

Decision 99-12-018 December 2, 1999

**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)

**OPINION**

On June 26, 1998, GTE California Incorporated (GTEC) filed a Petition to Modify Decision (D.) 96-03-020. GTEC's Petition for Modification is specifically in regard to D.96-03-020's prohibition against granting of pricing flexibility for reclassified Category II services not previously granted such flexibility until price floors for these services are adopted for incumbent local carriers (ILECs) in the Commission's Open Access and Network Architecture Development (OANAD) proceeding, R.93-04-003 and I.93-04-002. D.96-03-020 moved almost all non-residential basic exchange access line services to Category II (services subject to emerging competition), which is afforded pricing flexibility. However, Conclusions of Law 32 and 33 excepted from flexibility any service which did not have a current price floor on file and clarified that price floors for those services would be established in the pricing phase of OANAD.

Conclusion of Law 33 provided that ILECs be permitted to implement pricing flexibility for tariffed Category II services only after relevant price floors were established in the OANAD proceeding for the reclassified services.

### **Positions of Parties**

GTEC argues that more than two years have passed since the issuance of D.96-03-020, and it was not anticipated that OANAD issues as they apply to GTEC would be unresolved for such a long period of time.

GTEC requests that D.96-03-020 (including Conclusions of Law 32 and 33) be modified to provide that until such time as price floors are established in the OANAD proceeding, GTEC may obtain interim price floors for particular tariffed services by using the Advice Letter process. Interim floors would be set using the existing approved LRIC cost methodology.

GTEC does, in fact, use this cost methodology today in support of other filings, including its new service offerings. This methodology was also previously approved for use in setting price floors for other services previously granted pricing flexibility (see, D.94-09-065, In the Matter of Alternative Regulatory Frameworks for Local Exchange Carriers, I.87-11-033, Conclusion of Law Paragraph 151), such as CentraNet and toll. It is also the same standard that GTEC was authorized to use for customer-specific contracts for the same reclassified services at issue in its Petition.

While D.96-03-020 did allow GTEC some ability to submit customer specific contracts for these reclassified services, GTEC claims this process does not provide the same efficiency or timeliness as pricing flexibility under its tariffs. According to D.96-03-020, each customer specific agreement would require provision of specific information (such as open and working competitive local carriers (CLC) NXX codes and customer specific cost floor information). GTEC states this process involves significant resources and time.

GTEC claims that the requested modification to D.96-03-020 is warranted in order for it to obtain pricing flexibility within a reasonable time frame.

GTEC claims that continued delays in its ability to exercise Category II pricing flexibility has impacted its ability to compete for business customers. For example, business customers with PBX equipment can route Zone Usage Measurement (ZUM) traffic along with their toll traffic to their toll provider via the least cost routing feature of their PBX. ZUM and toll are packaged together by carriers at discount rates. GTEC claims that its inability to flexibly price ZUM service has thus handicapped its ability to compete for intraLATA toll. (See, GTEC Petition Exhibit C (Pani Declaration)). In addition, when CLCs bid for GTEC business customers' local service, their Local Measured Service (LMS) rates are discounted below GTEC's LMS rates, and they often offer ZUM Zone 3 calling at the same rates as LMS. Thus, GTEC argues that competitors have effectively created a 16-mile local calling area for the customer at rates below GTEC's 12-mile calling area. GTEC claims that the same local service bids often contain pricing for measured business lines that are roughly half the price of GTEC's tariffed business lines.

Responses in opposition were filed by the California Telecommunications Coalition (Coalition) and by the Office of Ratepayer Advocates (ORA).

The Coalition and ORA object to the requested modification arguing GTEC's Petition is an inappropriate vehicle for a request for interim pricing flexibility to meet alleged competitive pressures. First, parties argue that more than a year of that delay is the direct result of defects in GTEC's cost studies and GTEC's subsequent requests for additional time. To the extent GTEC is responsible for the delay, parties believe GTEC's petition should be denied. Parties note that in D.96-08-021, the Commission adopted, with certain modifications, Pacific's total service, long-run incremental cost (TSLRIC) studies for use in developing both its UNE prices and retail price floors. The Commission, however, found that "[w]hile Pacific's studies are generally

consistent with the TSLRIC principles agreed upon during the workshops and adopted in D.95-12-016, GTEC's are not." (D.96-08-021, p. 70.)

The Coalition argues that had it not been for GTEC's attempt to ignore the Commission's costing principles and file a completely deficient TSLRIC study, GTEC would not be facing a continued delay in exercising pricing flexibility for its retail local services. The Coalition thus claims that any delay GTEC experiences in achieving pricing flexibility, beyond when such flexibility is available to Pacific, is entirely a matter of GTEC's own making.

Second, parties dispute GTEC's claims about the progress of competition. ORA states that granting GTEC's request will not assist the development of competition, but that there are better ways to achieve the objectives of the petition. The Coalition argues that the only competitive losses identified by GTEC are for intraLATA toll service, but not for any local exchange services (e.g., ZUM calling and 1MB). Moreover, the Coalition claims GTEC is in a much better position than its competitors to capture customers, viewed in the context of the significant amount of interLATA traffic it has garnered since 1996. Yet, because interexchange carriers (IXCs) cannot purchase wholesale local exchange services or UNEs at economically efficient prices, they have been prevented from entering GTEC's local market in the same aggressive manner.

For these reasons, ORA and the Coalition argue that GTEC has failed to support its claim that increased competitive pressures warrant granting GTEC increased pricing flexibility at this time.

The Coalition proposes, at a minimum, that before the Commission contemplates GTEC's request for local service pricing flexibility, GTEC must provide market share information, and other relevant evidence, similar to the type of information that the Commission has requested from Pacific as part of its

"§ 271" filing documentation, and demonstrate that potential competitors can actually efficiently order and purchase UNEs at economically viable prices.

ORA notes that Pacific has lowered its price ceilings (tariffed rates) for local usage and ZUM calling in another proceeding, A.97-03-020, (D.98-07-033), its filing to offset the explicit California High Cost Fund-B (CHCF-B) subsidy with permanent rate reductions. ORA claims GTEC also could make a similar filing with the Commission to lower these tariff rates, thereby meeting competitive pressures without risking company revenues, as an alternative way to meet its alleged competitive pressures.

GTEC filed a third-round pleading on August 7, 1998, responding to the opposing parties.

GTEC disagrees with ORA's suggestion that GTEC can obtain lower rates, e.g., for ZUM, by offsetting the explicit California High Cost Fund-B (CHCF-B) subsidy with permanent rate reductions for these services.

In order to obtain an offset to any rates, GTEC must file an application, which would require further action by the Commission and a determination as to how that subsidy will be distributed. Thus, GTEC denies that such a measure would enable it to quickly obtain lower rates.

GTEC also provided additional information concerning its reduction in ZUM revenues, and the extent of facilities-based competition in its territory.

GTEC also claims that the limited pricing flexibility it may exercise on a customer-specific contract basis does not offer a satisfactory solution. GTEC argues that significant resources are required to develop and submit an Individual Case Bases (ICB) contract to the Commission. The Commission would be required to review each ICB, including the customer-specific cost floor support for each contract. As a result, GTEC does not believe ICBs are generally practical except for larger customers. An ICB would not be a practical solution to

offer lower toll rates to individual small business or residential customers, or to offer usage based calling plans for residential and small business customers. Thus, while it is true that the ICB process provides some limited flexibility, GTEC believes it does not provide sufficient flexibility and is a resource intense process.

### **Discussion**

We conclude that GTEC's requested modification should be granted, but in a modified form. At the time we placed the restriction on GTEC's use of pricing flexibility for Category II services, we did not anticipate the extended delay in the establishment of price floors in OANAD. GTEC must share responsibility for at least some of this delay. In D.96-08-021, the Commission cited various shortcomings in GTEC's cost studies, and ordered GTEC to make a compliance filing of adjusted price floors based on the filed TSLRICs. GTEC has also requested various extensions of time to file its cost studies. While GTEC's failure to submit acceptable cost studies has contributed to the overall delay in establishing price floors, however, there were various other contributing factors over which GTEC has had no control. In any event, our primary concern is whether the granting of GTEC's petition will further the overall goal of promoting a competitive local exchange market.

We concluded in D.96-03-020 that it would enhance competition to move most of GTEC's Category I services to Category II, concurrently with opening GTEC's local exchange market to competitors. We expected only a short interval of time to transpire before GTEC would have price floors approved in OANAD. On that basis, we deemed it reasonable to wait a short time for the adoption of those price floors before granting Category II pricing flexibility to GTEC. The outstanding question is whether, in view of the extended delay in adoption of OANAD price floors, should we permit GTEC to exercise Category II pricing

flexibility now before final price floors are established in OANAD. Price floors serve as a minimum price below which the ILEC may not price a Category II service, thereby preventing pricing below cost in an anticompetitive manner.

On the other hand, by restricting GTEC's ability to exercise Category II pricing flexibility, GTEC is precluded from competing in price against CLCs that are not restricted in the same way. Parties dispute the extent to which local competition has developed within GTEC's service territory since 1996, and whether GTEC has experienced competitive harm with respect to its provision of local service.

Without conducting an extensive inquiry as to the extent of competition within GTEC's service territory, we cannot make comprehensive findings of fact in this regard. For the limited authority sought in GTEC's Petition, however, we conclude that a sufficient showing has been made that GTEC has experienced some competitive losses in local service offerings since the opening of its markets to competition in 1996. As noted by GTEC, it experienced a significant reduction in ZUM revenues during the period March 1996 to December 1997, even with an increase in access lines. GTEC is also impeded in its ability to respond competitively to CLCs' discounted pricing of LMS service. CLCs often offer ZUM Zone 3 calling at the same rates as LMS. By being precluded from exercising pricing flexibility, GTEC is unable to offer packages of LMS, ZUM, and toll service at prices as low as its competitors. A customer can also bypass GTEC by using 1010xxx dialing for LMS and ZUM calling.

Moreover, we are unpersuaded that the GTEC's use of the CHCF-B subsidy provides an alternative solution to lower rates for Category II services. GTEC has approximately \$26 million to be offset as its CHCF-B subsidy. (See D.96-10-066, Appendix D in Docket R.95-01-020/I.95-01-021). Even if this

amount were all to be applied to ZUM and LMS (which has not at this time been determined), it would not significantly lower these rates.

Offsetting rates by the CHCF-B subsidy will still not provide GTEC with the desired pricing flexibility to address particular customer groups or segments, for example, to initiate usage based calling plans for residential or small business customers or to respond to customers seeking lower pricing on a packaged basis (i.e., local, ZUM, and toll).

In view of the unanticipated delay in the authorization for GTEC to engage in Category II pricing flexibility, the previous restriction imposed in D.96-03-020 warrants revisiting. We conclude it is reasonable to permit some limited price flexibility for tariffed Category II services given the unanticipated delay that has occurred in setting OANAD price floors. GTEC's interim price floors as provided for herein will be used during the period remaining before final price floors are set for GTEC in OANAD. This interim approach strikes a fair balance in view of the changed circumstances since the issuance of D.96-03-020, and will reasonably guard against anticompetitive pricing while providing an opportunity for GTEC to respond competitively to the pricing strategies of the CLCs.

We conclude that during the remaining interim period until final price floors are established in OANAD, it would promote a more competitive market to permit GTEC to obtain interim price floors for particular services using the advice letter process, as outlined in its Petition. Upon submission of an advice letter for a particular service, interim price floors can be set. We decline, however, to base interim price floors on GTEC's LRIC methodology. This methodology was previously approved for use in setting price floors for other services previously granted pricing flexibility such as CentraNet and toll (see D.94-09-065, Conclusion of Law 151). We also authorized GTEC to use the same



LRIC methodology in D. 96-03-020 for customer-specific contracts for Category II services.

We are concerned, however, that the use of a LRIC-based proxy could understate the price floors for Category II services. The LRIC standard which GTEC proposes to use is based on outdated information dating back to the Implementation Rate Design (IRD) proceeding. Consequently, the use of LRIC-based price floors as proposed could result in excessively low price floors, enabling GTEC to set its prices below cost with anticompetitive consequences. Moreover, if interim price floors were to be approved which were even lower than those yet to be approved in OANAD, then GTEC would have lessened economic incentive to devote necessary resources to finalizing the necessary cost and price studies to establish final price floors in OANAD. Such an outcome could have counterproductive results.

As a compromise measure, we shall adopt an alternative approach which provides GTEC with some interim pricing flexibility, but which does not rely upon the LRIC basis proposed by GTEC. Instead, we shall authorize interim price floors for GTEC based upon the methodology we recently approved for Pacific in D.99-11-050 in OANAD. In that decision, we adopted a methodology for price floors for Pacific whereby Pacific may price down to the volume-sensitive portion of the TSLRIC for the services at issue, plus the contribution for monopoly building blocks (MBBs). For purposes of Pacific's price floor formula, only three unbundled network elements (UNEs) were found to constitute MBBs, namely, the loop, ports (i.e, switching), and white page listings. The contribution imputed into the price floor for the MBBs, as prescribed in D.99-11-050, is the difference between the TELRIC-based price and the volume-sensitive portion of the TSLRIC for each of the three UNEs.

We shall thus apply this same price floor methodology on an interim basis to GTEC, using GTEC's most recently filed TELRIC study filed in OANAD as the basis for computing the contribution for the three UNEs, consistent with the approach adopted for Pacific in D.99-11-050. Although GTEC's studies remain to be litigated in OANAD, we find it reasonable to permit their use for the limited purpose of setting interim price floors on the basis outlined above.

As an interim measure until final price floors are adopted in OANAD, we conclude that the use of interim price floors on this basis is reasonable to enhance GTEC's ability to compete.

### **Comments on Draft Decision**

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g) and Rule 77.1 of the Rules of Practice and Procedure. Comments were filed on September 27, 1999, and reply comments were filed on October 4, 1999.

### **Findings of Fact**

1. In D.96-03-020, the Commission moved most of GTEC's local exchange services to Category II concurrently with opening the local market to competition.
2. While authorizing the Category II reclassification, the Commission deferred granting Category II pricing flexibility for GTEC's tariffed services pending the adoption of price floors in the OANAD proceeding.
3. Price floors serve as a minimum price below which the ILEC may not price a Category II service, thereby preventing pricing below cost in an anticompetitive manner.
4. The adoption of price floors in OANAD has been significantly delayed beyond the date originally anticipated in D.96-03-020 due to various factors.

5. The unanticipated delay in being authorized Category II pricing flexibility to GTEC has impeded its ability to respond competitively to the pricing of packaged local services offerings to business customers.

6. Although a LRIC-based methodology was previously approved for use by GTEC in setting price floors for certain other services which have been granted pricing flexibility, the use of LRIC as a basis for Category II price flexibility could enable GTEC to price below cost.

7. Although GTEC's currently submitted TELRIC studies remain to be litigated in OANAD, they provide a suitable basis to set interim price floors using the same methodology as adopted for Pacific in D.99-11-050.

8. The \$26 million amount which GTEC must offset as its CHCF-B subsidy is not large enough to significantly lower ZUM or LMS rates.

9. Offsetting rates by the CHCF-B subsidy would not provide GTEC with sufficient competitive flexibility to address particular customer groups or segments.

10. The pricing flexibility currently available to GTEC for customer-specific contracts is only practical in the case of larger customers, but not to small business or to residential customers.

### **Conclusions of Law**

1. During the remaining interim period until final price floors are established in OANAD, it would promote a competitive market to permit GTEC to obtain Category II pricing flexibility using interim price floors through the advice letter process, as outlined in GTEC's Petition.

2. The LRIC-based methodology previously approved in D.94-09-065 for use by GTEC in setting price floors for other services is not a reasonable interim basis for setting price floors for Category II services until permanent price floors are established in OANAD.

3. For interim purposes, price floors for GTEC's Category II services should be allowed using the same price floor methodology as adopted for Pacific in D.99-11-050 and based upon GTEC's most recently filed TELRIC studies in OANAD.

4. GTEC's Petition to Modify D.96-03-020 should be granted in accordance with the order below.

## O R D E R

**IT IS ORDERED** that:

1. The Petition to Modify Decision (D.) 96-03-020, as filed by GTE California Incorporated (GTEC) is hereby granted.
2. D.96-03-020 is modified, as set forth below:
  - a. Conclusions of Law 32 and 33 are modified, as follows (with modified text in bold):
    32. Category I services reclassified to Category II by this order should **continue to be priced at their currently tariffed rates with no pricing flexibility until appropriate costs studies are completed, and Category II price floors are adopted by the Commission, except that GTEC may seek interim pricing flexibility as provided for in this decision.**
    33. GTEC should be permitted to implement **interim pricing flexibility for the services reclassified as tariffed Category II services by D.96-03-020. Upon submission of an Advice Letter for a particular service, interim price floors would be set using the same methodology as adopted for Pacific in D.99-11-050, using GTEC's currently filed OANAD cost studies. The price floor methodology as adopted in D.99-11-050 is set equal to the sum of the contribution of the prescribed monopoly building blocks plus the volume-sensitive portion of the TSLRIC for the service. Interim floors would be replaced once relevant price floors are established for GTEC in the OANAD proceeding for the reclassified services.**

b. The following new ordering paragraphs (OPs) are added after OP 15:

16. GTEC may obtain interim pricing flexibility for services reclassified as Category II in this Decision through the Advice Letter process. Price floors for a service for which interim pricing flexibility is sought will be established using the methodology as outlined in Conclusion of Law 33 above. These interim floors will be replaced once the relevant price floors are established in OANAD for the reclassified service.

This order is effective today.

Dated December 2, 1999, at San Francisco, California.

RICHARD A. BILAS  
President  
HENRY M. DUQUE  
JOSIAH L. NEEPER  
JOEL Z. HYATT  
CARL W. WOOD  
Commissioners