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ORIGINAL

Decision No. 90309 MAY 22 1979

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's own motion into the rates, tariffs, costs, and practices of Centrex service by any or all of the telephone corporations listed in Appendix A, attached hereto.	Case No. 10191 (Filed October 13, 1976)

(Appearances are listed in Appendix A.)

OPINION

On October 13, 1976 this Commission issued an Order Instituting Investigation (OII) in Case No. 10191 to determine the correct levels for Centrex[1/] rates and the underlying cost basis for such rates.

In the OII the Commission stated:

> "We agree that proper exploration of Centrex costs is vital. Centrex is a competitive product; therefore, while it is important that Centrex rates not be too high, to the detriment of the customers of the various telephone corporations within our jurisdiction, it is just as important that such rates not be too low, which would be unfair to any competitors of such telephone corporations which offer equipment similar to Centrex."

The Commission also stated that pending hearings in the OII it may consider whether interim Centrex rate relief is necessary

1/ Centrex is a system intended for large business telephone customers. It provides the subscriber with many telephone lines which may be called individually, rather than through a switchboard; which may be used independently for outgoing calls; and which may be used for intercommunication purposes. Schedule Cal. PUC No. 121-T (The Pacific Telephone and Telegraph Company's tariff).

in Application No. 55492 and Case No. 10001. Except for questions relating to interim relief, Centrex rate issues were severed from the above proceedings.

The OII specified a 12-month test year for cost data beginning July 1, 1977 noting that this did not mean that recorded information could not be introduced and relied upon.

The respondents were all public utility telephone corporations as listed in Appendix B, attached hereto.

Hearings

A prehearing conference and 13 days of public hearing were held before Administrative Law Judge (ALJ) Donald C. Meaney in San Francisco and Los Angeles between February 14, 1977 and February 15, 1978. Starting in October 1978 an additional six days of public hearing were held before ALJ John J. Doran in San Francisco and Los Angeles. The last day of hearing was November 1, 1978 and the matter was submitted on reply briefs filed as of January 10, 1979. Seventy-four exhibits were introduced and the transcript covered 1,863 pages.

Rate History

Centrex service has been offered by The Pacific Telephone and Telegraph Company (Pacific) since it was first tariffed in 1962. Neither the original filing, nor any of the subsequent increases were based on a study of the costs of providing Centrex service.

In Decision No. 74917 dated November 6, 1968, the Commission granted a general increase to Pacific including a rate increase for Centrex service without full cost information.

Centrex rates were increased in Decision No. 80347 dated August 8, 1972, again without complete cost studies.

In Decision No. 83162 dated July 23, 1974 in Application No. 53587 filed September 19, 1972 (general rate proceeding) Pacific was authorized a 15 percent surcharge in Centrex rates.

In Decision No. 85287 dated December 30, 1975 in Application No. 55214 filed September 30, 1974 (wage offset rate proceeding) Pacific was ordered to file Centrex cost studies within 90 days, but was not authorized any change in Centrex rates.

Decision No. 88232 dated December 13, 1977 in Application No. 55492 filed February 13, 1975 (wage offset rate proceeding) and amended application filed January 16, 1976 found that Pacific's Centrex rates should remain unchanged pending further study in Case No. 10191.

Petitions for Interim Rate Increases

Petitions for interim rate increases for Centrex service were filed by:

1. California Interconnect Association (CIA) on August 12, 1977.2/
2. Pacific on Feburary February 21, 1978.
3. CIA again on July 20, 1978.

Parties filed replies to the petitions for interim increases. We chose to issue a final opinion based on a complete record. All petitions or motions still outstanding are denied.

Centrex Service

Pacific's Centrex service provides station lines, attendant positions, direct inward dialing to individual stations, identification of outgoing calls and other optional features similar to modern PBX service. Centrex service allows subscribers to make intercommunication

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2/ CIA also moved to consolidate the Centrex investigation with Application No. 55492 and Case No. 10001 (a then being heard wage offset rate proceeding of Pacific).

calls using less than seven digits, access to the exchange and toll networks, and to transfer and add on calls within the system. It is a complex, integrated service offering, which combines the features and capabilities of both exchange and intercommunication services. Supplemental services such as Tie Line, Foreign Exchange (FEX), and Wide Area Telephone Service (WATS) may be associated with Centrex systems at rates and charges applicable to the particular service.

The switching equipment required to operate a Centrex system presently may be located on the customer's premises (Centrex-CU) or on Pacific's premises (Centrex-CO). Centrex-CU service is presently provided by a 701 Step-by-Step or by a 101 ESS switch. These switches are no longer manufactured. Centrex-CO service is presently provided by a No. 1 ESS or No. 5 Crossbar switch. As of January 1, 1978, approximately 75 percent of Pacific's Centrex-CO service was being provided from ESS central office switches and 25 percent from No. 5 Crossbar central office switches. All new installations of switching equipment in California by Pacific will be ESS. Pacific presently offers Centrex I and Centrex II service. Centrex I service includes dial intercommunication service, direct inward dialing, station line identification of outward multi-message unit and toll traffic, and transfer of incoming calls from one station to another. Centrex II service provides more features than Centrex I, including dial transfer of incoming calls and conference calls. Centrex features are presently included in the Centrex primary station line rates.

Pacific had 519,000 primary lines in service as of January 31, 1977, including 360,000 Centrex-CO lines and 159,000 Centrex-CU. Seventy-five percent of the Centrex-CO lines were in ESS central offices and the remainder in No. 5 Crossbar central offices. Pacific's annual Centrex revenues are estimated to be $80 million from its 720 Centrex customers.

Cost Alternatives

From the outset, the Commission has been aware that this case raises issues relating to competition and has sought to discharge its responsibility to weigh those effects in resolving the contentions of the parties. The record has been thoroughly developed as to the extent to which Centrex is offered in a competitive atmosphere; not simply with equipment offered by competitors, but also with other services offered by Pacific. The effect on competition is of paramount importance in the Commission's determination of the correct levels for Centrex rates and the underlying cost basis for such rates.

Initially, Pacific announced its intention to conduct several different cost studies, including a fully allocated cost study using the GE-100 methodology (used by Pacific for many years to cost vertical terminal equipment services), and a directly assigned cost study to be used in conjunction with a long-run incremental analysis (LRIA) study. The LRIA study was intended to be dispositive of Centrex rate issues in Pacific's view, as it was expected to provide the data necessary to set Centrex rates so as to generate the largest possible revenue contribution. This maximized contribution approach was identified as the basic pricing policy of Pacific and a way to provide the Commission with more information in order to have a more informed basis for determining prices, rather than relying just on the GE-100 study.

The staff indicated that it would utilize each of these studies in making its ultimate recommendations, as well as an embedded results of operations study.

Witness Selwyn, testifying on behalf of California Retailers Association and California Manufacturers Association (CRA/CMA), recommended that a differential cost methodology be adopted, with emphasis on a distinction between new and existing customers. Witness Selwyn expressed interest in the LRIA results, but was skeptical of the company's ability to complete a meaningful study. Witness Effron, testifying on behalf of CIA, was critical of several features of Pacific's proposed LRIA study and also expressed reservations regarding the likelihood that the study could be successfully completed.

Subsequently, Pacific admitted that its LRIA study had failed. Consequently, it proposed that rates be set on the basis of a fully allocated cost study using the GE-100 methodology. The staff indicated it concurred that the results of Pacific's fully allocated cost study were sufficient to determine rates for Centrex service and offered an adjusted GE-100 study. CIA and CRA/CMA each offered adjusted GE-100 data that reflected the original criticisms that each had made of Pacific's methodology. Of all of these studies, the staff study provides the Commission with the best reasonable basis for setting the revenue requirement for the reasons hereafter set forth.

The failure of the LRIA study leaves the Commission with two basic choices in adopting a cost methodology: the fully allocated cost basis recommended by Pacific, staff, and CIA, or the differential avoidable cost basis advocated by CRA/CMA. We find from the record that the fully allocated cost basis more reasonably balances the competing interests and results in reasonable rates that are in the public interest.

The record contains numerous references to competitive products offered by Pacific and the interconnect companies. There is no specific information in the record regarding the pricing or costs of the products offered by the interconnect companies. However, it is clear that one of the most significant competing vehicles is the Dimension PBX, offered by Pacific. The rates for Dimension were approved by this Commission by Decision No. 87962 on October 12, 1977 in Application No. 55723.

The Dimension proceeding required that the Commission choose between an incremental market analysis approach (similar to LRIA) preferred by Pacific, or a fully allocated cost study based on GE-100 methodology, recommended by the staff. Decision No. 87962, which adopted the fully allocated cost basis, stated in part as follows:

> "The use of the incremental cost concept to justify the price of an offering by a utility in such a competitive situation would allow the utility to allocate its overhead and fixed costs to its monopoly services. Leaving the effects of such an allocation on the utility's competitors aside, incremental cost pricing would obviously be unfair to the utility's monopoly customers in that they would bear all costs except the incremental costs associated with competitive markets.
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> "The unfairness of the incremental cost method on the utility's monopoly customers would alone be sufficient to rule out its use. The requirement that we must consider the anticompetitive aspects of a utility's offering upon suppliers who have no monopoly service to bear the overhead and fixed costs further militates against incremental cost pricing." (Mimeo. p. 47.)

The above is equally applicable in this Centrex proceeding.

There are similarities between the CRA/CMA differential cost approach and the incremental market analysis offered in the Dimension proceeding. Both methods exclude overhead and fixed costs from the cost study, but allow for some recovery of such costs by way of contribution.

Witness Selwyn's recommendation that the price of alternate service should control the price of Centrex supports the staff position because the only meaningful alternate service, the price of which is readily ascertainable in this record, is the price of Dimension service. The basic methodology used by the staff in this proceeding is from the Dimension decision.

GE-100 Fully Allocated Cost Results

Pacific presented a complete fully allocated study of GE-100 results. The staff recommended adjustments to Pacific's results.

The major complexity of the Centrex cost study involved the determination of the unit investments in typical service configurations. ESS Centrex-CO service involved the assignment of a portion of the investment in the central processor to the Centrex service. The staff after analyzing the program used by Pacific, used the same processor utilization factor that was used by Pacific. As was the case in the complex cost issues, CIA recommended a processor utilization factor that would produce a higher cost and thus higher rates for the ESS Centrex-CO service. Also, CRA/CMA recommended a processor utilization factor that would produce a lower cost and thus lower rates for the ESS Centrex-CO service. The processor utilization factor used by Pacific and the staff is reasonable and is adopted because it recognizes unused central office processor capacity in the development of Centrex costs.

Pacific's cost study used a weighted average composite of 75 percent ESS and 25 percent No. 5 Crossbar costs, reflecting the mix of ESS and Crossbar plant in Centrex service during the test year. The staff recommended that only ESS costs be used. A staff witness stated the basis for the recommendation as follows:

"Pacific proposes and the staff concurs that the Crossbar offering be limited to existing capacity in offices already arranged to provide Centrex service. Future projections indicate significant growth is expected in the ESS Centrex offering which will far exceed the growth to be permitted in the Crossbar service offering. Pacific has indicated that the existing Crossbar capacity will be reserved for growth in existing Crossbar systems. I do not believe the compositing relationship employed by Pacific is appropriate for fixing future rates. In view of the rapidly declining proportion of Crossbar served CO-Centrex services and the fact that it is anticipated that all new Centrex systems will be served by ESS central offices, I recommend that the switching cost component of basic CO-Centrex service be based on the ESS switching costs."

This proposal is concurred in by witnesses for CIA and CRA/CMA.

The practice of setting rates requires that the test period results be adjusted for "reasonably anticipated changes...which did not obtain throughout the test period but which are reasonably expected to prevail during the future period for which rates are to be fixed" (PT&T v PUC (1965) 62 Cal 2d 634, 645). Therefore, the use of ESS costs is reasonable and is adopted.

Pacific and staff methodologies differ in the development of net plant factor. Pacific utilized the overall company net plant factor to determine the depreciated investment from which annual capital costs are calculated. This practice has been adopted in studies for many years. CRA/CMA contend that a 50 percent ratio is appropriate because it equates to the circumstances of an equipment lease. However, in Pacific's Dimension proceeding, the Commission adopted the reserve ratio for the large PBX equipment (Account No. 234) to be used to determine the Dimension depreciated investment. In the Dimension PBX decision we stated:

"While recognizing that the use of the capital recovery concept and a 50 percent ratio is mathematically correct in the long run and therefore appealing for that reason, we must also recognize that the reserve ratio for Pacific's plant as a whole is 21 percent (resulting in the 0.79 net plant factor) and the ratio for Account 234, Large Private Branch Exchanges, is only 9 percent (for a 0.91 net plant factor). The use of a 50 percent ratio, while it would produce rates that would be mathematically correct in the long run, would be low compared to the overall level of Pacific's present rates which are tested for reasonableness against a rate base which is determined by use of Pacific's overall 21 percent depreciation reserve ratio. They would be particularly low when compared to PBX rates that would produce a reasonable return on a present day net investment, or rate base, on the large PBX plant alone, with its 9 percent depreciation reserve ratio.

"The use of the GE-100 method has the further advantage that, for equipment offered in competition with that supplied by other manufacturers, it tends to compensate for any superior financial strength that the utility may have. Pacific, with its high credit rating, and ready access to capital markets, would experience little difficulty with rates that are designed to recover costs and return uniformly over the life of the offering. An outside manufacturer, with somewhat less favorable sources of financing, would normally be expected to be under pressure to recover as much of his investment and return as possible in the early years of the offering. The GE-100 method, by shifting the recovery of investment and the return to the early years of the offering, promotes competition by producing rates that would be more likely to be attractive to nonutility manufacturers."

The staff's development of a 92 percent net plant factor is reasonable and consistent with the Dimension decision method, and is adopted.

The staff recommended an adjustment to Pacific's study to reflect federal income tax savings available from investment tax credit and accelerated depreciation. Taxes on income are combined with the rate of return to develop one factor in the GE-100 process. The taxes include both state and federal income taxes and recognize tax-free debt money as a component of the total cost of money. The factor used by Pacific did not include the tax expense savings available to Pacific from investment credit and accelerated depreciation. The tax approach which is used by Pacific in its Centrex cost studies was developed before the present income tax benefits were available. In its Decision No. 87962 in Pacific's Dimension PBX proceeding, the Commission required the tax savings afforded the utility on a ratemaking basis be included in the development of the costs of Dimension. Inclusion of the tax benefits available to the utility in the cost calculations for Centrex service results in a more accurate estimate of the cost of the service and is consistent with general ratemaking methodology and with Decision No. 87962, and is adopted.

Pacific and the staff used the same rate of return factor (10.5 percent); other parties used higher or lower percentages. In Pacific's Dimension PBX proceeding, the Commission adopted 12 percent to recognize the risk of offering the new discretionary service, to reflect the higher costs of new capital needed to provide Dimension PBX service, and to price Dimension service at a relatively premium level to discourage rapid displacement of older and obsolescent PBX equipment. Plant used for Centrex service has a high degree of ultimate reusability and is not considered as high a risk. Therefore, the use of a 10.5 percent rate of return in costing the investment is reasonable.

Pacific - Centrex Rate Increase

The fully allocated cost study using the GE-100 methodology as adopted herein is the most reasonable basis for setting Centrex rates for Pacific's subscribers. This is the basis that was used in the Dimension decision and is a reasonable way of balancing the competing interests. The revenue effect of the adopted rates is estimated at $14.4 million repressed (including the effect of estimated customer diversion) and $21.5 million unrepressed.

It has been suggested that a rate increase for Centrex is unreasonable, without a corresponding rate reduction in some other element of service. Section 728 of the Public Utilities Code states:

> "Whenever the commission, after a hearing, finds that the rates or classifications, demanded, observed, charged, or collected by any public utility for or in connection with any service product, or commodity, or the rules, practices, or contracts affecting such rates or classifications are insufficient, unlawful, unjust, unreasonable, discriminatory, or preferential, the commission shall determine and fix, by order, the just, reasonable, or sufficient rates, classifications, rules, practices, or contracts to be thereafter observed and in force."

Hearings have been held and present rates have been shown to be insufficient. Reasonable future rates for Centrex service may be set without regard to the other rates of the utility. However, we will recognize the revenue increase authorized herein when setting rates in Pacific's pending general rate increase, Application No. 58223 and consolidated OII No. 21. The Centrex rate design authorized herein reasonably addresses the Centrex cost issues. The rate increase phasing adopted herein mitigates the impact of the increase on customers.

General Telephone Company of California (General)

General furnishes Centrex service to 35 customers. The annual revenues from such service are about $4,765,000. All of General's Centrex customers are served from electromechanical step-by-step central offices. No new customers have been added to the system for several years. There is no known requirement for new central office plant to provide Centrex service during the next few years.

General's Centrex rates were originally developed in 1963 utilizing the weighted average rate for PBX trunks as the basic rating component. Added to the trunk rate were the estimated costs associated with inward dialing capabilities. These rates have subsequently been changed several times as the result of Commission action in general rate applications.

General proposes no change in its rates for Centrex service, although its cost study indicates insufficient revenue to recover the fully allocated costs of the service. General forecasts no demand for new Centrex systems and little growth in the existing services provided by step-by-step central offices. General states that if the rates indicated by its cost study were adopted, a significant number of Centrex users would choose another serving alternative. General's witness Spaulding testified that most of the central office equipment used to provide Centrex service could be reused for other services if it were gradually displaced, but the rate increases indicated by the cost study would accelerate displacement and thus reduce the reusability of existing central office equipment. The staff did not develop a comparative cost study of General's Centrex service. It is reasonable that no rate changes be ordered for General's Centrex service at this time.

General is presently developing an Enhanced Business System Service (EBSS), which will be provided from three No. 1 ESS central offices that will be purchased from Western Electric and possibly from other types of central offices that may be installed in the future. General states that this service will offer many of the advanced service features now available from No. 1 ESS equipped central offices, including Centrex type service. However, the availability of EBSS is still several years away. General recommends that if a new customer should request Centrex service prior to the availability of EBSS and General has the equipment available in the step-by-step office providing service to the area in which the customer is located, it should be permitted to do so. It should not require that customer to subscribe to some other service offering with fewer features until the time when EBSS becomes a reality.

General's position that Centrex service should be limited to new customers, on an equipment available basis, so that any prospective customer will not be deprived of the service features that are only available from General through its Centrex service is reasonable and is adopted.

General will be required to submit to the Commission as a part of its next formal rate proceeding the cost studies, market analysis, and service and rate proposals associated with the proposed EBSS. Present Centrex rates and service will then be subject to reevaluation.

Rate Design

A comparison of the effect of the rate proposals offered in this proceeding are as follows:

CENTREX-CO RATE COMPARISON

System	Pacific		Staff	CRA/CMA
	Present	Proposed	Proposed	Proposed
200 Line	$ 3,130	$ 4,790	$ 4,700	$ 3,250
825 Line	10,820	16,760	16,450	10,760
4,000 Line	44,990	61,870	59,760	40,990

The above tabulation shows the effect upon a typical small (200 lines), medium (825 lines), and large (4,000 lines) ESS Centrex-CO customer system. For each size customer other data were based upon the specified number of primary station lines and a number of various (about 16) rate elements to develop a typical customer's requirements. When no new rate was proposed for an element, Pacific's proposed rate was used.

Pacific's recommended rate design for Centrex service which includes the network access charge, line and station rate for basic Centrex service, the restructure of mileage charges, and the "hardware" or "unbundled" pricing of the various optional features available with Centrex was generally paralleled by the staff. However, the staff differed from Pacific with respect to the approach for determining the rate levels for basic Centrex service.

Pacific's basic line rate for Centrex-CO is based on a 75 percent to 25 percent composite of the ESS and Crossbar switching costs. Pacific includes in the development of the basic rate the composite switching, outside plant loop, telephone instrument, and inside wire costs. The primary line rate proposed by Pacific is designed to recover the switching, loop and inside wire costs, and a portion of the instrument costs. A separate rate is proposed for the station.

The primary line rate proposed by the staff is based on ESS switching and outside plant costs. The staff recommended that the Centrex station rate be based upon fully allocated costs associated with the station instrument and station inside wire. It is the staff's position that such a station rate will permit a customer to purchase and connect certified, non-Bell station instruments and reduce telephone service monthly billings from the regulated utility. The staff rate design modified to reflect Pacific's method of handling inside wire and station costs and, when further modified to have uniformity in station rates (the station rate applicable to basic telephone service), is reasonable and is adopted.

Pacific proposes to increase the rate for private line (PL) terminations associated with Centrex-CO and to establish a new rate for FEX terminations associated with Centrex-CO based on a composite of the costs of ESS and Crossbar central office terminations. Staff recommends that the rates for Centrex-CO, PL, and FEX terminations be based on the ESS costs only. The staff proposal is consistent with the rate treatment proposed for the Centrex-CO basic rate and is adopted.

Pacific and staff recommend that the higher rate per primary station line for the first one hundred station lines for Centrex-CO service be eliminated. Pacific and staff propose to eliminate the Type I Centrex-CO service offering and to provide attendant transfer on an optional basis at fully allocated cost-based rates.

Pacific's Centrex-CO rate design proposals for exchange network access, station features, attendant equipment, nonrecurring charges, and mileage were concurred in by the staff. However, the staff adjusted the rate levels associated with certain attendant equipment elements for ESS served Centrex-CO and certain rate elements requiring a central office loop to reflect the staff adjustments to Pacific's cost studies.

Pacific proposes to withdraw the service offering of Centrex-CU to new customers. In addition, Pacific proposes to restructure the existing Centrex-CU tariff for present customers to include the concepts proposed for Centrex-CO. These tariff revisions include separate line and station rates and "unbundling" of attendant equipment and features. The staff concurred with Pacific's proposals for Centrex-CU except for the rate levels proposed for basic Centrex-CU service. Pacific proposed to maintain the present general relationships between Centrex-CO and Centrex-CU basic rates. The staff recommended that the composite line rate for Centrex-CU (network access, line, station, and inside wire) lines in excess of one hundred lines be increased approximately in the same ratio as is the composite line rate for Centrex-CO. The staff recommended no change in the level of rates for the first one hundred Centrex-CU station lines except for the reduced network access charge. The staff-proposed station instrument and station inside wire rates for Centrex-CU are the same as for Centrex-CO.

The staff design is reasonable and is adopted except for the Centrex-CO station rate and inside wire costs, and the Centrex-CU first one hundred lines' rate which has been heretofore discussed.

The staff recommended that basic termination charges (BTCs) applicable to primary station lines of Centrex-CO not be assessed as of the effective date of rate relief. The basis for this recommendation is Pacific's evidence that the facilities and equipment used to provide primary station and its features for Centrex can be reused for other classes of service. The nonrecoverables were stated to be small. Pacific recommended eliminating the charge for new service only. At the time existing customers selected Centrex service, the BTC liability was an essential part of the tariffs under which they made their decision to subscribe to Centrex service. The waiver of the BTC for existing

Centrex customers is unreasonably discriminatory to customers who subscribed to other services under tariff providing for BTCs. It is unreasonable to waive the BTCs in existing tariffs for existing customers. It is reasonable to not apply BTCs to new customers.

Authority to Set Centrex Rates

The City and County of Los Angeles and the University of California (University) argue that the Commission cannot increase Centrex rates outside the context of a general rate proceeding.

Pacific cited Decision No. 89112 dated July 25, 1978, and Decision No. 88232 dated December 13, 1977 as authority for authorizing a Centrex increase at this time. Decision No. 88232 stated that the Commission had power to authorize telephone answering service equipment rate increases outside of General's general rate proceeding. Decision No. 89112 stated that the impact on General's rate of return could await consideration until the next general rate proceeding.

Pacific's proposed rates would result in about a $16 million revenue increase and results in about a 0.15 percent increase in its overall rate of return.

We have the necessary authority to authorize Centrex rate increases at this time, particularly in view of Pacific's pending general rate proceeding wherein we can recognize the revenue effect of this increase as it relates to Pacific's overall revenue requirement.

Phasing of New Rates

The City and County of Los Angeles and the University have each objected to Pacific's proposed six-month period for the phasing in of Centrex rates. Witnesses for these parties generally stated that a period of three years was necessary for them to adjust to the rate increase.

Pacific originally requested increases in the Centrex rates in January 1976 within its request in Application No. 55492. It is over three years since that application was filed. The OII test period, ended July 31, 1978, has passed. During this time rates for Centrex service have not covered full costs. The City and County of Los Angeles and the University state that they need additional time to adjust to an increase in rates. Pursuant to Rule 24 of the Commission's Rules of Practice and Procedure and as demonstrated by Exhibits 72 and 73, both the City and County of Los Angeles were sent notices of Application No. 55492 when it was filed on February 13, 1975. Additional notice was sent in the spring of 1976 to all subscribers from Pacific which briefly set forth the revisions in the Centrex rates, and the effect on large business subscribers such as the City and County of Los Angeles.

Both the City and County of Los Angeles were served with a copy of the order instituting Case No. 10191, issued on October 13, 1976.

The University witness wanted a similar multi-year phasing period. The witness recommended that the Commission's General Order No. 96-A be used as a basis of the University being given preferential rates. If the University is given Centrex service at preferential rates below Pacific's costs to provide the service, then other ratepayers must necessarily provide the revenue requirement to support this subsidy. This is contrary to Section 453 of the Public Utilities Code and is unreasonable.

The staff proposal for the phased implementation of Centrex rates calls for an interim increase based on a portion of the costs indicated in Pacific's studies, and then a subsequent increase to the final authorized rate levels. Pacific would be required to notify all customers of the proposed interim rates. Thereafter, Pacific would file an advice letter for the approved rates, which could become effective 30 days later.

The staff's proposal will have the effect of imposing two increases for most all of the Centrex rate elements resulting in unnecessary duplication of work and difficulties.

Pacific proposed an interim increase to the full authorized amount for only those rate elements that are simple to implement and which have a minimum effect on customer systems. This increase is to be followed at a later date by an increase to the full authorized amounts for those other rate elements which have greater impact on customer Centrex systems. Under Pacific's proposal the rate for each element is changed only once. Pacific's proposal for phasing final rates (some elements now, others later) is much easier to implement, will minimize disruption of customer planning for Centrex service, and is modified to extend the 6 months' effective date to 12 months for the second increase and is reasonable and is adopted.

Petition for Proposed Report

A petition for a proposed report was filed by CIA on the last day of hearing, November 1, 1978, and joined in by TURN and SP Communications, Inc. The petition is based upon the matter being complex, substantial, and processed over a long period of time with one change in assigned ALJs.

This petition does not state how such a report will substantially aid the parties and Commission nor why such a report would not unreasonably delay the proceeding. After hearing, this matter was fully briefed (opening and reply), is ready for final decision, and granting of the petition will unnecessarily delay the decision. The petition is denied.

Motion to Receive Certain Information Under Seal

Pacific made a motion that Attachments JW-1 and JW-2 to Exhibit 62, Prepared Testimony of CIA witness Wilson, be received under seal, that it not be incorporated as part of the public record, and that it not be open to the public.

Pacific states that the document is a trade secret, a confidential document, that was developed by the American Telephone and Telegraph Company for the use of the operating companies.

The material in question contains reproductions of a document entitled "ESS Cost Analysis Manual". It was furnished to CIA under a protective order issued by the ALJ on May 15, 1978.

CIA's position is that the material is not confidential or proprietary and should not be received under seal.

Parties had use of the subject material at hearing. Parties could reference the material in briefing to all parties, in as abbreviated form as possible.

Pacific does not disclose the material to the general public or others outside the business. The material is of value to others, in particular, competitors of Pacific. Unregulated competitors need not furnish their market and price plans. Attachments JW-1 and JW-2 to Exhibit 62 were not necessary or material to our determination of Centrex rates. The motion to seal is granted.

Findings of Fact

1. Centrex is a system intended for large business telephone customers. It provides the subscriber with many telephone lines which may be called individually, rather than through a switchboard; which may be used independently for outgoing calls; and which may be used for intercommunication purposes.

2. Centrex service is offered only by Pacific and General in California. Centrex has been offered by Pacific since 1962 and by General since 1963.

3. Centrex service is a telecommunications service for which there are available competitive alternatives.

4. The GE-100 fully allocated cost methodology of Pacific, as modified by the staff, reasonably balances all competing interests.

5. The processor utilization factor used by Pacific and the staff is reasonable and should be adopted because it recognizes unused central office processor capacity in the development of Centrex costs.

6. Using only ESS costs rather than a mix of ESS and No. 5 Crossbar is reasonable because Pacific is moving toward all ESS central offices.

7. A net plant factor for the central office equipment portion of the cost study based on the reserve ratio of the electronic central office accounts, as proposed by the staff, rather than use of total plant as proposed by Pacific, is more reflective of actual plant utilized using the same approach for costing other capital items and is reasonable for the same reason.

8. In determining tax expense, utilizing the savings available from investment credit and accelerated depreciation is reasonable because it is consistent with our general ratemaking treatment.

9. Centrex service has a high degree of reusability and is not a high-risk service from the standpoint of having plant potentially rendered unuseful because of competition.

10. A 10.5 percent rate of return for Centrex service is reasonable.

11. Pacific's recommended rate design for Centrex service is reasonable when: (1) adjusted to the staff level of revenue increase; (2) modified to use the switching costs associated with ESS served Centrex-CO in developing the Centrex-CO basic line rate; (3) modified to use ESS costs only in developing rates for Centrex-CO, PL, and FEX terminations; (4) modified to adjust rates for attendant equipment elements for ESS served Centrex-CO and rate elements requiring a central office loop; and (5) when adjusted to reflect a uniform station rate authorized for other classes of service.

12. There is no economy of scale in providing Centrex service. Therefore, using the same rate for each primary station line regardless of the number of lines in the Centrex system is reasonable.

13. Pacific's proposal to restrict Centrex-CU service to existing customer systems at their present locations is reasonable in view of equipment availability.

14. Pacific's proposal to restrict Centrex-CO service served from No. 5 Crossbar central office switching equipment to the existing capacity of central offices presently arranged to provide Centrex service features is reasonable.

15. Pacific's proposal to offer only basic Centrex-CO service, and eliminate the unnecessary distinction between Type I and Type II Centrex-CO service will enable the rates to reflect costs and is reasonable.

16. Pacific's last general rate decision was based upon an overall rate of return of 8.85 percent.

17. The application of the President's Wage-Price Guidelines on Pacific's operations will be considered in the context of Pacific's pending general rate Application No. 58223 and need not be considered herein. The test year and the costs relied on herein were in effect before issuance of the guidelines.

18. The annual revenue increase effect of the adopted Centrex rate increases on Pacific is approximately $14.4 million, after estimated repression.

19. Applying a gross-to-net multiplier of 1.966, adopted as reasonable in Decision No. 88232, Pacific's latest rate case decision, results in an overall, after tax effect increase in annual revenues of approximately $7.3 million. Dividing this by $5,304,821,000, the adopted rate base in Decision No. 88232, indicates an approximate increase in overall rate of return of 0.14 percent.

20. The effect of the increases authorized herein will be recognized in determining Pacific's overall revenue requirement in pending rate Application No. 58223.

21. The governmental entities participating in this proceeding comprise nearly 45 percent of Pacific's Centrex service.

22. The rate increase authorized herein may place a significant cost increase upon these governmental customers.

23. Extending the phasing period from 6 months to 12 months for increases in certain rate elements having a significant revenue effect will give all customers some opportunity to adjust to the rates or reevaluate their service needs.

24. The Centrex rates authorized herein will not have an unreasonable anticompetitive effect on competitors in the California terminal equipment market and will, if anything, promote competition.

25. Pacific is subject to extensive regulations and its competitors in this terminal equipment market are not subject to such regulations.

26. The Centrex rates authorized herein insure that Pacific's Centrex service will not be subsidized by the monopoly exchange services which Pacific offers the general public.

27. The increases in Centrex rates and charges authorized herein are justified; the rates and charges authorized herein are reasonable; and the present Centrex rates and charges insofar as they differ from those prescribed herein, are for the future unjust and unreasonable.

28. Increases in the rates and charges authorized herein for station transfer, attendant positions, private line tie terminations, FEX terminations and mileage should be made effective within 12 months of the effective date of this order or upon customer acceptance, whichever occurs first. All other rate charges authorized herein should be made effective within 30 days of the effective date of this order.

29. Postponement of the effective date of the rates and charges authorized herein for longer than 12 months after the effective date of this order is not in the public interest because such postponement may have an unreasonable anticompetitive effect on Pacific's competitors in the California terminal equipment market.

30. Pacific's proposal to eliminate basic termination charges for future customers and to recover all nonreusable capital-related expenses by a combination of the installation charge and the monthly recurring charge is reasonable because of the expected high degree of reusability of the equipment.

31. Basic termination charges for existing Centrex subscribers are part of the lawful filed tariffs under which the service was ordered.

32. The waiver of basic termination charges for existing Centrex customers would be discriminatory toward other customers who evaluated and selected other comparable services under tariffs providing for basic termination charges. Accordingly, retention of basic termination charges for existing Centrex customers is equitable and would mitigate against a discriminatory result for all who selected service under existing tariffs and conditions.

33. The information contained in Sections JW-1 and JW-2 of Exhibit 62 is an exact reproduction of certain portions of Pacific's ESS Cost Analysis Manual.

34. The information contained in the ESS Cost Analysis Manual is valuable to Pacific's competitors and disclosure could be competitively disadvantageous to Pacific.

35. It is reasonable that no rate changes for General's Centrex service for its electromechanical central offices be directed at this time.

Conclusions of Law

1. It is proper to change and to increase Centrex rates, based solely on the record in this proceeding. Rates for Centrex service furnished by Pacific should be increased and phased in to the extent authorized by the following order.

2. There should be limitations on Pacific Centrex-CU and Crossbar served Centrex-CO.

3. General's Centrex offering to existing and new customers should be limited to an equipment available basis.

4. Establishing special Centrex rate treatment for the Cities of Los Angeles and San Diego, the County of Los Angeles, the City and County of San Francisco, and the University, as recommended by those government entities would result in unlawful discrimination.

5. The information contained in Sections JW-1 and JW-2 of Exhibit 62 constitutes Pacific's proprietary and trade secret information and should be received under seal.

6. General's Centrex service should be limited to existing customers and to new customers on an equipment available basis in the central offices providing service to the areas in which such customers are located.

7. General should be required to submit to the Commission, as a part of its next general rate proceeding, the cost studies, market analysis and service, and rate proposals associated with the proposed EBSS. General's present Centrex rates and service should be subject to reevaluation in that proceeding.

8. All motions in this proceeding which have not previously been disposed of should be denied.

9. The investigation in Case No. 10191 should be terminated.

10. The effective date of this order should be the date hereof because Pacific is already incurring the costs, and the rates herein authorized will, if anything, promote competition.

O R D E R

IT IS ORDERED that:

1. On and after the effective date of this order, The Pacific Telephone and Telegraph Company (Pacific) is authorized to file the revised rate schedules attached hereto as Appendix C.

2. Pacific's schedule (Appendix C) shall become effective on not less than thirty days' notice and shall apply only to service rendered on and after the effective date except that increases in the rates and charges authorized herein for station transfer, attendant positions, private line tie terminations, foreign exchange terminations, and mileage shall become effective on twelve months' notice or upon customer acceptance, whichever occurs first.

3. Pacific is directed to furnish to each Centrex customer within ten days after the effective date of this order, notice of the effect of the increase upon small, medium, and large Centrex customer systems. Customers shall be requested to contact their Pacific account representative if they desire additional information.

4. On and after the effective date hereof General Telephone Company of California (General) shall file tariffs to limit its present Centrex service offering to existing Centrex customers and to such additional customers for whom equipment is available in the step-by-step central offices providing service to the areas in which such customers are located.

5. General shall submit to the Commission as a part of its next formal rate proceeding the cost studies, market analysis, and service and rate proposals associated with its proposed Enhanced Business System Service.

6. The information contained in Sections JW-1 and JW-2 of Exhibit 62 is received as evidence under seal.

7. All motions in this proceeding not previously disposed of are denied.

8. The investigation in Case No. 10191 is terminated.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 22nd day of MAY, 1979.

John E. Bryson
President

Vernon L. Sturgeon

Richard D. Gravelle

Claire T. Dedrick

Leonard M. Grimes, Jr.
Commissioners

APPENDIX A

LIST OF APPEARANCES

Respondents: Christopher Lee Rasmussen, Milton J. Morris, B. Haven Walling, Jr., and Cathy L. Valentine, Attorneys at Law, for The Pacific Telephone and Telegraph Company: A. M. Hart, H. Ralph Snyder, Jr., and Kenneth K. Okel, Attorneys at Law, for General Telephone Company of California; and Richard S. Kopf, Attorney at Law, for Southern Pacific Communications Company.

Interested Parties: Allen B. Wagner, Attorney at Law, for The Regents of the University of California; John H. Oliphant, for the University of California; Avalino B. Montes, for Communications Workers of America; Joel Effron, for Scott-Buttner Communications, Inc.; Ann Murphy, Attorney at Law, for Toward Utility Rate Normalization; Brobeck, Phleger & Harrison, by Gordon E. Davis and William H. Booth, Attorneys at Law, for California Retailers Association and California Manufacturers Association; Thomas M. O'Connor, City Attorney, by Robert Laughead, for the City and County of San Francisco; Edward J. Perez, Deputy City Attorney, for Burt Pines, City Attorney, for the City of Los Angeles; John W. Witt, City Attorney, by William S. Shaffran, Deputy City Attorney, for the City of San Diego; Robert W. Russell, by Manuel Kroman, for the Department of Public Utilities & Transportation, City of Los Angeles; William L. Knecht and Cohn & Marks, by Edwin B. Spievack, Attorneys at Law, for California Interconnect Association; Anthony F. Martini, Attorney at Law, for Los Angeles County; and David L. Wilner, for Consumers Lobby Against Monopolies (CLAM).

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APPENDIX C

RATES - The Pacific Telephone and Telegraph Company

Schedule Cal. P.U.C. No. 121-T, Centrex Service, shall be revised as set forth in Exhibit No. 50 as modified by Exhibit No. 57, Appendix A, pages 1, 5, 6, 8, and 10 through 12, except line and station rates shall be as set forth below:

	Installation Charge	Monthly Rate
Centrex-CO		
Primary lines, each*	$17.00	$ 8.30
Primary lines, semi-restricted, each*	17.00	8.30
Primary lines, interior, each	17.00	8.05
Extension lines, each	18.00**	.65
Extension lines, off-premises, each	17.00	4.90
Stations, each	18.00**	.85***
Centrex-CU		
Primary Lines****		
Type I		
Non-cabinet (701), each		6.25
Cabinet (101 ESS), each		6.60
Type II		
Non-cabinet (701), each		7.60
Cabinet (101 ESS), each		7.85
Type I and II, Interior Lines		
Non-cabinet (701), each		4.20
Cabinet (101 ESS), each		4.40
Extension Lines		Same as Centrex-CO
Stations		Same as Centrex-CO

Note: For Centrex-CO, basic termination charges applicable on or before (effective date of tariffs) shall remain in effect.

* Minimum rate and charge applicable is for 100 lines, primary, semi-restricted or in combination.

** Charge from Schedule 28-T. Only one $18.00 charge for extension line and station installed on same order.

*** Rate from Schedule 4-T, extension telephone.

**** Minimum rate applicable is for 100 primary lines, Type I or II, cabinet or non-cabinet.