witnesses, after reviewing SPCC's evidence, recognized this premise as unfounded.

Concerning the FX restriction in particular, SPCC contends (1) the staff's argument that to allow FX connections would divert Pacific's FX customers is erroneous because Pacific has no FX service between San Francisco and Los Angeles and only 14 such connections along the routes SPCC would serve, (2) the staff also

conceded that message toll growth is sufficiently greater than exchange service usage to preclude shifting of message toll expenses to exchange, and SPCC's entry into the field will not affect this situation, and (3) because Pacific offers both FX service and tie-line service between private branch exchange (PBX) switchboards, SPCC also needs to do so if it is to compete in the private line market.

SPCC points out that the staff witness testified that so long as SPCC and Pacific operate at equivalent[3/] rates, he would withdraw his recommendation that SPCC be required to arrange tie-line connections between PBX boards to prevent through calls to and from the exchange.[4/]

Pacific advocates that our interim order, with the restrictions, be made permanent since discontinuing them would result in diversion of exchange network revenue. It is Pacific's toll and FX services, Pacific argues, which help provide the necessary revenue support to keep basic exchange rates low. Pacific challenges SPCC's assertion that there is virtually no intrastate private line service on the routes served by SPCC. Pacific states that its Los Angeles-San Francisco route has grown substantially since the Commission ordered a rate reduction in 1974, and that the revenues produced help subsidize basic residential exchange service.

Pacific points out that historically, the private line and FX-type services have never been considered to be the same; FX service has been categorized as exchange-type service, priced in recognition of the loss of toll revenues resulting from intrastate

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3/ "Equivalent" does not mean "identical" since various rate and service packages offered by SPCC are not the same as Pacific's. See the interim decision for a discussion of the offerings (78 CPUC 123, 137-143).

4/ But see footnote 5, infra.

FX connections. Thus, according to Pacific, SPCC is seeking "to provide a type of exchange service, a right which clearly should be denied them in furtherance of the general ratepayer." (Pacific's opening brief, page 3.)

In sum, Pacific recognizes that our interim decision attempted to achieve competitive parity between Pacific and SPCC in the private line sector, but denies that tie-line arrangements and FX-type service are in that category.

Regarding the tie-line restrictions, Pacific argues that SPCC seeks to provide its customers with connections to the exchange network at both ends of its private lines, while Pacific does so only on a one-end-at-a-time basis and subject to certain restrictions. Pacific points out that notwithstanding the staff witness's testimony[5/] the staff continues to support the restriction.

General Telephone Company of California and Continental Telephone Company of California essentially agree with Pacific's arguments, pointing to possible loss of settlement revenues if private line carriers are allowed to provide exchange-type service.

The staff's final position is that the tie-line restrictions may be removed, provided that the removal is connected to a requirement that SPCC operate at equivalent rates for tie-line service. Regarding FX, the staff continues to support the restriction, arguing, as did Pacific, that FX service is exchange and not private line service.

5/ As mentioned, SPCC argues that the testimony of the staff witness is to the effect that if SPCC and Pacific operate at equivalent rates, he would withdraw his recommendation in favor of the restrictions. The staff witness (Mr. Popenoe) testified that, based on SPCC's evidence, his prepared testimony to the effect that Pacific's intrastate San Francisco-Los Angeles revenues help to underwrite Pacific's private line services elsewhere was not correct. (Tr. 990-991.) We find it difficult to construe this testimony as a full withdrawal of the staff's position that the restrictions be retained. On brief, the staff agrees that the tie-line restriction may be removed (assuming equivalent rates are continued) but that the FX restriction should be continued.

Discussion

We choose to terminate the tie-line restriction (with certain limitations), although we emphasize at the outset that we consider such termination a controlled experiment, and we reserve the right to re-institute these or similar restrictions later, if we find that there is undue diversion of exchange or toll revenues due to such termination which is not in the public interest. We stated in Finding 10 of our interim opinion (78 CPUC 155):

> "Undue diversion of revenues from MTS, WATS, and private line revenues of Pacific and similarly situated companies should be controlled through proper rate and tariff regulation. The need for the new services outweighs the advantage of offering existing carriers absolute protection against loss of revenues by way of denying entry into the specialized private line market by SPCC."

By the same token, we think that, if at all possible, rate and tariff limitations, rather than prohibitions, should control possible undue diversion of exchange network or toll revenue.

We will restrict SPCC's tie-line connections so that they are the same as Pacific's. The tie-line feature will be offered as a separate tariff, and not as a "package", at rates equivalent to Pacific's.

The restriction against FX service will remain in force. FX service has always been strictly exchange-type service. A Pacific exchange service subscriber may have FX service, but a private line customer is allowed only a tie-line connection. Dropping the FX restriction entirely would place SPCC into exchange network competition against Pacific. Or, to state the problem from a different perspective, terminating the restriction would permit an SPCC private line customer to have an FX connection while a Pacific private line customer could not.

We realize that the interstate tariff situation is somewhat different. American Telephone and Telegraph Co. Long Lines Department offers a "Type 2006"[6/] interexchange channel in connection

6/ Tariff FCC No. 260, 9th revised page 54 and 7th revised page 55, effective 6/1/77 and 6/13/74 respectively.

with interstate private line service, with characteristics similar to FX service, and SPCC has a similar interstate offering. The use of these particular interstate tariffs for intrastate purposes was not developed on this record; therefore, we are not prepared to decide herein whether both SPCC and Pacific should be allowed to offer private line customers service similar to an FX connection. We are, however, concerned with possible further diversion of intrastate traffic (and associated revenue) to interstate if we prohibit what is permitted under interstate tariffs for the same class of private line service, unless the parallel interstate tariffs appear clearly unreasonable for intrastate use and there is no alternative to an outright prohibition. While this is also a problem that has not been quantified,[7/] if interstate tariffs for parallel private line offerings are much more attractive, we recognize that "rusty switch" connections will result (arrangements of private lines, particularly for medium-to-large size private line customers, which include interstate capability even though little or no actual interstate traffic is intended, for the purpose of allowing a private line customer to take advantage of more attractive interstate tariffs). Therefore, our ruling on FX is without prejudice to Pacific or SPCC to apply for modification of FX restrictions in the future.

Under the FCC's ruling, sustained by the federal courts, we believe that California and other states are placed in an unreasonably weak position in setting their own course regarding how they will deal with private line and specialized carrier development, primarily because of the "rusty switch" problem. We will continue

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7/ Pacific asserts on brief (opening brief, pp. 3-4) that it is of the opinion that any customer who could economically establish a "rusty switch" arrangement has already done so. We believe this to be uncertain, in view of the continual growth in the private line market.

to support legislation which, in our opinion, more properly balances the authority of federal and state regulators in this regard.

Pacific's argument that its tie-line offerings prohibit two-way tie-line connections is correct. We will structure SPCC's tariffs so that, for the present, SPCC may offer tie lines only under an arrangement whereby access is prevented to the exchange network at a PBX where the exchange network can also be accessed simultaneously into the PBX at the other end.

Final Rates

SPCC urges us to consider its evidence for the lower rates it originally proposed. This would mean also deciding whether to adopt Pacific's high-low rate plan, Pacific's proposed competitive response to SPCC's lower rates.

At the time that federal litigation over the FCC's order began, it seemed more appropriate to stay our determination of final rates until the conclusion of such litigation, since its outcome would affect our position in constructing tariffs vis-a-vis corresponding intrastate tariffs. Estimates available at the time indicated a delay of considerably less than two and one half years.

SPCC points out (1) that we have had the issue of final rates under submission since 1975, (2) the interim decision specifically reserved the issue and evidence was subsequently taken on it, (3) since the evidence is in the record it would be unfair to withhold a decision based on it, and (4) not to issue a "final rates" decision and to make rates intended as interim final would be a failure on the Commission's part to decide what rates are "just and reasonable" (Public Utilities Code Section 455).

We believe we should accept the position of the staff and Pacific and (subject to the conditional removal of the tie-line restrictions) make the rates set in Decision No. 84167 permanent, without prejudice to the filing of new applications for rate relief or rate modification by SPCC or Pacific.[2/]

We believe we should not base any decision concerning either lower rates for SPCC or Pacific's suggested competitive response on the record in this proceeding.

The record is now stale. The 1975 evidence presented projections through 1977. Little recorded data was available for SPCC. SPCC comments about the inconvenience and expense of witnesses who have testified for final rates returning for further appearances; however, at this point we would at least need hearings to bring the

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2/ We note that Pacific filed Application No. 58223 on July 14, 1978, an application for general rate relief. Pacific is requesting further consideration of private line rates in that application. We have made SPCC a respondent to OII No. 21 issued July 25, 1978, in connection with that application.

Commission up to date on results of operation. Under the circumstances it is more appropriate to terminate the applications which request rate relief. In any new rate application which is filed, we may take notice of any evidence in these proceedings which is of value.

In any event, a review of the evidence offered for "final rates" convinces us that there are certain problems with it which mean that a preferable course of action is to consider newer evidence. For example, Pacific estimated that with SPCC's proposed rates in effect (Exhibit 6 - "Advice Letter No. 1") it would lose between $436,000 and $462,000 in private line revenue. The estimate was, however, based on comparing Pacific's full-time rate with SPCC's 12-hour rate. Pacific's intrastate revenue diversion estimates apparently fail to consider that substantially all long-haul private line service for Pacific is interstate because of the use of "rusty switch" connections. As for SPCC's showing, SPCC's proposed lower rates were based primarily on Exhibit 16, which in turn contains (on Sheets 11 and 12) marketing forecasts. We consider this exhibit to have an inadequate underlying foundation to form the basis for SPCC's proposed lower rates. We previously commented on the problems connected with SPCC's forecasts of profitability in Decision No. 84167.9/ Other problems connected with the evidence could be cited.

SPCC's argument that we violate a statutory duty to set "just and reasonable" rates under Public Utilities Code Section 455 if we do not set "final" rates based on all the evidence herein is

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9/ Finding 7 of Decision No. 84167 states: "Forecasts of [SPCC's] profitability for 1975 California intrastate service are speculative and are based upon SPCC's proposed rates against Pacific's present rates; therefore, we should order the filing of certain financial data as specified in the order." See also discussion, 78 CPUC 152, fourth and fifth full paragraphs.

not meritorious. First of all, we are, from a legal point of view at least, setting "final" rates for this proceeding based on the evidentiary record before us. As explained, we believe that the staleness of the record[10] and problems with the evidence militate against our changing the rates at this time. Secondly, although the interim rates will now become final, we are specifically making them so without prejudice to SPCC or Pacific to file new applications. Rates previously authorized by the Commission are presumed lawful and reasonable until changed (Southern Counties Gas Co. (1957) 55 CPUC 589; Rating on Certain Paint Material (1954) 53 CPUC 211).

Findings and Conclusions

1. The operating restrictions against SPCC contained in Ordering Paragraph 8 of Decision No. 84167 dated March 4, 1975 (78 CPUC 123) should be terminated, subject to the following conditions:

a. Tie lines should be offered only under an arrangement whereby access is prevented to the exchange network at a PBX where the exchange network can also be accessed simultaneously into the PBX at the other end.

b. Tie-line service should be offered as separate services in separate tariffs. The rates should be on a parity with Pacific's.

2. The evidence taken in this proceeding concerning lower rates for SPCC, and concerning Pacific's proposed competitive response

10/ In our opinion, SPCC is not in a position to complain of the delays in setting final rates. We imply nothing improper in SPCC's seeking declaratory relief from the FCC, but it was this course of action on the part of SPCC that led to these matters being removed from calendar until the outcome of this challenge to the Commission's jurisdiction over certain routes was resolved.

thereto, was taken in 1975. Such evidence is outdated and, for the other reasons mentioned in the discussion section of this decision, is not sufficient to allow either SPCC's proposed rates or Pacific's high-low rate plan.

3. Because of the problems described in Finding 2, the rates, charges, and conditions ordered into effect in Decision No. 84167 (as modified by Decision No. 84560 dated June 17, 1975, and as further modified herein) are found to be just and reasonable as final rates for this proceeding, subject to the modifications herein, and without prejudice to Pacific or SPCC to file new applications for rate, or other, relief concerning the subject matter herein.

4. The issues in Case No. 9728 have been fully determined by Decision No. 84167, and this case should be dismissed.

5. SPCC's Advice Letter No. 1 should be permanently suspended and proceedings in Case No. 9731 should be terminated.

6. Proceedings in Application No. 55284 and Application No. 55344 should be terminated.

7. The issues in Case No. 9929 are moot because of the FCC ruling and the subsequent federal appeal court action sustaining it; therefore, Case No. 9929 should be dismissed.

8. Pacific's Advice Letter No. 11631 should be permanently suspended, and Case No. 9933 should be dismissed.

9. Case No. 9971 should be dismissed. The Commission should decide whether another OII into private telephone line service is necessary at the time of subsequent filings.

10. Record keeping regarding SPCC's results of operations required by Decision No. 84167 should continue to be required, and Ordering Paragraphs 9, 11, and 13 should remain in effect.

FINAL ORDER

IT IS ORDERED that:

1. Subject to the modifications herein, the rates, charges, and conditions ordered into effect in Decision No. 84167, as modified by Decision No. 84560, shall remain in effect as final rates, without prejudice to The Pacific Telephone and Telegraph Company (Pacific) or Southern Pacific Communications Company (SPCC) to file new applications for rate or other relief concerning the subject matter herein.

2. The operating restrictions contained in Ordering Paragraph 8 of Decision No. 84167 are terminated, subject to the conditions in this order.

3. Tie lines shall not be connected to the exchange network at both ends. They shall be offered only under an arrangement whereby access is prevented to the exchange network at a private branch exchange (PBX) when the exchange network can also be accessed simultaneously into the PBX at the other end.

4. Tie-line service shall be offered, in separate tariffs, at rates equivalent to Pacific's.

5. Subject to the preceding ordering paragraphs, the rates contained in Decision No. 84167, as modified in Decision No. 84560 dated June 17, 1975, are made our final rates herein, without prejudice to SPCC or Pacific to file new applications for rate or other relief on the subject of private lines and associated services and offerings.

6. Ordering Paragraphs 9, 11, and 13 of Decision No. 84167 shall remain in effect.

7. Cases Nos. 9728, 9929, 9933, and 9971 are dismissed.

8. Proceedings are terminated in Case No. 9731 and Applications Nos. 55284 and 55344.

9. Pacific's Advice Letter No. 11631 and SPCC's Advice Letter No. 1 are permanently suspended.

10. SPCC may file tariffs in accordance with the provisions of this order on or after the effective date hereof, to be effective on not less than five days' notice.

The effective date of this order shall be thirty days after the date hereof.

Dated at San Francisco, California, this 31st day of OCTOBER, 1978.

President

William Symons Jr.

Vernon L. Sturgeon

Richard D. Gravelle

Commissioners

I abstain

Robert Batinovich

I abstain

Claire T. Dedrick