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Decision 97-09-115 September 24, 1997

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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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

O P I N I O N

By today's decision, we extend the coverage of our adopted rules for local exchange competition to include the service territories of California's two midsized incumbent local exchange carriers (MSLECs), Roseville Telephone Company (RTC) and Citizens Telephone Company (CTC). Specifically, we adopt interim rules herein to initiate the filing of requests by competitive local carriers (CLCs) for authority to provide local exchange service within the RTC and CTC service territories. To date, the Commission's rules for local competition have only been applied to the territories of Pacific Bell (Pacific) and GTE California, Inc.(GTEC). We shall establish the date of January 1, 1998, for certificated facilities-based CLCs to begin offering service in the MSLEC territories. We shall establish February 2, 1998, as the date for qualifying CLC resellers to begin service.

Pursuant to both state and federal legislative mandates, this Commission has undertaken a comprehensive program to institute competition in the local exchange telecommunications market throughout California. Assembly Bill 3606 (Ch. 1260, Stats. 1994) expresses the California Legislature's intent to open all telecommunications markets to competition.

The MSLECs are also subject to the requirements of the Federal Telecommunications Act of 1996 (Act), which imposes various obligations upon

incumbent local exchange carriers (LECs) among which include the requirement to provide interconnection and impose no unreasonable limitations on the resale of telecommunications services by CLCs.[1]

RTC and CTC are the only independent MSLECs operating within California. Since Contel of California has been merged with GTEC effective January 1, 1997, the former Contel territory will be served by GTEC and will be covered by the rules already in place for GTEC. At this time, there is no indication that CLCs have any imminent plans to enter the service territories of those LECs smaller than RTC and CTC. Therefore, the rules being adopted in this decision will be limited to the service territories of the two MSLECs. We will proceed in the future with the development of rules for the territory of the small LEC.

I. Background

On April 26, 1995, this proceeding was opened to institute competition for local exchange service throughout California. As a first priority, rules were adopted which only applied to the service territories of the two largest incumbent LECs, Pacific and GTEC. We deferred consideration of rules for competition in the territories of the smaller LECs within the state to a later phase of this proceeding.

An Administrative Law Judge (ALJ) ruling issued on May 3, 1996, solicited preliminary comments from parties on rules for local exchange competition within the service territories of those incumbent LECs within California smaller than Pacific and GTEC. Responsive comments were filed on July 31, 1996. At that time, there was no pending request by any CLCs seeking Certificate of Public Convenience and Necessity (CPCN) authority to enter the MSLECs' local exchange market. The first formal

[1] Section 251(f)(1) of the Act, however, grants an exemption from the requirements of Section 251(c) for "rural telephone companies" until they receive a "bona fide request" for interconnection, service or network elements, and the state commission determines that the exception should be terminated. Section 251(f)(2) permits LECs with fewer than 2% of the nation's access lines to petition a state commission for suspension or modification of the requirements of Section 251 (b) and (c).

application by a CLC seeking local-exchange CPCN authority within the service territory of a MSLEC was filed in April 1997 by Electric Lightwave, Inc. (ELI) (Application (A.) 97-04-061). ELI sought authority to offer local exchange service within the service territory of RTC.

On June 4, 1997, a protest to the ELI application was filed by RTC, arguing that no CLC should be permitted to enter the service territories of the MSLECs until the Commission has adopted applicable rules governing competition within the MSLEC territories. In filing its protest, RTC did not seek suspension of the requirements of Sections 251(b) and (c) or Section 251(f), but did seek modification of certain Commission rules for local competition which apply to the Pacific and GTEC territories.

In view of ELI's application and RTC's protest, an ALJ ruling was issued on June 19, 1997, soliciting further comments concerning the adoption of generic rules for the entry of CLCs into the service territories of the two MSLECs. Comments were filed in response to the ALJ ruling on July 15, 1997 by the two MSLECs (RTC and CTC), by the two major incumbent LECs (Pacific and GTEC), by various interests representing CLCs (AT&T Communications/MCI Communications (AT&T/MCI); California Cable Television Association/Teleport Communications Group; and Sprint Communications (Sprint)), and the Office of Ratepayer Advocates (ORA).

Based on our review of the filed comments, we adopt the following rules and procedural plan for the competitive entry of CLCs into the local exchange market of the MSLECs.

II. CLC CPCN Filing Requirements

Our first priority is to adopt rules for the filing requirements for CLCs seeking CPCNs to offer facilities- or resale-based or resale local exchange service within the MSLECs' service territories. With these initial rules in place, as set forth below, CLCs are now positioned to file petitions for local exchange authority.

A. Positions of Parties

Parties generally agree that it is not necessary to reinvent the rulemaking process already conducted to establish new rules for local competition within the

MSLECs territories, particularly with respect to CPCN filing requirements. Parties are in disagreement, however, concerning the degree of pricing flexibility which CLCs and MSLECs should have. These disputes are discussed separately in the section below dealing with CLC rates.

B. Discussion

Based on a review of parties' comments, we conclude that the basic requirements previously adopted in Decision (D.) 95-07-054 and related decisions for the filing of CPCN authority by CLCs to compete within the service territories of Pacific and GTEC should also be applied within the RTC and CTC service territories. The draft tariffs which are included with the petition may be limited to the rates and services to be offered in RTC's and/or CTC's service territory. For those CLCs previously certificated by the Commission, it is not necessary to refile the rules of service, e.g., deposits, billing, etc. In preparing their petitions, CLCs must identify the particular boundaries of the MSLEC territory they propose to serve. Hence, each CLC is to indicate whether its proposed territory will include only that of RTC, only that of CTC, or both.

We shall therefore authorize candidates seeking CLC CPCN authority within the MSLEC territories to begin making filings effective immediately, following the applicable rules previously adopted in D.95-07-054 and subsequent decisions in this proceeding. Requests for CLC CPCN authority shall be filed in the form of a petition docketed in Investigation (I.) 95-04-044, following the same rules and procedures previously adopted for filings to compete within the Pacific and GTEC service territories.

We shall establish two separate groups of consolidated petitions: (1) those seeking facilities-based authority (a CLC may also request authority to offer resale local exchange service as part of its facilities-based petition) and (2) those seeking only resale

authority. Those petitions seeking facilities-based authority shall be processed on a quarterly cycle in accordance with the procedure adopted in D.96-12-020.[2]

Petitions for facilities-based CLC CPCN authority in the MSLEC territories filed with the Commission's Docket Office by November 1, 1997, shall be processed as the first consolidated group. After review and processing of the filings, we shall grant CPCN authority to offer facilities-based local exchange service in the MSLECs' territory to this first group of qualifying CLCs with such authority beginning February 1, 1998. Those CLC petitions for facilities-based authority which are filed after November 1, 1997, shall be included in subsequent CLC groups subject to consideration during future quarterly reviews.[3]

In the case of those CLC candidates which seek resale-based authority exclusively, the CPCN filing shall also be made as a petition docketed in I.95-04-044. In similar fashion to the approach previously adopted in D.95-07-054, we shall process the CLC-reseller-only petitions under a separate schedule from the facilities-based petitions. We shall establish the deadline of December 1, 1997, for the filing of CLC petitions seeking resale-only authority. Those CLC reseller petitions filed by December 1, 1997, shall be processed for approval in an initial consolidated group. We shall set the deadline of April 1, 1998, for the certification of eligible CLC resellers to offer service within the MSLECs' service territories. Any requests for CLC-reseller-only authority filed after December 1, 1997, shall be docketed as separate applications.

Before CLC resellers can actually begin to offer service in competition with the MSLECs, however, applicable wholesale discount rates must be determined.

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[2] In D.96-12-020, we adopted a schedule for the quarterly processing of facilities-based CLC petitions covering the Pacific and GTEC territories on a consolidated basis to correspond to the processing of the Mitigated Negative Declaration required under the California Environmental Quality Act.

[3] The CPCN application previously filed by ELI has been converted into a petition and shall be included within the first group of petitioners seeking facilities-based CLC CPCN authority within the MSLECs' territory, scheduled for processing in the fourth quarter of 1997. ELI previously indicated its plan was to serve the RTC territory.

We address the procedures for developing wholesale rates below. In their proposed tariffs filed with their petition for resale authority, CLC candidates should insert asterisks as placeholders for actual rates which are to be inserted later, once actual wholesale rates have been established for RTC and CTC.

III. Development of Wholesale Tariffs for RTC and CTC

As part of the authorization of resale competition, wholesale tariffs must be developed for RTC's and CTC's services subject to resale.

In the case of Pacific and GTEC, we initially authorized the resale of various services in D.96-03-020. An interim wholesale discount was adopted for Pacific and GTEC in D.96-03-020 based upon certain identified retail cost accounts which represent avoided costs at the wholesale level. We then designated the Open Access and Network Architecture Development (OANAD) proceeding to develop permanent wholesale rates based upon further detailed cost studies. In D.97-08-059, we expanded the range of Pacific and GTEC retail services subject to resale and removed various resale restrictions.

In June 19, 1997, ALJ ruling, comments were sought on whether the existing rules for the resale of Pacific and GTEC telecommunications retail services should be applied to resale of the MSLECs' services. We specifically asked whether there is any valid reason to deviate from the avoided-cost formula previously adopted in D.96-03-020 in deriving discounts for RTC and CTC, and if so, in what respects.

A. Positions of Parties

RTC proposes that the Commission institute a proceeding while it is processing CLC applications to consider the appropriate level of wholesale discount for the MSLECs based on the average-avoided-retail-cost methodology adopted in D.96-03-020. RTC objects to a wholesale rate which is merely set equal to that of Pacific or GTEC. RTC argues that it should be permitted to submit its own avoided-cost wholesale-rate proposal using a similar method to that employed in D.96-03-020, and supported using the evidence in RTC's most recent rate case order (D.96-12-074). RTC believes that a workshop would be an appropriate forum to identify the parties

interested in the development of RTC's wholesale rates and the issues which are likely to come into dispute.

CTC argues that the avoided-cost-discount formula adopted for Pacific and GTEC cannot be automatically applied to the MSLECs, but that the Commission must investigate the specific cost data of each MSLEC through evidentiary hearings before adopting wholesale discounts. Since CTC's most recent rate order was issued in 1995, based on early 1993 cost studies using embedded costs, CTC believes it should be permitted to provide more updated cost studies. As an interim measure, until the Commission has completed evidentiary hearings to review the specific avoided costs of each MSLEC to determine the appropriate wholesale discount, CTC proposes that the Commission allow the MSLECs to negotiate mutually agreeable wholesale discount rates with the CLCs based on each MSLEC's specific costs.

AT&T/ MCI recommend that the Commission merely apply the 17% avoided cost discount previously adopted for Pacific as interim discounts for the wholesale services of both RTC and CTC, and then establish proceedings to set permanent wholesale rates. AT&T/MCI also recommend that the Commission require the MSLECs to eliminate all resale restrictions that appear in their current tariffs (except the ban on reselling residential service to business customers) in order to promote a competitive resale market.

RTC objects to the establishment of an interim discount rate without further proceedings as arbitrary, capricious, and confiscatory. If CLCs demand immediate access to wholesale rates, RTC proposes that the Commission authorize resale at RTC's current retail rate levels, subject to refund of any discount ultimately adopted by the Commission.

CCTA agrees that the avoided cost discount approach adopted in D.96-03-020 for Pacific and GTEC should also apply in setting wholesale rates for RTC and CTC, with the specific numerical inputs based on the costs of RTC and CTC. CCTA believes that the permanent discount formula to be developed in OANAD should also apply to RTC and CTC.

B. Discussion

We conclude that it would be inappropriate simply to use the 17% discount previously adopted for Pacific as an interim wholesale discount off the MSLECs' rates. Each LEC's discount should be based on its own separate cost structure. Separate avoided-cost discounts should be developed for RTC and for CTC.

We conclude that the next steps in the development of tariffed wholesale discounts for the MSLECs should be addressed in the OANAD proceeding. We already are currently considering alternative models for the development of avoided-cost wholesale rates for Pacific and GTEC in the OANAD proceeding. In the interests of consistency and efficiency, we conclude that further consideration of tariffed wholesale rates for RTC and CTC should be addressed in the OANAD proceeding. In the OANAD proceeding, we shall consider whether the cost model which we adopt for Pacific and GTEC in the OANAD proceeding should also be applied to RTC and CTC, with a determination of the actual company-specific discounts based on the cost inputs for each company.

We hereby place RTC and CTC on notice of our intention to consider making them subject to the cost model adopted in OANAD, and we shall provide them the opportunity to participate in the process of determining the appropriate cost model now under way in the OANAD proceeding. The assigned ALJ in the OANAD proceeding has issued a ruling dated August 21, 1997, alerting parties to this procedural plan in order to provide RTC and CTC with the opportunity to address their concerns in that proceeding regarding the adoption of an avoided-cost model.

Until the time that tariffed wholesale discount rates are adopted for RTC and CTC, individual CLCs may enter into negotiations with each of the MSLECs to seek agreement on an interim wholesale discount rate. Disputes over the terms of resale arrangements may be submitted to the Commission for arbitration pursuant to the provisions of Section 252(b)(1) of the Act and Commission Resolution ALJ-174. Any negotiated agreements containing interim discount rates are subject to revision once tariffed wholesale discount rates are adopted in the OANAD proceeding.

We shall direct that each of the MSLECs make available all of its retail services for resale under the same terms and conditions which have previously been adopted for Pacific and GTEC as set forth in D.96-03-020 and D.97-08-059.

IV. Pricing Rules for MSLECs

A. Positions of Parties

RTC and CTC argue that the MSLECs have significantly less market power in comparison to Pacific and GTEC, and that, as a result, the MSLECs should be regulated as nondominant carriers with no greater regulatory burden than that placed on a CLC, including pricing flexibility on par with CLCs. RTC notes that, under the Act, a LEC with fewer than 2% of the nation's access lines may seek relief from any obligations imposed upon it by the Act. While RTC has not formally sought relief from any obligations required under the Act, RTC claims that, by virtue of its smaller size, it should be subject to less restrictive rules than those imposed on Pacific and GTEC. RTC argues that competition is now spreading through the Sacramento metropolitan area, of which only approximately 12% is in the RTC service territory. RTC states that large CLCs will have easy access to the whole Sacramento metropolitan market, including the small portion served by RTC.

CTC argues that the issues of rate rebalancing and geographic deaveraging for MSLECs should be addressed and resolved through evidentiary hearings in conjunction with the establishment of rules for local competition within the MSLECs' territories.

Other parties filing comments oppose treating the MSLECs as nondominant or granting the MSLECs the same pricing flexibility as the CLCs. AT&T/MCI argue that, within their own local service territories, RTC and CTC each control the bottleneck facilities used in the provision of local exchange service and that the MSLECs each remain dominant within their respective local markets. AT&T/MCI argue that the MSLECs should be accorded pricing flexibility only on a service-by-service basis and only upon a showing through evidentiary hearings that sufficient competition exists for the particular service to prevent the MSLEC from engaging in

monopoly or anticompetitive pricing. ORA states that, as the incumbent service providers within their own local exchange territories, RTC and CTC each possesses the same degree of market power as Pacific possessed at the onset of competition. ORA believes that, if the incumbent MSLECs were treated as if they were incoming CLCs with little or no customer base, it would irreparably harm the start of competition.

B. Discussion

We conclude that it is premature at this time to treat the MSLECs as nondominant carriers subject to the same pricing flexibility granted to CLCs. The mere lifting of legal barriers to competitive entry does not, of itself, constitute sufficient evidence that the MSLECs are no longer dominant carriers. Although the MSLECs are substantially smaller than Pacific and GTEC, as well as the larger CLCs, the MSLECs still control the essential bottleneck facilities within their own local exchange markets. For purposes of the initial entry of CLCs into MSLECs' markets, we shall apply the same pricing flexibility rules for the MSLECs which we adopted for Pacific and GTEC in D.96-03-020. Specifically, we reclassified most local exchange services of Pacific and GTEC from Category I to Category II since they conformed to our definition of "partially competitive services for which the local exchange carrier retains significant (though perhaps declining) market power" (D.89-10-031, p. 152). The list of Category I and reclassified Category II services for Pacific and GTEC appear on page 55 of D.96-03-020. We hereby adopt that same categorization for RTC and CTC.

In D.96-03-020, we stated that Pacific and GTEC would be permitted to implement pricing flexibility for tariffed Category II services once relevant price floors were established for the reclassified services in the OANAD proceeding. We shall apply this same policy to RTC and CTC.

In the case of customer-specific contracts covering Category II services, we permitted gradual implementation of pricing flexibility for Pacific and GTEC. We stated in D.96-03-020 that we would consider approval of LECs' advice letter requests for pricing flexibility for customer-specific contracts on an exchange-by-exchange basis contingent on (1) the establishment of a customer-specific price floor for the service in

accordance with D.94-09-065 and (2) the demonstration of competition within a given exchange from at least one facilities-based CLC. As evidence that the facilities-based CLC is actively competing, the LEC had to show that the CLC has executed an interconnection agreement with the LEC, has opened one or more NXX codes within the exchange, and has originated or terminated traffic to CLC customers within the LEC's exchange.

We further required that the competing CLC must be other than Pacific or GTEC.

Any LEC advice letter request for a customer-specific price floor was required also to conform the process outlined in D.94-09-065:

> "[C]ustomer-specific LRICs must be calculated on an appropriate uniform per-unit basis (e.g., per-foot, per-line). The LEC must establish per-unit LRICs in a compliance filing setting forth the calculation and cost basis for the unit price. The LEC may then apply the unit price to the appropriate characteristic of the customer...to establish customer-specific LRICs for use in calculating price floors for the individual contracts." (D.94-09-065, p. 229.)

In the case of Category II services which were so classified prior to D.96-03-020, previously existing rules for the approval of customer-specific contracts remained in place for Pacific and GTEC. However, in the case of contracts for bundled services that include services we have placed in Category II as a result of D.96-03-020, we applied the rules we have designed for these services. We did not require a showing of competition by a facilities-based CLC for approval of customer -specific contracts for previously existing Category II services. We shall apply the same customer-contracting pricing flexibility provisions to RTC and CTC.

In D.96-03-020, we also permitted Pacific and GTEC to bundle Category II and III services as long as customers are able to purchase the individual services separately at tariffed rates, and as long as proper imputation of price floors for each separately unbundled Category II service is verified. As prescribed under PU Code § 2282.5: "Cross-subsidy of the enhanced services by the noncompetitive services

offered by the local exchange telephone corporation is prohibited." For any bundled tariffed Category II services, we required a full demonstration of the imputed underlying tariffed rates. We did not allow bundling of Category I services. We shall apply the same bundling provisions to RTC and CTC.

In D.96-03-020, we set the effective date for the reclassification of Pacific's and GTEC's Category I and II services at March 31, 1996, the implementation date for the LECs' wholesale tariffs. Consistent with this policy, we shall set the effective date for the reclassification of RTC's and CTC's retail services and authority to bundle Category II and III services to be the effective date for their wholesale tariffs. We shall determine this date in a subsequent order.

We shall leave open the option of considering additional MSLEC pricing flexibility, including geographic deaveraging as competition develops within their markets. For purposes of the initial entry of CLCs, however, such flexibility is premature.

We acknowledge the concern raised by CTC that a MSLEC cannot compete against Pacific or GTEC as a competitor in the MSLEC territory when Pacific or GTEC are allowed to average their rates over a significantly larger, more diverse statewide customer base than that of any MSLEC. We shall direct the ALJ to take further comments on whether or not Pacific and GTEC should be permitted to compete as CLCs in the MSLEC territories in light of their ability to average their rates over a more diverse customer base. While Pacific and GTEC will be permitted to file requests for CLC authority within the MSLEC territory, we shall not approve their requests until we have reviewed parties' comments on this issue and determined if there are any anticompetitive concerns that may warrant deferral of such approval.

V. Retail Pricing Rules For CLCs In MSLEC Territories

A. Positions of Parties

RTC seeks more stringent requirements for CLCs competing in its service territory than is required for CLCs competing in Pacific's and GTEC's territories. Specifically, RTC argues that the Commission should prohibit below-cost pricing by

CLCs in connection with the certification process, and should conduct an initial inquiry into whether the CLC applicant proposes to engage in "predatory pricing" below cost.

RTC argues that the California Supreme Court has instructed this Commission that it must consider economic and antitrust aspects of a certification application (*See U.S. Steel Corp.* v. *Public Utilities Commission*, (1981) 29 Cal 3d 603). RTC acknowledges that in the case of many CPCN applications, this is not an issue, and the CLC should not be required to provide cost justification for its rates in such cases. RTC proposes, however, that in those cases where a CLC applicant proposes a retail rate for resold services that is below the wholesale rate offered plus the CLC's own retail costs, the Commission should investigate the CLC's proposed prices and require a cost study if necessary to justify the proposed rates.

CTC opposes RTC's proposal for CLCs to file cost studies for services provided in the MSLEC territories, arguing that the Telecommunications Act does not support adding additional burdens on CLCs. CTC does not believe such studies will resolve the issues raised regarding the ability of smaller MSLECs to compete against the larger carriers entering the MSLECs' territories.

Other parties likewise oppose any rules requiring CLCs to provide cost data to justify their tariffed rates, noting that the Commission has not required any cost studies to support rates charged by CLCs competing in the Pacific and GTEC territories. Sprint states that CLCs will enter the MSLECs' markets with no customers and no market share. ORA argues that imposing cost studies would merely slow competitive entry, be economically inefficient, and would needlessly consume scarce Commission resources.

B. Discussion

We find no basis to require CLCs to provide cost studies to justify their proposed rates. We impose no such requirement on CLCs which compete in the Pacific and GTEC territories since we concluded in D.96-03-020 that such CLCs lacked the market power to engage in anticompetitive pricing. Likewise, CLCs entering the

MSLECs' territories with no established customer base or market share lack the market power to engage in anticompetitive pricing.

RTC proposes that only those CLCs pricing services below cost should produce cost studies. Other CLCs would not be required to produce cost studies. We find practical problems with implementing such a policy. RTC does not explain how it could be determined that a CLC was pricing below its own costs unless a cost study was already completed, identifying the costs of the CLC.

In the event that a CLC reseller were to propose to charge a retail rate that is deemed to be unfair or unreasonable, parties have recourse to file a complaint as provided in the Commission's Rules of Practice and Procedure (*see* Article 3). We see no reason, however, to require a cost study by the CLC as a basis for justifying its rates. Such a requirement would unnecessarily impede the development of competition.

We affirm the June 19, 1997, ruling of the ALJ converting the application of ELI into a petition in this Docket. Although ELI filed a draft tariff with its application showing rates substantially below RTC's rates, we view this rate only as a nominal placeholder. Since RTC had no wholesale rate in effect at the time ELI made its filing, ELI was unable to base its retail rates on a realistic RTC wholesale rate. We invite ELI to amend its tariff filing to reflect the actual RTC wholesale rate once it is adopted.

VI. Implementation Costs

A. Positions of Parties

RTC proposes that, as part of an order establishing rules for competitive entry into its service territory, the Commission should grant RTC authority to recover its implementation costs. RTC notes that, in D.96-03-020,the Commission authorized Pacific and GTEC to establish memorandum accounts to record implementation costs incurred on and after January 1, 1996. RTC argues that it would be reasonable for the Commission to permit RTC to begin recording implementation costs incurred on and after January 1, 1997, in a memorandum account.

CTC also requests authority to establish a memorandum account for implementation costs, but does propose any particular starting date for accrual of such

costs. CTC proposes that any recovery of such costs be provided through a competitively neutral mechanism, such as an end-user surcharge.

No other party specifically addressed the issue of the MSLECs' implementation cost recovery.

B. Discussion

Consistent with our previous authorization for establishment of a memorandum account for Pacific and GTEC in D.96-03-020, we shall likewise authorize RTC and CTC each to establish a memorandum account to accrue implementation costs. In the case of the memorandum accounts established for Pacific and GTEC in D.96-03-020, we authorized the accrual of implementation costs incurred only on or after January 1, 1996, the official date for the entry of CLCs into their respective markets. We did not authorize Pacific or GTEC to accrue any costs incurred retroactively prior to January 1, 1996, since they had not made a request to establish such a memorandum account prior to that date. It would be inappropriate, therefore, to authorize the MSLECs to retroactively recover costs incurred prior to the date of their request seeking cost recovery. Therefore, we shall not authorize the retroactive recording of costs in a memorandum account dating back to January 1, 1997. We shall, however, authorize RTC and CTC each to begin accruing implementation costs incurred prospectively in a memorandum account beginning with the effective date of this decision.

The granting of authority for RTC and CTC to record implementation costs in a memorandum account in no way prejudges the reasonableness of those costs or whether and how implementation costs may be explicitly recovered at a later time. We shall consider issues dealing with the MSLECs' implementation costs later in this proceeding.

VII. Intercompany Arrangements

As stated in the June 19 ruling, we also must consider rules governing CLCs' intercompany arrangements with the incumbent MSLECs and related aspects of their

operations after they have become certified (e.g., access to databases and directory listings, etc.). We shall generally defer these rulemaking issues to a subsequent decision.

In instances where CLCs and MSLECs are unable to reach mutual agreement on the terms of interconnection and resale arrangements, the contract disputes may be submitted to the Commission for arbitration, pursuant to the provisions of § 252(b)(1) of the Act and our own implementing rules adopted in Resolution ALJ-174.

As provided under § 252(d) of the Act, the state commission must resolve arbitrated issues in a manner consistent with the pricing standards contained in the Act. The state commission cannot approve an interconnection agreement arrived at through arbitration that does not meet the requirements of § 251 of the Act and the standards set forth in § 252(d) of the Act relating to pricing for interconnection, network elements, transport and termination, and wholesale rates. (§ 252(e)(2)(B) of the Act.)

We shall consider the need to adopt further rules governing intercompany arrangements at a later date as conditions warrant.

VIII. Extended Service Area

ORA has proposed that the Commission should order workshops to explore the issues related to Extended Area Service (EAS) arrangements. ORA argues that, unlike Pacific and GTEC, the MSLECs' revenue streams can be significantly affected by EAS arrangements. We shall direct the ALJ to issue a further ruling determining the procedural steps to address this issue, and whether this issue should be limited to the MSLECs or considered on a broader statewide basis.

Findings of Fact

1. Pursuant to both state and federal legislative mandates, this Commission has undertaken a comprehensive program to institute competition in the local-exchange telecommunications market throughout California.

2. Prior to this decision, the adopted Commission rules for local exchange competition only applied within the service territories of Pacific and GTEC.

3. The first formal application by a CLC seeking local exchange CPCN authority within the service territory of a MSLEC was filed in April 1997 by Electric Lightwave, Inc. (ELI) (A.97-04-061).

4. Parties identified no significant differences between the two major incumbent LECs and the MSLECs which would require modification of the previously adopted rules governing the filing of CLC CPCN requests, with the exception of issues relating to rates.

5. In order for CLCs to offer local exchange service on a resale basis, wholesale rates need to be determined based on the specific costs of RTC and CTC.

6. In D.96-03-020, the Commission previously adopted a methodology for deriving interim wholesale discounts for the resale of Pacific and GTEC services based on avoided retailing costs.

7. The Commission is currently considering the adoption of an avoided-cost wholesale-discount model in the OANAD proceeding.

8. Although the MSLECs are substantially smaller than Pacific and GTEC, as well as the larger CLCs, the MSLECs still control the essential bottleneck facilities within their own local exchange markets.

Conclusions of Law

1. The local exchange rules previously adopted for CLC filings requesting authority to offer local exchange service in the territories of Pacific and GTEC should be extended to apply to the service territories of RTC and CTC.

2. CLC candidates should be authorized to begin making filings for local exchange authority within the service territories of RTC and CTC.

3. In their proposed tariffs for resale-based authority filed within their petitions or applications for a CPCN, CLC candidates should insert asterisks as placeholders for actual rates to be inserted once actual wholesale rates have been established for RTC and CTC.

4. The development of interim wholesale discounts for the MSLECs should be further considered in the OANAD proceeding, in conjunction with the development of cost models and with specific cost inputs from each MSLEC.

5. It would be premature to treat the MSLECs as nondominant carriers merely because of the adoption of rules permitting the entry of CLCs into the MSLECs' local exchange territory.

6. Given the current dominant status of the MSLECs within their own local exchange markets, there is no basis to conclude that CLCs presently have the market power to engage in anticompetitive pricing within the MSLECs' territory subject to receipt of further comments on the issue raised in Conclusion of Law 7.

7. Further comments should be taken to determine whether the ability of Pacific and GTEC to average their rates over a more diverse statewide customer base than the MSLECs poses a significant impediment to MSLEC competition, and whether as a result, Pacific and GTEC should be permitted to compete as CLCs in the MSLECs' territories.

8. The pricing-flexibility rules adopted for Pacific and GTEC in D.96-03-020 should be applied to the MSLECs to become effective concurrent with the effective date of the MSLECs' wholesale tariffs, pending further monitoring of how competition develops over time. The specific pricing flexibility rules to be applied to the MSLECs relate to the reclassification of Category I to Category II tariffed services, the approval criteria for flexibly-priced customer specific contracts, and the bundling of Category II and III services.

9. The pricing flexibility rules adopted for CLCs in D.96-03-020 should be applied to CLCs entering the MSLECs' markets.

10. It would be consistent with the previous authority granted to Pacific and GTEC to permit RTC and CTC each to establish a memorandum account to record implementation costs associated with local competition.

11. Neither RTC or CTC has justified why the Commission should retroactively authorize the recording of implementation costs that may have been incurred before the request for establishing a memorandum account was made.

12. RTC and CTC should each be permitted to establish a memorandum account to accrue implementation costs related to local competition on a prospective basis beginning with the effective date of this order.

O R D E R

IT IS ORDERED that:

1. Effective immediately, competitive local carriers (CLCs) are hereby authorized to begin filing for local exchange operating authority within the service territories of Roseville Telephone Company (RTC) and Citizens Telephone Company (CTC), California's mid-sized local exchange companies (MSLECs). One copy of the petition shall be filed with the Director of the Telecommunications Division.

2. CLCs seeking local exchange authority within the MSLECs' territories shall file petitions docketed in Investigation 95-04-044 subject to a consolidated review and processing cycle.

3. CLC petitions for facilities-based local exchange authority within the MSLEC territories filed with the Commission's Docket office by November 1, 1997, shall be subject to consideration for approval by February 1, 1998. One copy of the petition shall be served on the Director of the Energy Division.

4. CLC petitions for local exchange authority within the MSLEC territories filed with the Commission's Docket office after November 1, 1997, shall be added to the CLC petitions subject to review during the subsequent quarterly cycles.

5. CLCs seeking local exchange authority for resale in addition to facilities-based authority may request such resale authority as part of the CLC petition filing.

6. CLCs seeking only resale-based authority, but not facilities-based authority, shall file with the Commission's Docket office separate petitions in I.95-04-044 by December 1, 1997, to be considered for approval by April 1, 1998.

7. Resale-only CLC requests filed after December 1, 1997, shall be docketed as separate applications.

8. The assigned Administrative Law Judge (ALJ) is directed to establish a schedule for a workshop to explore the issues related to Extended Area Service arrangements as they are impacted by local exchange competition.

9. RTC and CTC are each authorized to establish a memorandum account and accrue therein actual implementation costs for local exchange competition prospectively beginning with the effective date of this order.

10. The assigned ALJ is directed to take comments on whether Pacific and GTEC should be permitted to compete as CLCs in the MSLECs' territories in light of their ability to average rates over a more diverse customer base than MSLECs.

This order is effective today.

Dated September 24, 1997, at San Francisco, California.

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

President P. Gregory Conlon,
being necessarily absent,
did not participate.