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Decision 97-05-096 May 21, 1997

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion into Compensation for Local Exchange Service.	)	R.95-04-043 (Filed April 26, 1995)
Order Instituting Investigation on the Commission's Own Motion into Competition for Local Exchange Service.	)	I.95-04-044 (Filed April 26, 1995)

O P I N I O N

On April 12, 1996, Pacific Bell (Pacific) filed a Petition for Modification of Decision (D.) 96-03-020 (the Resale Order).

The Commission issued D.96-03-020 on March 13, 1996. The decision was one in a series of opinions in which the Commission is setting forth policies and procedures for implementing competition in California's local exchange markets. Among other items, D.96-03-020 set discounted rates for wholesale services provided by the incumbent local exchange carriers (LECs), determined the degree of pricing flexibility appropriate for the LECs, concluded that competing local carriers (CLCs) should be allowed to establish their own rate centers for rating and pricing calls, and set forth a procedure for the LECs to track and seek later recovery of implementation costs.

Pacific requests the following modifications to the Resale Order. First, Pacific believes Ordering Paragraph (OP) 13 should be modified to make clear that the paragraph refers to nonrecurring charges related to the transfer of an end-user from Pacific to a CLC reseller. Second, Pacific proposes that

Conclusions of Law (COL) 47 and 48 be revised to allow Pacific to use retail tariff prices to determine the price floor of packages of its services until price floors are established for all Category II services. Finally, Pacific seeks modification of COLs 42 and 44 and OP 16 to allow Pacific to offer CLC resellers Category I resale services at discount prices under contract.

Responses to Pacific's Petition were filed on May 13, 1996, by the California Telecommunications Coalition (Coalition) and the Division of Ratepayer Advocates.[1]

1. Nonrecurring Charges for Customer Migration

Position of Pacific

Pacific seeks modification of OP 13 of the Resale Order which currently states:

> "Pacific shall limit any nonrecurring charges billed to CLC resellers to an amount no higher than the existing retail tariff charges found in its tariff schedule Cal.P.U.C. No. A3 of $5 per residential line and $7 per line for all other services, less the avoided cost discount of 17%."

Pacific believes that this paragraph is intended to reflect the Commission's conclusion regarding the appropriate nonrecurring charge when a customer transfers from a LEC to a CLC reseller as indicated by COL 25, which states:

> "Pacific and GTEC should be allowed to recover from CLC resellers for nonrecurring charges associated with transferring costumers' accounts from the LEC to a CLC reseller. On an interim basis, such nonrecurring charges should be limited to the LECs' existing retail rates for transfers of customer accounts who remain at the same physical location, less a 17% discount for Pacific and a 12% discount for GTEC. (Emphasis added.) *"

1 Effective September 10, 1996, the Division of Ratepayer Advocates was succeeded by the Office of Ratepayer Advocates (ORA).

"* See also Resale Order, pp. 35-36."

Pacific notes that the language of OP 13 does not make this context clear and the paragraph could be misread as limiting all nonrecurring charges by Pacific to a CLC. For example, when a brand new customer orders service from a reseller, the OP could be read to require the supersedure price be charged in place of the standard installation charge. Installing a new line is obviously not like a supersedure.

Therefore, Pacific requests that the Commission revise OP 13 so that it clearly refers only to the nonrecurring charge applicable when an end-user transfers from Pacific to a CLC. Specifically, Pacific proposes that the Commission adopt the following language for OP 13:

> "Pacific shall limit any nonrecurring charges billed to CLC resellers related to the transfer of a Pacific customer to a CLC reseller to an amount no higher than the existing retail tariff charges found in its tariff schedule Cal. P.U.C. No. A3 of $5 per residential line and $7 per line for all other services, less the avoided cost discount of 17%."

Position of Coalition and ORA

Both the Coalition and ORA concur with Pacific's request to modify OP 13 to clarify that it refers to transfers of a Pacific customer to a CLC reseller since this clarification is consistent with the reference to nonrecurring charges associated with customer transfers that appears in COL 25 and on pages 35 and 36.

Pacific's recommendation only addresses recovery of its own nonrecurring charges in OP 13. Since OP 14 contains comparable language for GTE California Incorporated (GTEC), ORA recommends that the Commission similarly modify OP 14 so that D.96-03-020 treats the two LECs' recovery of nonrecurring charges in a consistent manner.

The Coalition argues that the decision must also be clear that the proper discount applied to any nonrecurring charges is 17% regardless of whether the customer is business or residential. The Coalition observes that the Commission specifically ordered a 17% discount off Pacific's tariffed supersedure charge for both residential and business customers.

Discussion

We agree with the parties that the language in OP 13 was intended to apply to situations where a retail customer transfers from a LEC to a CLC. In order to make this intent clear, we shall grant the modification to OP 13 as requested by Pacific. OP 14 contains a parallel provision applicable to GTEC. We shall therefore modify OP 14 in a similar fashion, as proposed by ORA, to apply the same language consistently to GTEC. The proper discount to apply to any nonrecurring charges is 17% for Pacific and 12 % for GTEC whether a customer is classified as business or residential.

2. Use of Retail Tariff Prices as Price Floors for Packages of Services

Position of Pacific

Pacific seeks modification of COL 47 of the Resale Order which states:

> "The price floor for any package should be the sum of the price floors of the individual parts of the package (including any imputation requirement in setting the price floors.)"

Pacific states that the limitation on its ability to package services effectively deprives customers of valuable packages, and believes that LECs should be able to use as price floors for recently reclassified Category II services the service's retail price during the period before price floors are adopted. Pacific claims that using retail prices in calculating the price floor eliminates any opportunity for anticompetitive pricing of these services when offered in a package. In particular, Pacific

believes that use of the service's tariffed retail price precludes below-cost pricing and anticompetitive price squeezes.

Therefore, Pacific recommends that the Commission revise COL 47 as follows:

> "The price floor for any package should be the sum of the price floors or tariffed retail prices of the individual parts of the package (including any imputation requirement in setting the price floors)."

Similarly, Pacific proposes that COL 48 be modified to provide that use of the retail price of residential service in calculating the floor for a package of services including residential service satisfies the existing imputation rules. COL 48 would be revised as follows:

> "When packaging residential services, the existing imputation rules should apply and are satisfied by using the retail price in calculating the floor of the package."

Position of Coalition and ORA

The Coalition and ORA oppose any modification of COLs 47 and 48. The Coalition claims that if Pacific were permitted discretion to use either the tariffed rate or the price floor of the individual services making up a bundled package, Pacific could offer packages which ostensibly meet the Commission's imputation test even if the individual regulated services making up the bundle were provided at below-cost rates. The result, according to the Coalition, would be the subversion of the Commission's imputation requirements and its policies designed to prevent anticompetitive price squeezes. For example, if the tariffed rate for local exchange service was $10 but the cost was $20, Pacific could bundle that service with other regulated or nonregulated services because the price floor for the bundle would be based on the $10 tariffed rate instead of the $20 cost.

The Coalition warns that Pacific's proposed modification would undermine, if not eliminate, the Commission's imputation

requirements, and would violate D.94-09-065 which established that the primary purpose of imputation is to prevent anticompetitive abuses such as cross-subsidies and below-cost pricing.

Discussion

We deny Pacific's request for modification of COLs 47 and 48. It would be premature to permit the LECs to use tariffed retail prices of certain potentially-below-cost services for purposes of determining the price floor of bundled offerings. Contrary to Pacific's assertion, using retail prices in calculating the price floor does not eliminate any opportunity for anti-competitive pricing. As we stated in D.94-09-065, our decision in Phase III, Implementation Rate Design (IRD), of I.87-11-033, the price floor of a bundled service had to equal either the tariffed price of the monopoly building blocks used in providing the bundled service plus the long-run incremental cost of the competitive elements, or the long-run incremental cost of the bundled service plus its contribution. (56 CPUC2d 117, 232.) Further, we noted that "imputation should be based on the type of service that a competitor would most appropriately use in its competing service." (Id., 235.)

However, we have yet to determine the cost-based discounts of bundled wholesale services, or the prices of unbundled network elements based on total-service or total-element long-run incremental costs (TSLRIC or TELRIC). These are the means that the competitors are likely to employ to compete with Pacific's services. Until we do, we will be unable to perform the calculation of the price floor as set forth in the IRD decision. We are particularly mindful of the importance of proper imputation, given our explanation that:

> "[I]mputation's primary purpose is to serve as a safeguard against potential anticompetitive abuses by the LECs. It does this in two ways. First, it ensures that the price of LECs' bundled competitive offering at least recovers the cost of providing the service, so that

> customers of the LECs' regulated services do not subsidize competitive services. Second, it promotes fair competition by preventing the LEC from underpricing its bundled competitive offerings to the disadvantage of competitors." (Id., 228)

Accordingly, we decline to adopt the modification to COLs 48 and 49 as proposed by Pacific. Until we have determined appropriate cost-based discounts for bundled wholesale service and prices for unbundled network elements based on approved cost studies in the Open Access and Network Architecture Development (OANAD) rulemaking (R.93-04-003/I.93-04-002), it would be premature to permit LECs to set price floors for the bundling of Category II services based on existing retail tariffs.

3. Ability To Offer CLC Resellers Category I Resale Services at Discount Prices Under Contract

Position of Pacific

Pacific seeks modification of COL 44 of the Resale Order which states:

> "Pacific and GTEC may not enter into contracts which include Category I services at other than tariffed rates."

Pacific claims this language precludes the LECs from offering CLC resellers contracts for resale services at less than general tariff prices. This result arises from the prohibition against off-tariff pricing for Category I services and the classification of resale services as Category I. Some of the resale services, such as toll, are competitive and, Pacific argues, it may need to offer resellers lower-than-tariff prices to retain their business. In order to make available to CLC resellers and their end-users contract-based below-tariffed pricing for resale services, Pacific requests the Commission revise COL 44 as follows:

> "Pacific and GTEC may enter into contracts for Category I wholesale services at other than tariffed rates, subject to the imputation and other rules applied to the Category II retail

version of the wholesale service. Contract restrictions will continue to apply to all other Category I services."

For clarity, Pacific proposes that COL 42 also be revised as follows:

"Pacific and GTEC should not be authorized to bundle the remaining Category I services, excepting Category I wholesale services ordered in this decision, with Category II and/or III offerings."

Pacific suggests that OP 16 also be modified as follows:

"The LECs shall be allowed to offer flexible prices under customer-specific contracts for reclassified Category II services effective March 31, 1996 and Category I wholesale services ordered in this decision, subject to the filing of advice letters which include customer-specific price floors and showing of facilities-based competition."

Position of Coalition and ORA

The Coalition and ORA oppose Pacific's proposed modification to COLs 42 and 44 and OP 16 to allow Pacific to utilize contracts for Category I wholesale services and to bundle such Category I wholesale services with Category II or III services. They also oppose modification of OP 16 to allow Pacific to offer such customer-specific wholesale service contracts subject to the filing of customer-specific price floors and a showing of facilities-based competition.

The Coalition argues that D.96-03-020 left LEC wholesale services within Category I because of the LECs' market dominance and the absence of competition. (D.96-03-020, mimeo., Finding of Fact 26, p. 94.) D.96-03-020 did not allow Pacific immediate pricing flexibility even for those services that the decision placed in Category II. Certainly, argues the Coalition, authority for pricing flexibility for Category I services cannot be granted

without any showing of changed circumstances or justification for why such a change should be made.

The Coalition views Pacific's request as a disguised attempt to recategorize wholesale services from Category I to Category II. Yet, in D.96-05-036, the Commission stated, "Any generic issues regarding the existing service categories and the recategorization of services not resolved in the local exchange docket will be taken up in the 1998 [triennial] review." (D.96-05-036, mimeo., p. 5.)

The Coalition also warns that Pacific's proposed modification must be scrutinized in light of the application filed by Pacific's newly created affiliate, Pacific Bell Communications, Inc. (PB Com) to offer both local exchange and toll services. Under the proposed modification, the Coalition claims, nothing would stop Pacific from entering into a sweetheart wholesale arrangement to accord its own affiliate special wholesale rates so as to blunt any effective non-Pacific resale competition if, hypothetically, the Commission approves PB Com's application. Until the PB Com application is completely evaluated and litigated, as necessary, and appropriate safeguards are adopted to prevent Pacific from using PB Com to prey on its incipient CLC competitors, the Coalition argues, the instant request is at best premature and at worst a recipe for anticompetitive price discrimination in violation of Sections 532 and 453 of the Public Utilities Code.

Discussion

We deny Pacific's request to modify COLs 42 and 44 and OP 16 to authorize contracting of Category I LEC wholesale services at other than tariffed rates. The modification sought by Pacific would allow for pricing flexibility of LEC wholesale services similar to that allowed for Category II services. Yet, in D.96-03-020, we classified LEC wholesale services within Category I, recognizing that they did not satisfy our criteria for recategorization to Category II.

As stated in D.95-04-073 and reiterated in D.96-03-020, two criteria must be met before recategorization of a service can be considered, namely the existence of a sufficiently competitive market and established price floors supported by LEC-cost-study data. We agree with the Coalition that it is premature for Pacific to request further pricing flexibility for LEC wholesale services before these criteria have been satisfied.

Findings of Fact

1. The language in OP 13 regarding Pacific's billing of nonrecurring charges to CLCs was intended to apply to situations where a retail customer transfers from Pacific to a CLC.

2. OP 14 contains a parallel provision to OP 13 which is applicable to nonrecurring charges billed by GTEC.

3. The use of retail prices in calculating price floors does not necessarily eliminate any opportunity for anticompetitive pricing of packaged services.

4. In cases where the tariffed rate for a retail service is priced below cost, the use of the tariffed rate for floor pricing could enable the LEC to bundle that service with other regulated or unregulated service and offer the bundled package at the tariffed rate which would yield a below-cost price.

5. Pacific's proposed modification to COLs 47 and 48 with respect to bundled pricing policies would not eliminate any opportunity for anticompetitive pricing.

6. In D.94-09-065, the Commission determined that the price floor of a bundled service had to equal either the tariffed price of the monopoly building blocks used in providing the bundled service plus the long-run incremental cost of the competitive elements, or the long-run incremental cost of the bundled service plus its contribution. (56 CPUC2d 117, 232.)

7. Pacific's proposed modification of COLs 47 and 48 is premature since the Commission has yet to adopt the cost-based discounts and unbundled network element prices necessary to test

for compliance with the Commission's imputation requirements of D.94-09-065 prohibiting below-cost pricing of bundled services.

8. Pacific's request to modify COLs 42 and 44 and OP 16 to authorize contracting of Category I LEC wholesale services at other than tariffed rates would allow for pricing flexibility of LEC wholesale services similar to that allowed for Category II services.

9. In D.96-03-020, LEC wholesale services were classified within Category I since they did not satisfy Commission criteria for recategorization to Category II.

Conclusions of Law

1. Pacific's request for modification of OP 13 should be granted.

2. OP 14 should be modified to conform the applicable language for GTEC to the modification applicable to Pacific granted in OP 13.

3. As stated in D.95-04-073 and reiterated in D.96-03-020, before recategorization of a service can be considered, there must be the demonstration of a sufficiently competitive market and established price floors supported by LEC cost study data.

4. Pacific's request for modification of COLs 47 and 48 should be denied.

5. It is premature for Pacific to request further pricing flexibility for LEC wholesale services before the required criteria set forth in D.95-04-073 and D.96-03-020 have been satisfied.

O R D E R

IT IS ORDERED that:

1. Pacific Bell's (Pacific) Petition for Modification is granted to the limited extent set forth in Ordering Paragraphs (OP) 2 and 3 below.

2. OP 13 of Decision (D.) 96-03-020 is modified to read as follows:

> "Pacific shall limit any nonrecurring charges billed to CLC resellers related to the transfer of a Pacific customer to a CLC reseller to an amount no higher than the existing retail tariff charges found in its tariff schedule Cal. P.U.C. No. A3 of $5 per residential line and $7 per line for all other services, less the avoided cost discount of 17%."

3. OP 14 of D.96-03-020 is modified to read as follows:

> "GTEC shall limit any nonrecurring charges billed to CLC resellers related to the transfer of a GTEC customer to a CLC reseller to an amount no higher than the existing retail tariff charges found in its tariff schedule CAL. P.U.C. No. A-41 of $34.50 per business line and $17.25 per residential line, less a discount of 12% for avoided retail costs."

4. Pacific's Petition for Modification of Conclusions of Law 42, 44, 47, and 48 and OP 16 is denied.

This order is effective today.

Dated May 21, 1997, at Sacramento, California.

P. GREGORY CONLON
President
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
RICHARD A. BILAS
Commissioners