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ORIGINAL

Decision No. 90861 SEP 25 1979

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of The Pacific Telephone and Telegraph Company, a corporation, for telephone service rate increases to cover increased costs in providing telephone service.	Application No. 55492 (Filed February 13, 1975; amended September 19, 1975 and January 16, 1976)
Investigation on the Commission's own motion into the rates, tolls, rules, charges, operations, costs, separations, inter-company settlements, contracts, service, and facilities of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a California corporation; and of all the telephone corporations listed in Appendix A, attached hereto.	Case No. 10001 (Filed November 12, 1975)

ADDITIONAL APPEARANCES

David T. Wendells, Attorney at Law, for The Pacific Telephone and Telegraph Company, applicant.

Orrick, Herrington, Rowley & Sutcliffe, by Robert J. Gloistein, Attorney at Law, for Continental Telephone Company of California, respondent.

Glen J. Sullivan, Attorney at Law, for California Farm Bureau Federation; Dinkelspiel, Pelavin, Steefel & Levitt, by Alvin H. Pelavin and Douglas P. Ley, Attorneys at Law, for Calaveras Telephone Company, Dorris Telephone Company, Ducor Telephone Company, Evans Telephone Company, Happy Valley Telephone Company, Hornitos Telephone Company, Livingston Telephone Co., Mariposa County Telephone Company, Inc., The Ponderosa Telephone Co., Sierra Telephone Company, Inc., The Siskiyou Telephone Company, and The Volcano Telephone Company; interested parties.

OPINION

Background of the Proceeding

For many years, this Commission, most state regulatory commissions, and the Federal Communications Commission (FCC) have uniformly applied the FCC-prescribed separations procedures (currently the "Ozark Plan") to allocate telephone companies' property costs, revenues, expenses, taxes, and reserves between the respective intrastate and interstate jurisdictions.

Decision No. 88232 in Phase I of these proceedings, employed the Ozark Plan for allocating expense and plant between intrastate and interstate operations. However, we stated therein that the continued use of the Ozark Plan would be in issue in the separations phase of these proceedings and that rates determined in Decision No. 88232 would be subject to refund depending on the outcome of the separations issue.

At a hearing on July 23, 1976, Administrative Law Judge Gillanders indicated the scope of the legal and factual issues with regard to separations, namely:

(1) The revenue effect for the test year,

(2) The staff's recommendation regarding whether separations procedures prescribed by the FCC in its Rules, Part 67, or some other separations formula should be adopted,

(3) Whether there are any legal problems concerning its adoption, and

(4) How to adjust rates and rate spread, if this Commission should in fact decide to change its separations methods.

In response, at further hearings on March 15, 1977, the staff presented two witnesses and three exhibits, Nos. 260, 261, and 262. On March 16, 1977, TURN presented one witness and two exhibits, Nos. 263 and 264. At a further hearing on May 4, 1977, The Pacific Telephone and Telegraph Company (Pacific) presented a witness and one exhibit, No. 280, in rebuttal.

The staff witness at the March 15, 1977 hearing testified:

"I recommend the message minute mile (MMM) plan as being conceptually correct for application to the separation of California operations between interstate and state jurisdictions. At this time, I am unable to quantify the effects of this plan on California operations as an answer to my data request of Pacific Telephone has not yet been provided. Pacific Telephone had advised that the requested study was being undertaken and would be furnished by March 31, 1977. On March 11, 1977, the staff was advised that the study would not be completed until January 1, 1978. Since the study requires input from all the states in the United States, it is being made by AT&T. I cannot recommend implementation of the plan until we have received the requested information and had an opportunity to analyze it. At this time, I have no recommendation as to revised procedures to be applied to exchange plant. This should await completion of the NARUC studies."

Further hearings were held October 18 and 19, 1978, at which time the staff presented Exhibit 317, which indicated that the use of the Message-Minute-Mile (MMM) Plan would cause a shift of revenue requirement from the intrastate operations to the interstate operations of $55 million for the year 1976 and a like amount for the estimated year 1979. Exhibit 318 also demonstrated this effect for 1976. The staff witness testifying about Exhibit 317 also pointed out various events which occurred since the hearings which ended on May 4, 1977, which led him to conclude that, while agreeing with the merits of the MMM Plan:

"However I don't believe the Commission should unilaterally adopt the plan but should continue to pursue its adoption through the FCC-NARUC Joint Board and as provided by Section 703 of the California Public Utilities Code."

Pacific presented Exhibits 319 and 320 at the October 18 and 19, 1978 hearings in which it made clear its continuing opposition to the unilateral adoption of the MMM Plan by this Commission.

On October 18, 1978, TURN filed a "Petition for Proposed Report of the Presiding Officer". The petition is denied.

The separations phase of Application No. 55492 was completed on October 19, 1978, subject to the filing of concurrent briefs. Briefs were filed by the staff, Pacific, Continental Telephone Company of California (Continental), and TURN on November 6, 1978, and the matter submitted.

The Subject of Separations

Since telephone companies such as Pacific furnish both intrastate and interstate communications services, it is necessary to provide a separation (or allocation) of their properties, expenses, reserves, and revenues devoted to rendering service as between the two jurisdictions. In addition to jurisdictional separations for rate-fixing purposes, procedures are required to allocate the cost of doing business between utilities participating in the provision of a joint service such as message toll or extended area service. Separations studies may also be used in allocating cost of service between exchange and toll, between areas of operation, or between various segments of services within a common jurisdiction. The Commission has, for many years, required separated earning studies of toll service and exchange service in order to fix rates for each service in an equitable manner.

The staff presented Exhibit 262, which is a report prepared to provide the Commission with information on telephone separations methods and procedures. The report includes a history of separations, a review of current separations methods and alternatives, a discussion of problems and controversies connected with separations, and a statement of current areas of review.

The scope of the present proceeding deals only with intrastate and interstate separations as distinct from the other uses of separations procedures noted in Exhibit 262.

Current separations procedures used for allocating between state and interstate operations are set forth in the Separations Manual dated February, 1971 prepared by the NARUC-FCC Cooperative Committee on Communications. This Separations Manual is prescribed by the FCC in Part 67 of its Rules, Jurisdictional Separations. The current Separations Manual is a revision and update of the original Separations Manual issued in October, 1947. Changes and modifications of the manual were made in 1952, 1957, 1963, 1964, 1965, 1969, and 1971. Many of these manual revisions resulted in sizable shifts of revenue requirements between the state and interstate jurisdictions. The Separations Manual had its genesis in 1941 when a joint committee of representatives of the FCC and the NARUC prepared a document which was entered as Exhibit 2 in FCC Docket No. 6328, In The Matter of Methods For Separating Telephone Property, Revenues and Expenses.

The current separations procedures incorporate the "Ozark Plan" as the particular scheme was developed by a joint FCC-NARUC task force during a meeting at Lake of Ozarks, Missouri, in 1970. The Ozark Plan was the outgrowth of hearings held by the FCC in Docket No. 16258 which was initiated in 1965. The Ozark Plan provides for the assignment of subscriber plant costs to interstate operations by use of a two-part factor. The first part develops the basic subscriber plant cost of an exchange call. Industry studies indicated that the basic plant cost would be determined by applying an 85 percent factor to the study area interstate subscriber line usage (SLU) factor. The second part of the subscriber plant factor is twice the study area interstate SLU factor times the composite station rate (CSR) ratio. A comparison of the Ozark formula with the two other FCC orders follows.

Comparison of Formulas
Average Nationwide Subscriber Plant Apportionment Factor

FCC 7/5/67 Order		FCC 1/29/69 Order		Ozark Plan	
Component	Weight	Component	Weight	Component	Weight
SLUsa	4.9%	SLUsa	4.9%	(SLUsa) (85%)	4.2%
SLUnw	4.7	SLUnw	4.7	(SLUsa) (CSR)	6.0
SLUnw	4.7	(SLUsa) (CSR)	6.0	(SLUsa) (CSR)	6.0
	14.3		15.6		16.2

Factors In Above Formulas

SLUsa = Study area subscriber line usage.

SLUnw = Nationwide subscriber line usage.

CSR = Composite station rate ratio at average length of haul.

The procedure prior to the Ozark Plan used for allocating local dial switching equipment (COE) was on the basis of actual relative minutes of use for exchange and toll service with a weighting of the toll minutes of use by a factor of 1.5 that reflects the higher cost per minute of use for a toll call compared to an exchange call. The Ozark Plan provides for a split of this equipment between traffic sensitive and non-traffic sensitive plant. The non-traffic sensitive portion is allocated by the Ozark subscriber plant factor. The traffic sensitive portion is allocated on a relative minutes-of-use basis with toll minutes weighted by a factor varying from 1.3 to 2.3 depending on the size and type of switching equipment in an office.

Shortcomings of Ozark Plan

California representatives actively participated in the NARUC committee meetings and FCC proceedings leading up to the adoption of the Ozark Plan in 1970. During that time, the California representatives pointed out various shortcomings in the Separations Plan which became known as the Ozark Plan.

The Ozark Plan, in its entirety, was first proposed by the American Telephone and Telegraph Company (AT&T) in a letter of June 30, 1970 signed by R. B. Holt, Assistant Vice President. NARUC staff committees reviewed this plan at meetings at

Lake of the Ozarks, Missouri, in July 1970, and later in Washington, D.C. in August 1970. The matter was presented on August 6, 1970, to the Federal-State Joint Board on Separations convened pursuant to FCC Docket No. 18866. The Ozark Plan was presented to the Joint Board by a majority of the NARUC staff committees. The California representative, James M. McCraney, presented an alternate plan, referred to as the Modified NARUC Plan. A majority of the Federal-State Joint Board supported the Ozark Plan and recommended it to the FCC for adoption. The California member of the Joint Board, William Symons, Jr., issued a minority report endorsing the Modified NARUC Plan.

On August 26, 1970, the FCC issued its Further Notice of Proposed Rulemaking in Docket No. 18866, adopting the Joint Board recommendations and providing for comments to be filed by interested parties. The California Commission filed comments on September 3, 1970, and reply comments on October 9, 1970. In its comments, California pointed out the shortcomings of both the subscriber plant and central office equipment portions of the telephone-industry-sponsored Ozark Plan.

With respect to subscriber plant, the California comments indicated the following defects:

a. There was no substantiation of changed conditions from the time of issuance of the FCC's January 29, 1969 order.

b. The Ozark Plan failed to meet its stated objective of reducing short-haul interstate toll cost and increasing long-haul costs.

c. The distribution of benefits to states was erratic.

d. The AT&T-United States Independent Telephone Association agreement on settlements was irrelevant to jurisdictional separations.

e. The 85 percent factor applied to local SLU was merely a device to reduce the shift of revenue requirement to interstate operations.

f. Using an intrastate reduction factor for interstate allocations was unreasonable.

g. No evidence was introduced to nullify the earlier FCC findings in Docket No. 17975 concerning use of a nationwide SLU factor.

h. Probably the most serious defect of Ozark is that part of the allocation formula, the CSR ratio, is based on rate levels - which are in turn based on allocations - which are based on rates, etc. The effect is compounded because the CSR ratio is used twice in the Ozark formula.

i. The CSR ratio, which purports to reflect the deterrent effect of rates on usage, is not a good measure of actual deterrence.

j. The single additive provided in the Ozark Plan does not provide for as equitable a distribution among states as the January 29, 1976 plan of the FCC.

California's comments on the Ozark Plan revisions to the separation of local dial central office equipment indicated the following defects:

a. The entire central office should be allocated on the subscriber plant factor for the following reasons.

   1. Subscriber plant and local COE carry identical traffic.

   2. Toll requirements create a large portion of local COE costs.

   3. No direct relation exists between toll traffic volume and over-all COE cost.

   4. Local dial COE is an integral part of local exchange plant.

   5. Local COE has 97 percent standby capacity.

   6. Joint use of COE for toll and exchange provides economies to toll.

b. The assumption of 25 percent "non-traffic sensitive" plant is based on an arbitrary Bell System definition.

c. The variable weighting factor of 1.3 to 2.3 penalizes the most efficient central office design.

California's comments on the Ozark Plan concluded that while the Ozark Plan deals constructively with a number of problems inherent in telephone separations, it has, nevertheless, a number of defects which reveal its genesis as part of a compromise settlement arrangement between the Bell System and independent segments of the telephone industry. Mere acceptance by regulatory agencies of such a plan without consideration and necessary correction of the inherent defects is an abdication of regulatory responsibility.

To overcome the defects in the Ozark Plan, California urged the FCC to exercise its responsibility by requiring appropriate changes in the plan to meet reasonable regulatory objectives, including:

1. Minimizing state-interstate toll rate disparity;
2. Optimizing the interstate fair share of meeting the nationwide requirement for rate increases;
3. Maximizing the contribution of interstate rates in solving the increasingly serious telephone service deficiency problem.

In its final decision dated October 27, 1970 the FCC ruled against California's objections and adopted the Ozark Plan as Part 67 of its Rules.

Further Ozark Problems

On January 3, 1975 AT&T filed tariffs for higher interstate toll rates with the FCC that would produce $717 million in additional interstate revenue. Of this amount, $643 million was in message toll telephone rates. The pattern of these rates was to have large increases in short-haul rates and relatively small increases in long-haul rates.

This rate revision immediately raised the question of effect on separations under the Ozark formula. The California Commission staff noted that the portion of the formula known as the CSR ratio is determined by relating the toll rate at the average length of haul for each state with the toll rate at the average nationwide length of haul. If the rate revisions were flowed through to a

recalculation of the CSR ratio, the proposed rate increase would cause a transfer of interstate revenue requirements to the intrastate category of approximately $30 million[1] annually for Pacific. Corresponding effects would occur relative to the independent telephone companies in California. Similar results would occur in other states. Accordingly, the California Commission filed a petition protesting the Advice Letter.

The FCC never acted on California's petition, but AT&T subsequently made an oral commitment that the CSR ratio used for interstate separations would be frozen at the level used in 1970 at the introduction of the Ozark Plan. While the foregoing rate revision did not result in a direct adverse effect upon California or other states at that time, it clearly demonstrates the folly of basing the separations formula upon rate levels or rate patterns.

The California Plan

On December 19, 1973, the NARUC filed with the FCC a petition for rulemaking to amend the Separations Manual. This was assigned the designation RM-2302. NARUC sought changes in the separations formula for subscriber plant by application of a new plan often referred to as the California Plan. This plan was so called because it had been developed by an NARUC staff subcommittee meeting in San Francisco, California on November 14 and 15, 1973.

In support of its petition the NARUC alleged that, "the present separations methods embodied in the Ozark Plan reflect certain political compromises and were limited in the changes which could be effected by the amount of available excess revenue in the interstate operation. Accordingly, several appropriate changes were not included in the Ozark Plan which were necessary to properly reflect current modes of operation, present day calling patterns, and the latest developments in technology."

1/ The 1978 report of the NARUC Communications Committee indicates that the amount is $47,270,000 at the 1976 level of business.

The California Plan would affect the separation of both central office equipment and subscriber plant, as follows:

a. To revise the telephone separations procedures applicable to the allocations of local dial switching equipment (COE) investment and related reserves and expenses between state and interstate jurisdictions by providing that the total amount of such local dial COE be allocated on the same basis as subscriber plant and station equipment; and

b. To revise the telephone separations procedures applicable to the allocation of subscriber plant and station equipment investment and related reserves and investments and expenses between state and interstate jurisdictions by replacing the factor of two times the composite station rate (CSR) ratio at an average length of haul times study area SLU by the CSR ratio times SLU plus the CSR ratio squared times SLU.

A comparison of the Ozark Plan with the California Plan in formula form along with the 1972 value of the ratios is shown in the following tabulation:

Subscriber Plant Factor (SPF)

Comparison of Formulas

(1972 Factors)

Present Plan		CSR Squared	
(SLU) (.85)	4.65%	(SLU)(.85)	4.65%
(SLU) (CSR)	6.67	(SLU)(CSR)	6.67
(SLU) (CSR)	6.67	(SLU)$(CSR)^2$	8.15
Total	17.99	Total	19.47

Based on the 1972 level of business the California Plan would have transferred $383 million of revenue requirements to interstate operations nationwide.

The California Plan had a number of desirable features which would have produced a more equitable separations plan. For central office equipment the plan would recognize the inherent function and purpose of the COE plant and treat that plant as an entity. For the formula as a whole it would recognize the declining traffic volumes with length of haul more accurately than the Ozark formula.

In spite of these advantages it does not presently appear appropriate to apply the California Plan because of the heavy assignment of terminal equipment to the toll operations. Because of recent developments in the structure of the industry it may be necessary to eliminate any assignment of terminal equipment to the toll category.

The recent developments in telephone industry structure have resulted from the FCC's 1968 Carterfone decision[2] which, for the first time, provided that the customer could furnish the terminal equipment. When this happens there is an effect on separations to the detriment of exchange operations. When terminal equipment is provided by the utility, a portion of such equipment is assigned to toll on the subscriber plant factor. Since terminal equipment is generally priced to recover the annual charge on the equipment, the allocation of costs to toll provides a form of contribution to exchange operations. When the customer provides the equipment, this contribution is lost. Since it may be expected that there will be increasing use of customer-provided terminal equipment, there will result a gradual erosion of contribution through separations from this source. In addition, the FCC recently has instituted Docket No. 20981, in which alternatives to any allocation of terminal equipment to toll are sought. The California Plan would also continue the very undesirable Ozark feature of tying the separations formula to rate levels.

The MMM Plan

Since the earliest days of separations studies, regulators have been concerned with the cost disparity between the interexchange circuit plant utilized in interstate service versus that utilized in intrastate service. The interstate cost of service is less than intrastate for the following principal reasons:

a. The much lower average cost per circuit mile on main lines than on feeder lines; and

b. The much higher density of traffic on main lines than on feeder lines.

2/ Re Use of Carterphone (1968) 13 FCC 2d 420.

The modified Phoenix Plan, now discontinued, was a partial response to this disparity problem. Two other plans, the Circuit Mile Plan (CMP) and the Message Minute Mile (MMM) Plan, more directly address the problem of disparity. The CMP would eliminate the inequities in separations that result from the first of the above two conditions, whereas the MMM Plan would eliminate the inequities that result from both of the above conditions. For this reason the MMM Plan outweighs the CMP as a more reasonable method as well as in the more equitable results it would produce.

The CMP contemplates a periodic basic study to determine the average investment per circuit mile of the entire nationwide toll network. This basic factor of average investment per circuit mile would be multiplied by the number of toll line circuit miles separately in each state and each company to obtain a computed book cost of these facilities for purposes of allocating costs to state operations. The computed book cost would be allocated to state operations on the basis of the ratio of state MMMs to total MMMs in each state and each company. The balance of the actual toll line investment would be allocated to interstate toll operations.

The MMM Plan contemplates periodic studies of the total investment in interexchange toll lines plant and the total use of that plant as measured in MMMs to obtain the average investment per MMM. This basic factor would be multiplied by the number of intrastate toll MMMs in each state and each company to determine the portion of the investment in toll line facilities that would be assigned to state toll operations currently. The balance of the investment in toll line facilities would be assigned to interstate toll operations.

The result of the MMM Plan would be that the investment per MMM for state toll operations in each state and each company would be uniform with the system-wide average investment per MMM for interstate toll operations. This would give full and complete recognition to the fact that the nationwide toll network is one closely integrated system and that all of the parts of that network are interdependent upon each other. It would equalize the state toll investment per MMM for those companies that provide the portion of the nationwide toll network that consists of higher cost and lower density feeder lines with the lower cost and higher density main lines that are possible only because of these supporting feeder lines. It would remove any cause for toll rate disparities that would result from allocations of toll line costs and, hence, would clearly be in the best interests of the ratepayers.

The interexchange toll lines plant of the Bell System and independent industry is engineered and constructed on an integrated basis designed to render nationwide telephone service. The higher cost plant of the Associated Bell companies and independents which is used to render intrastate service in each state also constitutes the feeder plant for the lower cost, more efficiently used interstate backbone circuits of Long Lines. Without such feeder plant the economies and efficiencies of Long Lines interstate plant and operations could not be realized. If Long Lines were required to construct its own interstate feeder plant, it would increase the average cost of Long Lines plant per circuit mile. Therefore, in averaging Long Lines and Associated Bell and independent companies costs related to such plant the Associated Bell and independent companies are credited with the contribution which they make to the low cost Long Lines operation. The MMM Plan gives proper recognition to the characteristics of toll telephone service as a nationwide integrated operation in that this plan attributes a uniform cost per unit of use of the plant employed in such nationwide service.

In the interstate jurisdiction the rates and revenue requirements for interstate service are determined on the basis of the combined nationwide interstate costs without considering the variations of costs or usage which occur on particular interstate routes or for particular interstate distances. It therefore is reasonable to disregard the accidents of jurisdictional ratemaking barriers in determining the cost of any segment of the nationwide service.

Opponents of the MMM Plan have pointed out various alleged deficiencies of the plan including the view that utilization of such plan would exceed the ratemaking authority of federal and state regulatory agencies and that the plan is in derogation of the principle of actual use.

Position of the Parties

Staff

The staff endorses the conceptual merits of the MMM Plan over the existing Ozark Plan, but does not advocate its adoption herein for the reasons set forth in Exhibit 317, namely:

(1) Pending review of separations procedures by FCC-NARUC Joint Board;

(2) The Communications Act of 1978[3/] which was pending at the time of hearing; and

(3) Introduction of AT&T separations proposals in 1978.[4/]

The staff witness proposed that, in view of the foregoing, this Commission should pursue adoption of the MMM Plan through the FCC-NARUC Joint Board.

In further support of its recommendation not to implement the MMM Plan at this time, the staff believes that this Commission should consider the disparity between interstate toll and intrastate toll rates. According to the staff, interstate toll rates have historically been lower than intrastate toll rates. The situation is now reversed; California toll rates now yield $221 million less revenue than if priced at interstate levels. California rates are 14 percent

3/ This act was not passed. There is now pending in the House of Representatives the Communications Act of 1979 (HR-3333). Similar bills are pending in the Senate (S-611 and S-622).

4/ AT&T's proposal would transfer $49,780,000 of revenue requirements from interstate to California intrastate for Pacific at the 1976 level of business (1978 NARUC Communications Committee Report).

below the interstate rates based on the distribution of California's usage.

The staff acknowledges, however, that this Commission could unilaterally adopt the MMM Plan.

Pacific

It has been Pacific's position throughout the hearings that the Separations Manual, prescribed by the FCC pursuant to rule-making proceedings, establishes a single, uniform standard which must be applied by both state and federal regulatory bodies for purposes of allocating property costs, revenues, expenses, taxes, and reserves between intrastate and interstate operations. It has also been Pacific's position that the FCC's adoption of the Separations Manual preempts and, therefore, precludes state regulatory commissions, including this Commission, from imposing or adopting different separations procedures. Finally, it is Pacific's position that the separations plan suggested by the staff's two witnesses, and the interpretation of the Separations Manual suggested by TURN's witness, violate the Separations Manual, are unreasonable and, if adopted unilaterally by this Commission, would result in confiscation of Pacific's property. Therefore, Pacific contends that this Commission should not deviate from the currently effective Separations Manual (FCC Rules, Part 67).

Continental

Continental submits that this Commission should not adopt any change in jurisdictional separations that would be inconsistent with the methods prescribed by the FCC.

TURN

According to TURN, direct testimony was submitted only by it and the staff. In March 1977, the staff recommended the adoption of the MMM Plan conditioned on receipt of data regarding the revenue effect. This data finally was provided to the staff. Subsequently, the staff withdrew its recommendation with respect to the MMM Plan.

Thus, TURN contends the only showing recommending changes to separations before this Commission is Richard Gabel's (TURN's witness) proposed corrections to Pacific's alleged improper implementation of the Separations Manual with respect to the provision of interstate private line service. Based on the evidence submitted in this proceeding, TURN requests that this Commission adopt its recommendations.

According to TURN, it has made the Commission's duty considerably easier because the Commission need not decide whether it has the authority to adopt the NARUC Plan, or any other plan, as the only issue before the Commission is the adoption of an administrative change, which provides for proper implementation of the current Separations Manual.

Discussion of MMM Plan

While we do not agree with TURN that the only showing in regard to separations before us is Mr. Gabel's, the staff's testimony deserves special comment. The staff has placed into the record an extensive historical review of separations and an analysis of the deficiencies in currently used methods. The staff has presented a critique of present separations methods and has set forth in part what it believes to be superior methods. It has not recommended any change in the Separations Manual to be adopted by the Commission at this time.

The question before us is whether this Commission should base the rates for Pacific Telephone on the currently prescribed Separations Manual (FCC Rules, Part 67) or whether we should unilaterally adopt some other methodology in establishing Pacific's intrastate rates. There are various court decisions which support the position that this Commission may determine the appropriate intrastate allocations for use in determining the intrastate rate of return and the appropriate level of intrastate rates.[5/] However, in view of our disposition of this matter, we will not discuss these cases here. In the present situation it is our view that application of a separations method must be based upon practical considerations rather than abstract theory.

The present Separations Manual adopted by the FCC represents the culmination of a long period of activity by the states to secure fair and reasonable separations procedures that would be applied uniformly by all state jurisdictions and the FCC. The California Public Utilities Commission participated extensively in the various

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5/ New England Telephone and Telegraph Company v. State (1953) 97 A 2d 213, 99 PUR NS 111.

Lindheimer v. Illinois Bell Teleph. Co. (1934) 292 US 151, ...

Pacific Tel. & Tel. Co. v. Public Util. Comm., supra, (1965) 62 Cal 2d 634, 665-666.

proceedings including active participation in NARUC deliberations as well as in formal proceedings of the FCC. Such participation has been at both the staff and the Commission level and has included California commissioners on all the Federal-State Joint Boards set up to hear these matters. The various separations plans included in the Separations Manual represent a compromise between the interests of the various state jurisdictions and the federal jurisdiction. As such, the current methods of separations perhaps do not yield maximum benefit to California. Nevertheless, California does receive a very large benefit from separations. Due to the phenomenal growth in the toll business, the cost allocations to toll under present separations methods have been growing much more rapidly than the growth in the overall telephone business. For instance, while the total plant of Pacific Telephone from July 1977 to July 1978 increased approximately 9.5%, practically all of this increase has been assigned to the toll operation with only a 0.7% increase in exchange rate base over that period. It is for this reason, alone, that the telephone industry in California has avoided the necessity for large increases in basic rates over the last several years. Under the circumstances, California would be subject to much criticism should it unilaterally seek to increase the assignment of cost to interstate operations beyond the level provided in the current Separations Manual.

We take note of the fact that there is a current FCC docket on the subject of separations. While the procedures for separations changes through the FCC and Federal-State Joint Boards are ponderous, it nevertheless makes for a more orderly situation to follow those procedures. We are also aware that several bills have been introduced in Congress that would result in the elimination of the FCC regulatory authority over separations and settlements. For California to act unwisely at this time could only strengthen the hands of those who wish to eliminate separations and settlements procedures altogether.

While the Commission staff criticized the "Ozark" Plan and has extolled the Message Minute Mile (MMM) Plan, these plans are not alternatives to one another. Adoption of the MMM Plan would affect only the message toll portion of the telephone operation. The adoption of the Ozark Plan in 1970, on the other hand, affected only the subscriber plant portion of the local exchange operation. Thus the MMM Plan may not be considered as an alternative to the Ozark Plan; at best, they are complementary.

As noted earlier, we do not agree with the parties who claim we do not have authority to establish the MMM Plan. However, there are very practical problems with the MMM Plan. For one, it is dependent upon the input not only of data obtained in California but also data obtained nationwide from all other state jurisdictions and from the interstate operation. Because of this it would seem more appropriate that the MMM Plan be adopted by all jurisdictions on a nationwide basis if it is adopted. In addition, no thought has been given to how the independent companies would participate in the MMM Plan. Independent companies in California are full partners with Pacific Telephone in providing intrastate and interstate message toll service. Since imputing the MMM Plan to Pacific's operations would only result in a rate adjustment and not in any transfer of real dollars of operating cost to the interstate operation, the effect would be to lower the toll rate of return as calculated for settlement purposes. This would result in independent companies receiving a lower settlement payment. In turn, this could well trigger rate cases to be filed by the independent utilities to offset their loss of toll.

Furthermore, the MMM Plan was originally conceived to correct for the toll rate disparity between state and interstate rates. Historically, interstate toll rates were generally lower than intrastate in the postwar years due to the continuing reduction in interstate

rates. This situation no longer prevails. California toll rates are in the aggregate now below interstate rates primarily due to recent increases in short-haul interstate rates. If California intrastate toll business at the present time were repriced at the interstate rate levels, California customers would experience $221 million increase in billing for intrastate toll calls at 1976 levels. At present levels the billing increase would be about $400 million. Since California toll operations are earning a fair return at rate levels well below the interstate level, it is difficult to justify the MMM separations change which further reduces California's intrastate toll costs.

For the reasons set forth above, the MMM Plan would not correct any deficiencies of the Ozark Plan since they affect different segments of the telephone operation. In addition, there is no need for adoption of the MMM Plan at this time and there are many practical difficulties that lie in the way of such adoption. Accordingly, for purposes of this proceeding, we will make no adjustments with respect to separations methodology presently prescribed in the Separations Manual, FCC Rules, Part 67. We will, however, call upon our staff to continue work with the Federal Communications Commission to improve separations methodology. In particular, the next portion of this discussion concerning TURN's evidence will reveal important areas for further development of uniform separations procedures.

TURN's Recommendation

TURN recommends that we implement the separations proposals set forth by their witness, Richard Gabel, in this proceeding. TURN argues that Pacific has erred in its interpretation in regard to: (1) loopless interstate private lines, (2) the "value" of station equipment utilized by the private line user, and (3) its failure to apply a "use" criterion.

Loopless Interstate Private Lines

Gabel notes that under Pacific's interpretation of the manual, the customer of an interstate foreign exchange circuit not only pays for the interexchange line mileage charge under the interstate tariff, but he also pays for the station terminal charge or the channel terminal charge. The station/channel terminal charge is intended to compensate the company for the cost of the local exchange component of an interstate private line facility. These revenues are all booked and assigned to interstate operations. It is appropriate that the plant investment and associated expenses required for the exchange portion of the interstate private line facility be treated consistently, that is, assigned to interstate operations.

A number of private line services have evolved which do not require the provision of a local loop. For example, when an interstate private line terminates in a Centrex CO office installation, no physical loop is provided. However, it is the relative loop count which is the basis for allocation of station apparatus and telephone station connections. The Separations Manual states:

> "...the costs of telephone and miscellaneous station apparatus in Account 231 and telephone and miscellaneous telephone station connections in Account 232 are assigned to Category 2 by applying to these costs in the study area ratio of (a) the number of exchange loops used for telephone private line service to (b) the number of message telephone subscriber lines and exchange loops used for telephone private line services combined."

The Separations Manual specifies that station apparatus (Account 231-02) and station connections - telephone (Account 232-02) be assigned to the interstate jurisdiction on the basis of a relative loop count, with interstate private line loops as a proportion of total loops. Though such private line service requires no loop, it

still requires station apparatus and connections. But as Pacific currently implements the manual, no station apparatus and connection investment is assigned to the private line service.

Value of Station Equipment Utilized by the Private Line User

Gabel pointed out a further problem occurs where station equipment is assigned to private line service it is assigned on the basis of average station equipment per loop. Gabel states, "Account 231 - Station Apparatus includes a wide mix of equipment ranging from the black conventional residential handset to complex key systems and small private branch exchange equipment (under 100 lines). In general, the users of interstate private line telephone facilities are large commercial, industrial or governmental organizations. Their private line facilities would normally terminate in relatively expensive station equipment. By far the largest plant element of this account consists of standard residential handsets. By dint of the averaging process, assigning the same station investment to an interstate private line loop creates an unnecessary burden on intrastate operations."

"Use" Criterion

In his third point Gabel notes that the Separations Manual provides categories for plant assignment. The fifth category "Other Station Equipment" (Account 231 and Account 232) encompasses station equipment not assigned to the other four categories. Thus the balance of station equipment and connections is apportioned to the message telephone operations, inter- and intra-, by the application of the subscriber plant factors (SPF); the balance is assigned to the exchange operations. Whereas public message telephone service is assigned to the interstate jurisdiction on the basis of relative minutes of interstate message (interstate SPF) to the relative total intrastate (toll plus exchange) plus relative interstate message usage, interstate private line usage is not measured for purposes of jurisdictional allocation. The result is that station investment and

station connections for the provision of private line service (other than that directly assigned) are not properly assigned to the interstate message toll jurisdiction.

Analysis

To fully understand Gabel's position, a description of private line service is in order. A private line is a communication circuit dedicated to the exclusive use of a particular customer. Such private line circuits may be local private lines connected between two points within an exchange or they may be interexchange private lines terminating in telephone company wire centers at both ends. In the latter case, some additional arrangement is needed to extend the interexchange circuit to the customer's premises. Normally, a local loop is required. The local loop is a pair of wires, or the electrical equivalent, extending from the wire center in the telephone central office to the customer premises. Local loops normally use identical facilities to subscriber loops which are the lines connecting regular telephone exchange customers to the central office. At the subscriber premises the private line local loop would be connected to some type of terminal equipment. Types of terminal equipment include telephone instruments, data sets for use with teletypewriters or other data terminals, facimile equipment, radio transmitters, metering equipment, etc. Often a private line will terminate in a key on a key telephone or on a PBX. If there is a PBX termination on each end of a private line, the circuit is designated a tie line. Terminal equipment may be furnished either by the utility pursuant to tariffs or by the customer.

As Gabel notes, not all private lines terminate in a local loop. Some private lines, under interstate tariffs, may terminate directly in a local exchange central office on one end. When arranged in this manner, the service is designated interstate foreign exchange (FX) service. Under this arrangement, the customer at a distant point

may call out in the local exchange in the same manner as any subscriber located in the exchange. Likewise, he may receive calls from any subscriber with access to the exchange. California intrastate foreign exchange service is not offered under private line tariffs but rather under a separate, fully unified, foreign exchange schedule.

Another instance where a private line does not terminate in local loop is where the private line terminates in some type of switching arrangement such as a Common Control Switching Arrangement (CCSA). The CCSA provides for connection of an incoming interexchange private line to another interexchange line, to a local loop or directly to the local exchange in the manner of an FX connection. Many large industrial, commercial, and government customers have extensive private line networks with several switching arrangements, numerous interexchange private lines and local loops, as well as connections to the local exchange in various cities. Some of these networks are indeed nationwide with connections to most of the major cities in the country. In operation, an employee of the customer may originate a call at any point on the network to terminate at any other point on the network (on-net call) or the call may terminate in a local exchange telephone (off-net call).

Where calls originate or terminate off net, the calls become substitutes for message toll service. In other words, a private line customer in making a call to an off-net point in a distant city is receiving the same service as if he made a toll call to the same telephone number in the distant city. As Gabel points out, however, the separations treatment of the two calls is disparate. On the toll call, the time in use of the local plant is assigned to toll. On the off-net portion of the private line call, minutes of use of the local plant is assigned to exchange. Through the separations procedure, these minutes of use are ultimately used to allocate the costs of local central office and subscriber plant to toll and exchange. Thus an

interstate toll call results in an increased assignment of costs to interstate. A call between the same points over the private line results in an increased assignment of costs to the exchange operation in the exchange where the off-net station is located. Such assignment of cost to exchange must ultimately translate into higher exchange rates. This effect is compounded by the fact that the private line call will generally cost less to the customer and there will consequently be a lesser incentive to keep the call short as compared with a toll call. This results in stimulated usage which, in turn, further inflates exchange costs.

Discussion of TURN's Recommendation

While Gabel points out three apparent areas of difference in the interpretation of the Separations Manual, he provides us with only the impact of one of the differences, the so-called "use" criterion. We should note now that there was no dispute of any factual statements of TURN's witness, by either the staff or Pacific. The only criticism that Pacific was able to level with regard to Gabel's testimony was that he did not present such testimony to the FCC in 1976. We shall discuss Gabel's proposals.

With respect to the "loopless" interstate private lines, we agree with witness Gabel that costs of loop and terminal equipment utilized in lieu of a local loop should be assumed by the private line subscriber to the extent that the subscriber is not otherwise paying for such costs. As noted in Analysis, above, many private lines terminate in a switch where they may be switched to other private lines, to local loops (which are included in the loop count), or to exchange stations. Where the private line is connected through to an exchange station, a proper assignment of loop and station costs will result if Gabel's third adjustment for use criterion is applied. In Gabel's cited instance of private lines terminated in a CO centrex, the private line customer is presumably paying the full costs of the station terminations in his monthly bill for centrex service. Accordingly, if some of the costs of the centrex service are allocated to

private line, the customer's bill should be adjusted correspondingly with an increase in the private line charges and a decrease in the centrex charges. Because of these factors, we will make no adjustment for loopless interstate private lines. However, if definitive evidence is presented in some future proceeding to show that a specific class of equipment is used exclusively for private line service where there is a mismatch between revenues and investments or expenses, we will at that time consider the matter further.

In Gabel's second adjustment he suggests that use of an average station equipment (Account 231) investment per loop for assignment to private line at the same amount as assigned to exchange services results in an understatement of costs assigned to private line. He states that by far the largest plant element of this account consists of standard residential handsets. While he is probably correct in terms of numbers of individual items of equipment, we are unable to verify that the preponderance of investment is in basic telephone instruments. Under the uniform system of accounts, Account 231 includes all manner of terminal equipment, answering sets, data sets, single line telephones, key telephones, small PBX's, etc. Both business and residence terminal equipment is included. We agree that private line customers often make use of expensive equipment such as data sets and teletypewriters. On the other hand, many private lines terminate in customer-owned equipment involving no investment by the utility. Based upon the record herein, we are unable to conclude that an adjustment should be made for the differential value of station equipment used on private lines as compared with business and residence exchange lines. Nevertheless, Gabel has raised an important point which requires further consideration. To provide the Commission with adequate data for use in the future, we will require Pacific to make a study of a representative private line loop sample to determine the average terminal equipment investment per private line loop as compared with the average terminal equipment investment per exchange loop.

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Gabel's third adjustment, and the only one for which he provides figures, is the application of the use criterion to interstate private line calls terminating (or originating) in the local exchange. We agree that an apportionment of exchange costs to private line should be made on the basis of use. This is mandated not only by the Separations Manual, but by case law. In fact, the Smith case, Smith v. Illinois Bell Tel. Co. 282 US, 149 (1930), bears directly upon the case at hand. At page 150, the U.S. Supreme Court stated:

> "In the method used by the Illinois Company in separating its intrastate and interstate business, for the purpose of the computations which were submitted to the court, what is called exchange property, that is, the property used at the subscribers station and from that station to the toll switchboard, or to the toll trunk lines, was attributed entirely to the intrastate service. This method was adopted as a matter of convenience, in view of the practical difficulty of dividing the property between interstate and intrastate service. The appellants insist that its method is erroneous and they point to the indisputable fact that the subscribers' station, and the other facilities of the Illinois Company which are used in connecting with the long distance toll board, are employed in the interstate transmission and reception of messages. While the difficulty in making an exact apportionment of the property is apparent, and extreme nicety is not required, only reasonable measures being essential ... it is quite another matter to ignore altogether the actual uses to which the property is put. [Emphasis added.] It is obvious that, unless an apportionment is made, the intrastate service to which the exchange property is allocated will bear an undue burden - to what extent is a matter of controversy. We think that this subject requires further consideration, to the end that by some practical method the different uses of the property may be recognized and the return properly attributable to the intrastate service may be ascertained accordingly."

At the present time, Pacific implements the Separations Manual in such a way that the private line minutes of use are not counted as interstate usage for purposes of separations, even with the use required of the public message network. Such interstate use is measured as local use. This occurs when an interstate private line operates as a foreign exchange circuit or through an off-net connection. As such, these lines allow for message interchange between local exchange subscribers of the local central office and customers (lessors) of the interstate foreign exchange line. However, only local minutes of use are counted for separations. The result is that interstate dial equipment minute (DEM) is understated, with a corresponding understated interstate allocation of dial-switching costs. Likewise, interstate subscriber plant factor (SPF) is understated, with a corresponding understated interstate allocation of subscriber outside plant, large PBX, station apparatus and station connections.

Gabel's testimony and exhibits show that $48,703,000 in plant investment and $12,029,000 in related expense should be removed from the intrastate operations and assigned to the interstate operations as we have summarized below:

Item	Additional Investment Assigned Interstate ($000)	Additional Expenses Assigned Interstate ($000)
Station Apparatus Connections	$29,473	$ 8,488
Large PBX	8,257	1,346
Local Dial Central Office Equipment	10,973	2,195
Total	48,703	12,029

Our review of the evidence before us shows that Gabel's estimate of usage of the interstate private line network is somewhat imprecise. Likewise, it appears that Gabel overlooked some portions of plant assigned on SPF. Our review of the Separations Manual indicates that a revised SPF appropriately should have been applied to the exchange local loop plant (subscriber plant) and to the non-traffic sensitive portion of the central office. We do not have the dollar amount for this additional revenue requirement shift to the interstate jurisdiction. Accordingly, we will require Pacific to make a study and report on the proper amounts of exchange plant and exchange expense that should be assigned to private line operations under the use principle.

The overall effect of misapplication of the use criterion is that exchange subscribers have been subsidizing private line service in competition with message toll service. Message toll rates bear the allocated exchange costs based on use pursuant to the Separations Manual. Private line rates do not. The costs are borne by exchange ratepayers, resulting in private line "toll" connections being much cheaper than message toll connections to the local exchange, particularly for large users of private line off-net calling. Such a subsidy of private line toll will encourage greater use of private line service and lesser use of message toll service by those customers whose use is great enough to justify paying for a private line. This has two effects. It places a greater burden on exchange subscribers. It further results in misallocation of resources due to use of one-user dedicated private lines as compared with the common-user message toll network.

Application of Adjustment

Having determined that an adjustment should be made to reflect a proper assignment of exchange costs to interstate private line service on the basis of use, we will now address the application of the adjustment. There are five areas that require consideration: (1) application of adjustment from the effective date of Decision No. 88232 to the present, (2) application of the usage adjustment for the future, (3) adjustment of exchange rates to reflect reduced exchange costs, (4) method of cost recovery for increased interstate private line costs, and (5) treatment to be accorded intrastate and other carrier private line service to assure nondiscrimination.

Refunds from December 24, 1977

In Decision No. 88232, dated and effective on December 13, 1977, we provided for deferral of the separations issue herein considered and also provided that the rates then established were to be subject to refund with interest at 7% per year from date of collection. However, the prospective access charge rate plan and exchange rate reduction offset will result in no change in Pacific's total revenue in the future. Because we are, in effect, developing and prescribing rules for the future as set forth below, it does not appear appropriate to require refunds for a rule that was unknown to Pacific at the time the proceeding started. Furthermore, it should be understood that since under present tariffs there have been no access charges collected, no funds have been accumulated which would be available for refunds.

Future Application of Usage Adjustment

For the future, the adjustment for use of the local telephone exchange by interstate private line customers should be in accord with the principles of the Separations Manual on a non-discriminatory basis with the application of the manual to message toll service. Essentially, this means that the minutes of use of local exchange by interstate private line users should be measured,

and such minutes of use should be included in computing the Dial Equipment Minutes (DEM) and the Subscriber Plant Factor (SPF) factors for assigning central office costs and subscriber plant costs to the interstate operation. We realize, however, that private line usage of the local exchange network is not now separately measured. Accordingly, we will permit Pacific to make a determination of average minutes of use for each class of private line termination and to apply those averages to the number of private lines terminated in determining the appropriate DEM and SPF factors to be used for allocation of exchange costs of interstate.

Exchange Rate Adjustments

Making the determination specified in the previous paragraph will result in an increase in the costs assigned Pacific's interstate service and a decrease in the costs assigned exchange service. Because of the reduced exchange costs, Pacific's exchange rates should be reduced by the amount of the reduced costs. To accomplish this, we will require Pacific to file a statement showing the reduced level of exchange costs on the permanent future adjustment basis and to file a plan of reduced exchange rates reflecting the reduction in allocated exchange costs. Such rates shall be made effective after approval by the Commission.

Recovery of Increased Interstate Private Line Costs

The question will arise if Pacific has the opportunity to recover its increased costs assigned interstate. Normally, interstate rates are regulated by the Federal Communications Commission pursuant to its jurisdiction over interstate rates. In this case, however, we take official notice of the interstate private line tariffs filed by the American Telephone and Telegraph Company (AT&T) on behalf of Pacific and AT&T's other operating companies. In the interstate tariff private lines are deemed to terminate or originate at the point of connection with the local telephone exchange; rates established by the state commission apply to the extension of an

interstate message into the local exchange network. This is different from the message toll rates which apply to a message to the point of termination at a subscriber instrument in the local exchange and which reflect the costs of the local exchange in providing the service. Under the established method of charging for private lines, Pacific cannot look to the interstate jurisdiction for recovery of its local exchange costs assigned to private line usage. Accordingly, it becomes incumbent upon this Commission to establish rates which will permit Pacific to recover its costs assigned to interstate private line service. We will do this by authorizing Pacific to establish an access charge (or terminal charge) for interstate private line calls originating or terminating in the local telephone exchange network. Ideally, this charge should be applied on a per-minute-of-use basis. However, for the reasons stated above in regard to the cost assignment, it may not be feasible to measure the usage under present operating arrangements. Accordingly, we will authorize Pacific to file a fixed charge per line in lieu of a message charge for each type of private line terminating in the exchange. Such charge shall match the allocated costs as determined by the separations procedures described above.

At the present time, certain exchange service charges are applied to private line terminations in the local exchange as if the private line termination were an exchange station. Of course, they are not an exchange station; they receive a different service from an exchange station and should have a different rate treatment. While both the private line point and the exchange station have calling at local rates to and from all telephones in the local calling area, the private line termination has, in addition, calling to a distant point or points over the private line. The exchange station, however, must pay a toll charge for calling to the points that the private line

has available to it. Because of these differences, it is necessary to conclude that private line terminations and exchange stations are unlike services which do not require like rates. Since we are providing for a specific access charge computed on the same cost basis as message toll, it would be inappropriate to also apply a regular local exchange service charge. Our order will provide that the access charge authorized herein will be in lieu of all exchange service charges or message charges for calls within the local calling area. Calls outside of the local calling area of the exchange in which the private line terminates will, of course, be subject to the usual toll or multi-message unit charges for calls originating in the local exchange in addition to the access charge.

Intrastate and Other Carrier Private Line Rate Treatment

While the evidence in this proceeding was directed to interstate private line service, we must also consider intrastate private line service to assure that we are not creating a discriminatory situation. Intrastate message toll service is subject to the same separation and cost allocation procedures as interstate toll. Intrastate toll rates include allocations of local exchange costs utilizing intrastate DEM and SPF factors. Intrastate private line service is a substitute for message toll service to the same extent as interstate private line service is. Accordingly, we will provide that, for the future, intrastate private lines terminating in a local exchange shall have an access charge applied to them on a basis similar to that detailed above for interstate private line service.

In addition to the private line services of Pacific and AT&T, there are other carriers which provide interstate and intrastate private line service. To the extent that these other carriers provide services which terminate in the local exchange, they should be accorded an identical treatment to the Pacific and AT&T services to avoid

discrimination. We will provide that the interstate and intrastate access charges authorized herein shall be applied to similar exchange terminations of other carriers on the same basis as applied to Pacific's terminations.

The action taken herein with respect to allocation of exchange costs to private line service and application of an access charge should be considered an interim step pending development of nationwide standards and revision of the Separations Manual. As discussed by witness Gabel, when the Separations Manual was first developed in 1947, private lines were of minor importance with combined Bell System revenues of only $7.2 million. Today, however, private line service is now used extensively for direct connections to telephone exchanges. The Separations Manual has not kept pace with these changes. Because of the nationwide effect of private line usage on local exchange operations, the problem we are addressing in this proceeding is a problem which should be addressed on a national basis through a federal-state joint board. This Commission stands ready to fully support such a joint board, and we urge the FCC to institute such a proceeding. Upon development of suitable nationwide standards, we will terminate the procedures established herein and adopt such national standards.

We are aware that customers to private line service and connecting carriers utilizing the exchange network may not have been notified of this proceeding. Heretofore the customers who would be affected by the access charges have been unknown. In connection with the analysis which we are requiring Pacific to make there must be included an analysis of the customers for the services involved. To place these customers on notice we will require Pacific to notify each customer and connecting carrier of the access charge plan and rates applicable thereto at the time the plan is filed with the Commission. We will allow a 30-day period for such parties to comment on this matter to the Commission. In making our final authorization of the access charge plan we will give due consideration to such comments.

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Findings of Fact

1. Pacific furnishes both intrastate and interstate communications service.

2. Interstate operations of Pacific are under the jurisdiction of the FCC.

3. Pacific's intrastate operations are under this Commission's jurisdiction.

4. Intrastate-interstate separations procedures are prescribed by the FCC in Part 67 of its rules (Separations Manual).

5. The current FCC Separations Manual is dated February 1971 and includes a method of local exchange plant allocation commonly referred to as the Ozark Plan.

6. The Ozark Plan has various deficiencies which indicate a need for revision.

7. The MMM Plan affects interexchange plant and is not a substitute for the Ozark Plan.

8. The MMM Plan has the following advantages for the allocation of interexchange plant:

a. It eliminates the inequities that result from allocations that do not recognize the lower average cost per circuit mile on main lines than on feeder lines and the much higher density of traffic on main lines than on feeder lines.

b. The investment per MMM for state toll operations in each state and each company would be uniform with the systemwide average investment per MMM for interstate toll operations. This would give full and complete recognition of the fact that all of the parts of that network are interdependent upon each other.

c. It would equalize the state toll investment per MMM for those companies that provide the portion of the nationwide toll network that consists of higher cost and lower density lines that are possible only because of these supporting feeder lines.

d. It would remove any cause for toll rate disparities that result from the Ozark Plan allocations of toll line costs.

9. Adoption of the MMM Plan would shift $55 million of toll revenue requirement from California intrastate operations to interstate operations for the year 1976 and a like amount for each subsequent year.

10. Adoption of the MMM Plan could have a detrimental effect upon independent telephone companies in California, all of which are heavily dependent on toll settlements.

11. California intrastate toll rates are in the aggregate lower than the interstate rates for a comparable distance and the MMM Plan is not required at this time to correct for toll rate disparity.

12. No party to these proceedings has recommended that we unilaterally adopt the MMM Plan.

13. Changes to the Separations Manual, as would be required to adopt the MMM Plan, are appropriately made on a nationwide basis by a federal-state joint board.

14. A private line is a communications circuit dedicated to the exclusive use of a particular customer.

15. Private lines may terminate in a local loop with station equipment, may be connected to a switching arrangement, or may terminate in a local telephone exchange.

16. It is not appropriate to impute station equipment to a "loopless" private line where station equipment is not actually used, where station equipment is furnished by the customer, or where the customer pays for station equipment in connection with other uses.

17. There is no information in the record to determine if there is any actual station equipment used in connection with loopless private lines where there is a mismatch between revenues and expenses.

18. There is no information in the record to determine if the actual value of station equipment used in connection with interstate private line service is different from the average value of station equipment used on all local exchange subscriber loops.

19. Interstate foreign exchange (FX) circuits and some switched private line circuits terminate directly in a local telephone exchange permitting the private line customer to originate and terminate calls into the local telephone exchange network.

20. Calls originating and terminating on an interstate private line at one end and a local telephone exchange at the other end are substitutes for interstate message toll service.

21. Under Pacific's current practices, the use of local exchange plant for an interstate private line call is treated differently from the use of that plant for an interstate message toll call with respect to application of separations procedures.

22. Pacific counts interstate private line minutes of use as exchange minutes and interstate toll minutes of use as interstate minutes.

23. Because of the method of counting minutes of use for private line calls, both the interstate dial equipment minute factor (DEM) and the interstate subscriber plant factor (SPF) are understated.

24. The understatement of interstate DEM and SPF factors results in an underallocation of costs to interstate service and an over-allocation of costs to exchange operations.

25. Because of the uncertainties of the dollar effect of recognizing use of the exchange plant for private line calls, Pacific should be required to make a study of such effects.

26. Interstate private line rates cover the provision of service only up to the point of connection with the local telephone exchange; rates established by this Commission apply to the local exchange portion of a private line call.

27. An access charge applied to the local exchange portion of interstate private line communications will permit Pacific to recover its costs associated with the allocation of local exchange costs to the interstate private line service.

28. An interstate private line termination in the local exchange provides a different service from a local subscriber exchange station.

29. With respect to separations the same considerations apply to private line service by other carriers and intrastate private line service as apply to interstate private line service.

30. The Commission should require Pacific to notify each of its affected customers and connecting carriers of the details of the access charge plan to be filed with the Commission. Such customers should be allowed 30 days to submit any comments on the plan or applicable rates to the Commission.

Conclusions of Law

1. It is necessary to provide a separation (or allocation) of Pacific's properties, expenses, reserves, and revenues between intrastate and interstate operations.

2. The evidence does not support unilateral adoption by this Commission of separations methods different from those set forth in the Separations Manual prescribed by the FCC as Part 67 of its rules. The adoption of the MMM Plan would require such different methods.

3. This Commission has the responsibility and authority to interpret the Separations Manual, to prescribe appropriate administrative procedures for operations not covered by the Separations Manual, and to prescribe utility rate adjustments to correct for improper application of separations.

4. In allocating exchange plant costs, Pacific's practice of counting interstate private line minutes of use as exchange minutes of use ignores altogether the actual uses to which the property is put and is thus unlawful.

5. The basic principles of separations and the actual use of the local exchange plant require that an allocation of exchange plant to interstate be made for the use of the plant by interstate private line customers.

6. To avoid discrimination the DEM and SPF factors used to allocate costs to interstate private line service should be made on a consistent basis with the factors used for interstate message toll business.

7. Because of difficulties in measuring private line minutes of use on the local exchange network, it is reasonable to permit Pacific to make sample studies of average usage for each type of private line and apply such averages to the development of factors for the allocation of exchange plant.

8. The rules adopted herein are to be applied prospectively.

9. It is not appropriate to order refunds for a future rule change that results in no change in Pacific's future total revenue.

10. Under present interstate tariff arrangements, an interstate private line is deemed to terminate at the point of connection to the local exchange; accordingly, Pacific cannot recover the local exchange costs allocated to interstate under present interstate tariffs.

11. Pacific should be authorized to recover its local exchange costs assigned to interstate private line through application of an access charge applied to private lines using the local exchange network.

12. Exchange telephone stations and interstate private line terminations are unlike services and should be accorded different rate treatment; any access charges applied pursuant to Conclusions of Law No. 11 should be in lieu of any exchange rates for calling within the local service area of the terminal exchange.

13. In order to avoid discrimination between interstate and intrastate private lines terminating in an exchange, a similar allocation and rate treatment must be accorded to intrastate private lines.

14. In order to avoid discrimination between intercity carriers providing private line service terminating in the local exchange, a treatment similar to that described in Conclusions of Law Nos. 12 and 13 must be accorded to similar lines of all carriers.

15. The action taken herein should be modified at such time as the Separations Manual is revised to provide a proper treatment of the actual interstate private line use of the local exchange plant.

ORDER

IT IS ORDERED that:

1. Within 120 days after the effective date of this order, Pacific shall modify its separations practices to provide that private line minutes of use on the local exchange network shall be counted as interstate and intrastate private line minutes of use, as appropriate, and shall be used in computing the appropriate DEM and SPF factors for allocation of exchange plant costs to the interstate jurisdiction and to the intrastate state toll category.

2. Within 120 days after the effective date of this order, Pacific shall report to the Commission on the effects of the revised allocation procedures provided in Ordering Paragraph 2, including the estimated transfer of plant, annual expense, and annual revenue requirement for (a) interstate and (b) intrastate, separately stated for (a) Bell System private lines and (b) other carrier private lines.

3. Within 120 days after the effective date of this order, Pacific shall prepare and file a plan of reduced exchange rates reflecting the reduced exchange costs resulting from the revised allocation procedures provided in Ordering Paragraph 2, and, upon approval of such plan by the Commission, shall file tariffs for such rates to become effective on not less than five days' notice to the Commission and the public.

4. Within 120 days after the effective date of this order, Pacific shall prepare and file a plan of access charges to be applied to each type of private line terminating in a local exchange network with equal rates applied for similar terminations of all intercity carriers. Such access charges shall be computed to cover the allocated costs as determined pursuant to Ordering Paragraph 1 and shall be applied in lieu of any usage charges applicable to calls made within the local service area of the exchange in which the private line terminates. At the time of filing the plan with the Commission Pacific shall serve a copy upon each of its customers and connecting carriers to whom the access charge would apply advising such parties that any comments on the access charge plan should be submitted to the California Public Utilities Commission within 30 days. After approval of the plan by the Commission, tariffs covering such access charges shall be filed and made effective on not less than five days' notice to the Commission and the public.

5. Within one year after the effective date of this order, Pacific shall make a study of a representative private line loop sample to determine the average terminal equipment investment per private line loop as compared with the average terminal equipment investment per exchange loop and shall report the results of the study to the Commission.

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6. The investigation, instituted by the order in Case No. 10001 issued November 12, 1975, is discontinued. No further relief will be granted with respect to Application No. 55492 and that matter is now closed.

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

Dated SEP 25 1979, at San Francisco, California.

President

Commissioners

I dissent, California should not act unilateraly on this matter which is of concern to all fifty states

Vernon L. Sturgeon

I concur in this order except as to the failure of the Commission to grant a refund. See my attached dissenting part.

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D. ____________

Commissioner Richard D. Gravelle

I dissent in part:

The majority denies to the public refunds of $21.6 annually on the basis that, "It is not appropriate to order refunds for a future rule change that results in no change in Pacific's future total revenue.". The majority completely misconstrues Decision No. 88232 in Phase I of the proceedings as well as the solution adopted in this decision to mitigate the effect of the adopted separations interpretations.

In applying the recommendations of TURN's witness, Gabel, we are reallocating telephone revenue. All parties were aware of this possibility when Decision No. 88232 was issued and that is why we made the rates subject to refund with interest. To now deny that portion of the public who should have benefited at that time from separations modifications is grossly unfair. Pacific was fully aware of this fact when it accepted the rate increase granted by Decision No. 88232.

The prospective nature of the instant decision is simply an effort on our part to provide expeditious relief to Pacific with respect to the financial impact of our determination on the substantive issue; it is not a reason to deny that portion of the public who are entitled to rate refunds from receiving the benefits of applying witness Gabel's recommendations.

RICHARD D. GRAVELLE, Commissioner

San Francisco, California
September 25, 1979

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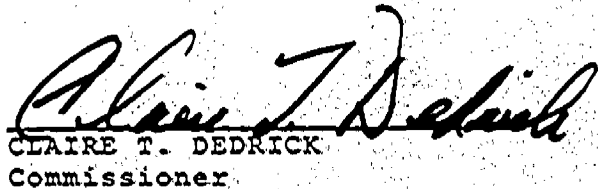
COMMISSIONER CLAIRE T. DEDRICK, concurring:

I agree with Commissioner Gravelle in his interpretation of the intent in D.88232 in December 1977.

However, nearly two years have passed since that decision and, in reviewing it now, it seems to me that the language was sufficiently vague that no real direction or authority was given to the utility. It would, therefore, be unfair at this point to penalize them.

I also would like to commend TURN for providing the witness Gabel, whose testimony was substantially helpful to this Commission.



CLAIRE T. DEDRICK
Commissioner

San Francisco, California
September 25, 1979