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Decision 99-02-013 February 4, 1999

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Bell Communications for a Certificate of Public Convenience and Necessity to Provide InterLATA, IntraLATA and Local Exchange Telecommunications Services Within the State of California.	Application 96-03-007 (Filed March 5, 1996)

(See Attachment D for List of Appearances.)

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OPINION

1. Summary

This application was originally filed by Pacific Bell Communications (PB Com or applicant), an affiliate of Pacific Bell. This order grants a motion by applicant for an amendment to its application to substitute Southwestern Bell Communications Services (SBCS) as the applicant in this proceeding, subject to the same commitments made by PB Com and the same obligations placed upon PB Com. This decision grants a certificate of public convenience and necessity (CPCN) to SBCS to provide long distance service in California upon attaining approval to do so from the Federal Communications Commission (FCC). We grant applicant's request to withdraw that part of its application seeking authority to operate as a local exchange carrier in competition with Pacific Bell. Applicant also is granted authority to provide local toll service, with some restrictions on its request to be authorized to construct facilities for local toll service. Following our own and FCC guidelines, we will permit Pacific Bell to joint market the services of its long distance affiliate, using customer records where appropriate, in order for consumers to take advantage of one-stop shopping for all or most of their local toll, long distance and other telephone services. We adopt appropriate safeguards in this process to deter anticompetitive practices. We also impose an audit requirement to assist applicant in its compliance with the Commission's affiliate transaction rules. This proceeding is closed.

2. Introduction

PB Com is a California corporation, wholly owned by Pacific Telesis,[1] and is an affiliate of Pacific Bell. PB Com was formed to be the long distance carrier for Pacific Telesis. SBCS is a wholly owned subsidiary of SBC Communications, Inc. A separate company is required because the 1996 Telecommunications Act[2] requires that the entry of Bell operating companies, such as Pacific Bell, into the in-region long distance market must occur through a fully separate affiliate.[3] The separate affiliate requirement will expire three years after applicant begins service, unless the time period is extended by the FCC, and applicant at that time presumably could be merged into Pacific Bell.[4]

To begin long distance service, applicant must obtain authority both from this Commission and from the FCC. In this application, applicant seeks a certificate of public convenience and necessity under Public Utilities (PU) Code § 1001 to provide interLATA, intraLATA and local exchange telecommunications services throughout California.[5] After hearings, PB Com announced that it was willing to forgo its request for local exchange authority because, in its view, recent FCC rulings make that authority unnecessary.

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[1] By Decision (D.) 97-03-067, a merger of Pacific Telesis Group with SBC Communications, Inc. was authorized. The merger was consummated on April 1, 1997.
[2] Pub. L. No. 104-104, 110 Stat. 56, 47 U.S.C. §§ 151 et seq.
[3] 47 U.S.C. § 272(a)(1).
[4] 47 U.S.C. § 272(f)(1).
[5] "LATA" is an acronym for Local Access and Transport Area. With divestiture of the American Telephone and Telegraph Company in 1984, the territorial United States was divided into 163 geographic units, or LATAs, which in turn were divided among the 22 Bell operating companies created in the divestiture. Telephone calls within a LATA are called local exchange calls or intraLATA toll calls (when a toll is assessed). Telephone calls between LATAs are called interLATA calls.

The application is criticized by long distance companies and by two consumer organizations. They argue that applicant's intended reliance on Pacific Bell to assist the new long distance service must be restricted in view of Pacific Bell's near monopoly status in local exchange service. Applicant argues that it and Pacific Bell must be able to market aggressively if applicant is to compete against entrenched long distance companies.

Most of the evidence in this proceeding has dealt with proposed restrictions on applicant's new service. According to applicant, an FCC order issued on December 24, 1996, rules against most of the restrictions.[6] Opponents disagree, arguing that the FCC order and a companion order in CC Docket No. 96-150 leave to the states the authority to deal with most of the issues before us in this proceeding.

An overview of the issues and arguments of the parties is set forth in Attachments B and C to this opinion. Attachment B is applicant's listing of restrictions proposed by other parties, along with applicant's analysis of the effect of FCC orders on those restrictions. Attachment C was prepared by the consumer organization The Utility Reform Network (TURN). TURN presents what it believes to be the competitive advantages enjoyed by Pacific Bell/applicant, by AT&T, and by competitive local exchange companies. TURN argues that the competitive analysis shows an overwhelming advantage for Pacific Bell/applicant and should form the basis for consideration of restrictions on applicant.

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[6] Implementation of the Non-Accounting Safeguards of Sections 271 and 272, CC Docket No. 96-149, First Report and Order and Further Notice of Proposed Rulemaking (December 24, 1996).

3. Procedural Background

PB Com filed its application on March 5, 1996. Protests were filed by the California Telecommunications Coalition, representing long distance carriers and others [7]; the Association of Directory Publishers, and the Commission's Division of Ratepayer Advocates, now the Office of Ratepayer Advocates (ORA).

Following a prehearing conference in May 1996, the parties met at the direction of the Administrative Law Judge (ALJ) in an attempt to define and narrow the issues. A further prehearing conference in July led to a schedule for submission of prepared testimony and for hearings.

An early question was whether this proceeding was the proper forum for the Commission to consider whether Pacific Bell has complied with an FCC competitive checklist for unbundling, dialing parity, reciprocal compensation and resale of services to competing carriers.[8] The Commission is to advise the FCC of Pacific Bell's compliance or noncompliance at the time that PB Com seeks FCC approval to begin long distance service.

On August 9, 1996, the parties were advised by a Managing Commissioner's Ruling that over-all compliance with the competitive checklist would be considered in another forum, drawing participants from the Local Competition and the Open Access and Network Architecture Development

[7] The Coalition includes AT&T Communications of California, Inc.; California Association of Long Distance Telephone Companies; California Cable Television Association; MCI Telecommunications Corp.; Sprint Communications Co., L.P.; Teleport Communications Group, and TURN (The Utility Reform Network).
[8] 47 U.S.C. § 271(c)(2)(B), (d)(2)(B).

proceedings.[9] The ruling stated that the Commission also would consider in that forum Pacific Bell compliance with PU Code § 709.2, also known as the Costa Bill.

Notwithstanding the ruling, parties were advised that facts developed in this proceeding would be weighed against requirements of the Telecommunications Act, the Costa Bill and other provisions of the PU Code.

Ten days of hearings were conducted between December 2 and December 19, 1996. The Commission heard from witnesses representing PB Com; Pacific Bell; Pacific Telesis; ORA; MCI Telecommunications Corp. (MCI); AT&T Communications of California, Inc. (AT&T); California Cable Television Association (California Cable); Sprint Communications Co., L.P. (Sprint); and TURN. The Commission received 110 exhibits into evidence, including 46 exhibits which the parties agreed would be sealed because they contained information deemed to be proprietary.

Concurrent opening briefs were filed by the parties on January 31, 1997. Reply briefs were filed on February 14, 1997, at which time the application was deemed submitted for decision. On March 6, 1997, California Cable, AT&T and MCI petitioned to reopen the proceeding to receive a Pacific Telesis declaration and to permit limited additional briefing. By ALJ Ruling dated March 21, 1997, official notice was taken of the declaration and limited briefs were permitted, with the final briefs filed on April 4, 1997. After additional briefing in May 1997, the Proposed Decision of the ALJ was released to the parties in May 1997.

The Proposed Decision approved the application. However, it imposed a requirement that the marketing of applicant's services by Pacific Bell must be

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[9] The Local Competition proceeding is Rulemaking (R.) 95-04-043/Order Instituting Investigation (I.) 95-04-044; the Open Access and Network Architecture Development proceeding is R.93-04-003/I.93-04-002.

conducted by a separate sales force which would not have access to or use of the CPNI of Pacific Bell. In July 1997, an Alternate Decision was released by Commissioner Duque. The Alternate Decision eliminated the requirement for a separate sales force within Pacific Bell, relying instead on the use of scripts and sequencing to ensure that customer were properly informed of their rights respecting CPNI.

Both decisions recognized the FCC's stated intention to evaluate issues concerning use of CPNI in CC Docket No. 96-115, and held open the possibility that the FCC might produce a different method of handling CPNI concerns. On August 29, 1997, PB Com filed a motion asking that the Commission withdraw the Proposed and Alternate decisions from the public agenda pending results of the FCC proceeding. The motion for withdrawal was granted, and the two decisions were withdrawn on October 15, 1997.

The FCC released its order dealing with CPNI on February 26, 1998. Applicant filed a motion on April 17, 1998, asking the Commission to reopen the record to consider the FCC order, along with a separate motion seeking authority to substitute SBCS for PB Com because of the merger of Pacific Telesis Group into SBC Communications, Inc. A Prehearing Conference to consider these motions was held on June 25, 1998. On July 2, 1998, Assigned Commissioner Neeper ruled that further evidentiary hearings were not necessary. He invited the parties to brief the issues of the substitution of parties and of the FCC's ruling on CPNI and joint marketing.

Briefs were filed on August 25, 1998, by SBCS, AT&T, MCI, California Cable, the ICG Telecom Group, Inc. (ICG Telecom), ORA, and TURN. Reply briefs were filed on September 11, 1998.

4. Regulatory Requirements

Federal regulatory requirements for long distance service by an affiliate of Pacific Bell are addressed in § 272 of the Telecommunications Act. Section 272(a) of the Act provides that a Bell operating company such as Pacific Bell may only offer interLATA long distance service in its own region through a separate affiliate. Section 272(b) sets forth structural and transactional requirements applicable to these companies. Specifically, § 272(b) states that, "The separate affiliate required by this section:

> (1) shall operate independently from the Bell operating company;
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> (2) shall maintain books, records, and accounts in the manner prescribed by the [FCC] which shall be separate from the books, records, and accounts maintained by the Bell operating company of which it is an affiliate;
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> (3) shall have separate officers, directors, and employees from the Bell operating company of which it is an affiliate;
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> (4) may not obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the Bell operating company; and
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> (5) shall conduct all transactions with the Bell operating company of which it is an affiliate on an arm's length basis with any such transactions reduced to writing and available for public inspection."

Section 272(c) sets forth non-discrimination safeguards applicable to Pacific Bell in its dealings with an interLATA affiliate such as PB Com. Those safeguards state that "a Bell operating company:

> (1) may not discriminate between that company or affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or in the establishment of standards; and

> (2) shall account for all transactions with an affiliate described in subsection (a) in accordance with accounting principles designated or approved by the [FCC]."

Section 272(e), entitled "Fulfillment of Certain Requests," sets forth four additional provisions applicable to Pacific Bell and PB Com. Those provisions are that a Bell operating company:

> (1) shall fulfill any requests from an unaffiliated entity for telephone exchange service and exchange access within a period no longer than the period in which it provides such telephone exchange service and exchange access to itself or to its affiliates;
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> (2) shall not provide any facilities, services, or information concerning its provision of exchange access to the affiliate described in subsection (a) unless such facilities, services, or information are made available to other providers of interLATA services in that market on the same terms and conditions;
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> (3) shall charge the affiliate described in subsection (a), or impute to itself (if using the access for its provision of its own services), an amount for access to its telephone exchange service and exchange access that is no less than the amount charged to any unaffiliated interexchange carriers for such service; and
>
> (4) may provide any interLATA or intraLATA facilities or services to its interLATA affiliate if such services or facilities are made available to all carriers at the same rates and on the same terms and conditions, and so long as the costs are appropriately allocated."

4.1. PU Code Requirements

The PB Com application also must be weighed against requirements of the PU Code, particularly those sections added by the Costa Bill. PU Code § 709.2(c) requires that the Commission, before authorizing interLATA long distance competition in a proceeding like this one, shall have determined:

(1) that all competitors have fair, nondiscriminatory, and mutually open access to exchanges

(2) that there is no anticompetitive behavior by the local exchange telephone corporation, including unfair use of subscriber information or unfair use of customer contacts generated by the local exchange telephone corporation's provision of local exchange telephone service.

(3) that there is no improper cross-subsidization of intrastate interexchange telecommunications service.

(4) that there is no substantial possibility of harm to the competitive intrastate interexchange telecommunications markets.

5. Should SBCS Be Substituted for PB Com

PB Com has moved to amend its application, asking that the requested certificate of public convenience and necessity be issued to SBCS, a wholly owned subsidiary of SBC Communications Inc., rather than to PB Com. SBCS will do business and provide long distance service in California as "Pacific Bell Long Distance" instead of "Pacific Bell Communications." There are no changes proposed in the application other than the substitution of SBCS for PB Com and revisions of exhibits to reflect information about SBCS. The amended application reflects the fact that applicant withdrew its request for local exchange authority at the close of hearings.

Before the merger, both Pacific Telesis Group and SBC Communications Inc. had established separate long distance subsidiaries in order to comply with Section 272 of the Telecommunications Act of 1996.[10] PB Com is the subsidiary established by Pacific Telesis Group; SBCS is the subsidiary for SBC Communications Inc. The Commission reviewed and approved the merger in Decision (D.) 97-03-067, 177 PUR4th 462 (March 31, 1997),[11] acknowledging that the two companies planned to enter the long distance market through a single company to capture the efficiencies made possible by merger. (177 PUR4th at 467.)

Applicant states that it will provide service in California through SBCS and will liquidate PB Com. Headquarters for the company will continue to be located in Pleasanton, California, at the PB Com location. SBCS essentially has the same personnel as PB Com. The financial capacity of SBCS is documented in a support letter from SBC Communications Inc. Applicants state that SBCS has obtained certificates to provide long distance services from more than 40 other states. Both in its motion and at the Prehearing Conference on June 25, 1998, SBCS pledged to be bound by the record and findings in this proceeding, to comply with the Commission's affiliate transaction rules, to honor all commitments made by PB Com, and to assume the legal responsibilities of a successor in interest to PB Com.

For the most part, the substitution of SBCS for PB Com is unopposed by other parties, provided our decision makes it clear that SBCS is stepping into the shoes of PB Com and is legally bound to the same extent as PB Com in complying

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[10] Pub. L. No. 104-104, 110 Stat. 56, 47 U.S.C. §§ 151, et seq.

[11] Under the decision, Pacific Telesis Group became a wholly owned subsidiary of SBC Communications Inc. Pacific Bell remained a subsidiary of Pacific Telesis Group. and a second-tier subsidiary of the combined company.

with Commission requirements, including affiliate transaction rules. AT&T sought additional assurances, but it acknowledged at the Prehearing Conference that it would be reassured if SBCS agreed that it was bound "directly and indirectly" to the rules applicable to PB Com. SBCS acknowledged that it would be so bound. ICG Telecom is the only party opposing the substitution of SBCS, arguing that SBCS should be subject to discovery and cross-examination. ICG Telecom's argument is speculative, however, raising no material issue that has not been dealt with in this proceeding.[12]

Our order today grants the motion to substitute SBCS for PB Com as the applicant in this proceeding, making it clear that SBCS is bound directly and indirectly in the same manner as PB Com by the Commission's rules and regulations.[13] While the record discussion will refer to PB Com as the entity on whose behalf the evidence was presented, the order will be directed to SBCS.

6. Should There Be Restrictions on PB Com Authority?

The primary issue in this proceeding is whether PB Com should be authorized to provide long distance and local toll service with no restrictions beyond those already imposed by this Commission and by the FCC, or whether additional restrictions are necessary to recognize the market power that Pacific Bell enjoys as the provider of virtually all local exchange service and most intraLATA service in its territory.

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[12] At the Prehearing Conference, ICG Telecom disputed Pacific Bell's practices regarding competitive access to CPNI. ICG Telecom acknowledged, however, that it had raised, this issue in the Draft 271 Proceeding, consolidated dockets R.93-04-003/ I.93-04-002 and R.95-04-043/I.95-04-044.

[13] At the Prehearing Conference on June 25, 1998, SBCS through counsel agreed that it would be bound "directly and indirectly" in the same manner as PB Com. (Prehearing Conference Transcript, at 95.)

PB Com argues that it already is constrained by federal and state regulations, and that it needs all of the flexibility it can get to compete with the dominant long distance carriers. Long distance carriers, joined by ORA and TURN, argue that Pacific Bell's marketing power gives the Telesis companies an unfair advantage that, unless constrained, will work to the long-term disadvantage of consumers.

No party questions PB Com's financial and technical competence to provide telecommunications services. Rather, critics of the application challenge the claim of PB Com that its unrestricted entry into the long distance and intraLATA markets will be in the public interest.

7. Position of PB Com

According to PB Com, the evidence in this proceeding demonstrates that competition in the long distance market will benefit from the entry of PB Com. PB Com witnesses testified that the long distance market in recent years has seen increased prices to consumers, despite reductions in access charges that are a major cost factor for long distance service.

PB Com witness Richard D. Emmerson, an economist, testified that the long distance market is not fully competitive despite the presence of more than 100 service providers across the country and the passage of more than 13 years since divestiture. He concluded that "PB Com's entry could very likely improve, perhaps significantly, the economic performance of the interLATA interexchange market." (Ex. 102, at 8-9.)

Robert Sofman, head of marketing for PB Com and a former marketing manager for AT&T, testified that today's national long distance market is dominated by three carriers (AT&T, MCI and Sprint), which collectively control 95% of consumer long distance revenue. He stated that these three carriers also dominate the residential long distance market with 93% of the households.

(AT&T and MCI state that more recent data from the FCC's report on Long Distance Market Shares First Quarter 1998, issued on June 5, 1998, show that AT&T, MCI and Sprint have 73.6% of customer long distance revenue and 85.2% of the nation's presubscribed lines.) Sofman said that this domination exists despite the presence of hundreds of "niche" competitors because of the major carriers' brand strength and their substantial advertising, attributes which he said PB Com will match. Referring to an AT&T rate increase of 5.9% in November 1996, and smaller increases by MCI and Sprint at the same time, Sofman said:

> "I think it's fair to say that...competition is not resulting in downward pressure on price, and I think the recent pricing actions of the three big carriers is evidence that there's not enough vigorous competition to have sustained downward pressure on price." (Transcript, Vol., 4, p. 492.)

Daniel O. Jacobsen, PB Com regulatory director, testified that PB Com intends to supplement the services provided by Pacific Bell, rather than compete for business that otherwise would remain with Pacific Bell, stating:

> "It is not our intention to target any of our marketing or do any promotions or do anything that would go after customers that would be better served or ... be inclined to buy service from Pacific Bell." (Transcript, Vol. 3, pp. 302-303.)

PB Com witnesses emphasized the importance of one-stop shopping, i.e., the ability to offer customers a bundled product of local, local toll and long distance service. They stated that other carriers are offering bundled products today, and that Pacific Bell, when authorized, expects to similarly compete by selling PB Com long distance and local toll services with Pacific Bell's local exchange service.

Sofman testified that PB Com will utilize a variety of marketing techniques, including advertising and direct marketing, but that 50% to 60% of its new long

distance customers are expected to come from Pacific Bell sales efforts. Under Commission affiliate transaction rules, he said, PB Com would pay for the time spent by Pacific Bell representatives (at the higher of fully distributed cost plus 10%, or market price) and will pay a 13% commission on sales.[14]

Jacobsen acknowledged in his testimony that Pacific Bell representatives will make use of Pacific Bell subscriber records in selling PB Com services. These records are called Customer Proprietary Network Information (CPNI), and include data related to the quantity, technical configuration, type, destination and amount of use of a subscriber's telephone service. Jacobsen said that no such use of CPNI would be made without first obtaining a customer's permission, that Pacific Bell would use CPNI on behalf of PB Com but would not disclose CPNI to PB Com without written authorization. He testified that Pacific Bell has internal procedures in place to prevent unauthorized use of a customer's confidential records.

7.1. Separate Affiliate Status

Under the Telecommunications Act, the long distance affiliate of a Bell operating company must operate independently, maintain separate books, have separate officers and employees, obtain no credit through the Bell company, and conduct all transactions with the Bell company on an arm's-length basis, with transactions reduced to writing and available for public inspection.[15] Further, in § 272(c) of the Act, Congress directed that a Bell company may not discriminate between its affiliate and any other entity in providing services,

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[14] PB Com cites the Commission's affiliate transaction rules set forth in D.86-01-026, 20 CPUC2d 237; D.87-12-067, 27 CPUC2d 1, and D.92-07-072, 45 CPUC2d 109.
[15] 41 U.S.C. § 272(b).

facilities and information. In § 272(d), the Act establishes audit procedures to ensure that the Bell companies comply with these requirements.

PB Com witnesses testified that the company has been organized to comply with the federal requirements. Michael Silacci, regulatory director for Pacific Telesis, testified that PB Com also will operate in compliance with this Commission's affiliate transaction rules. He testified that these rules, stemming from Commission decisions in 1986 and 1987 involving other Telesis affiliates,[16] include the following:

* PB Com will pay the tariff rate for any service from Pacific Bell that is offered under tariff.

* PB Com will pay the higher of fully distributed cost plus 10%, or a market rate, for any Pacific Bell service not offered under tariff.

* PB Com will pay a transfer fee of 25% of the annual salary of any Pacific Bell employee transferred to PB Com.

* PB Com will pay for Pacific Bell sales activities at the higher of fully distributed cost plus 10%, or market rate, and an additional 13% on revenue for a successful sale.

* Pacific Bell will report to the Commission any pending sale or transfer to PB Com of an asset with a fair market value in excess of $100,000.

* Pacific Bell will seek advance approval by the Commission on any guarantee of securities or debt obligations for PB Com. (Ex. 55 at 4-6.)

Silacci testified that, given the Commission's current ratemaking treatment of Pacific Bell, in which rates are subject to price caps and essentially frozen,

[16] D.86-01-026, 20 CPUC2d 237; D.87-12-067, 27 CPUC2d 1.

there is no risk that Pacific Bell customers would pay higher prices as a result of services provided to PB Com.

8. Position of ORA

Through its witness, economist Douglas W. Elfner, ORA maintains that restrictions must be imposed on PB Com to prevent it from competing unfairly for long distance business and draining resources from Pacific Bell that could mean deterioration of service or higher rates for Pacific Bell ratepayers. ORA recommends that the Commission apply a ratepayer indifference standard to dealings between Pacific Bell and its affiliate. Specifically, ORA urges the Commission to require that:

* Pacific Bell fully inform customers on incoming calls of their right to select a long distance carrier of their choice before Pacific Bell markets the services of PB Com.

* Pacific Bell conduct a market study demonstrating that PB Com services will not financially harm Pacific Bell.

* PB Com select a different and dissimilar name or be subject to marketing restrictions on calls that it receives that were intended for Pacific Bell.

* Non-tariffed services provided by Pacific Bell to PB Com be limited to those that are critical or essential.

* An independent audit of transactions between Pacific Bell and PB Com be conducted to ensure compliance with Commission orders.

* PB Com be regulated as a dominant carrier rather than a nondominant carrier if ORA's other safeguards are not adopted.

* PB Com be authorized to provide only those local and/or intraLATA toll services in Pacific Bell territory that it purchases from Pacific Bell.

* Pacific Bell demonstrate that it is not harmed in the transfer of an employee to PB Com.

In support of these proposals, ORA presented evidence through Elfner intended to show that Pacific Telesis has incentives to subsidize PB Com at the expense of Pacific Bell, that existing safeguards are inadequate to fully protect consumers and competition, that approval of PB Com's application is likely to reduce Pacific Bell revenues and cause its network to deteriorate, and that joint marketing proposed by PB Com may lead to inappropriate affiliate transactions.

Elfner testified that the likelihood of cross-subsidy is increased when one company is regulated because of its monopoly status and a sister company is not regulated. Price cap regulation of Pacific Bell has not eliminated this incentive, he said, adding:

> "The CPUC has established an 11.5% benchmark rate of return and a ceiling rate of return of 15% for PacBell. Earnings between the benchmark and ceiling returns are to be split evenly between ratepayers and the Company...PacBell and [the Pacific Telesis Group] have incentives to shift or allocate costs to their regulated operations that would be properly attributed to their competitive ventures so that PacBell may avoid sharing any earnings above the benchmark with ratepayers. Similarly, they have an incentive to shift profits to operations, such as those of PB Com, that may not be subject to any earnings sharing." (Ex. C-64 at 12.)

Elfner stated that existing affiliate transaction rules did not anticipate an application like that of PB Com, where an affiliate would compete with its sister company for intraLATA business. As subsidiaries of a common parent, Pacific Bell and PB Com have a shared objective – to maximize Telesis profits. Elfner testified that Telesis internal documents show plans to "migrate" high value customers from Pacific Bell to PB Com by offering one-stop shopping service. Despite repeated discovery requests, he said, the Telesis Group has provided ORA with no documented projections of toll revenues, customers or net income

expected to be lost by Pacific Bell as a result of PB Com's activities. Internal documents also show an intent, he said, to develop new services through PB Com instead of Pacific Bell. Elfner stated:

> "By offering such services in PB Com and not PacBell, [Pacific Telesis] would be able to migrate customers requiring those services to PB Com..." (Ex. C-64 at 29.)

Elfner noted that PB Com in its application reserves the right to build its own facilities for local toll services, in addition to purchasing such capacity from Pacific Bell. The risk of facilities-based service, he said, is that Telesis would pump resources into PB Com that otherwise would go to the Pacific Bell system. Competitors would be disadvantaged by such a tactic, he said, since they rely on Pacific Bell facilities for their resold services.

ORA recommends that should its proposed safeguards not be adopted, PB Com be regulated as a dominant carrier, like Pacific Bell, rather than as a nondominant carrier, like all other new long distance companies. It cited Elfner's testimony that price floors for PB Com services are necessary to be sure that PB Com services are not subsidized and priced below cost. Without dominant carrier status, or similar restrictions, Elfner testified that PB Com will have the incentive and opportunity to leverage Pacific Bell's market power in its own behalf and to engage in anti-competitive activity.

9. Position of AT&T and MCI

In a joint brief, AT&T and MCI urge the Commission to adopt restrictions on PB Com to curb potential misuse of what they term the "enormous market power" of Pacific Bell. AT&T and MCI witnesses testified that while local exchange markets recently have been opened to competition, entry into that market will be slow. Nina W. Cornell, an economist and former FCC official, estimated that it will be at least five years before most California customers have

a choice of facilities-based local exchange carriers. Pacific Bell has 94% of intraLATA local toll residential customers in its service area. AT&T's witness, Nicholas S. Economides, testified that Pacific Bell also enjoys a monopoly in the provision of access service, the service that long distance carriers need from incumbent local exchange carriers to originate and terminate long distance calls.

AT&T and MCI presented evidence showing that most of the officers and a majority of employees of PB Com have transferred from Pacific Bell jobs, and that PB Com has contracted with Pacific Bell for network engineering services. According to the interexchange carriers, the record also demonstrates that Pacific Telesis is coordinating the relationship between Pacific Bell and PB Com, selecting and managing the firms that will provide advertising and conduct market research. Relying on internal Telesis documents, AT&T claims that Telesis has taken an active role in determining the markets that each of its affiliates will pursue.

Cornell testified that because Pacific Bell serves as the administrator for long distance change orders for all carriers in its service territory, the danger of competitive abuse is significant. She testified:

> "If joint marketing were to take place in the manner described [by PB Com], Pacific Bell would no longer be providing information on interLATA carriers in a nondiscriminatory manner to end users. This would constitute a very significant anticompetitive abuse of the local exchange bottleneck...To allow Pacific Bell to make...a pitch for PB Com when customers call to establish [local exchange] service, move service, or to change their choice of an interLATA carrier would be a very unfair use of Pacific Bell contacts." (Ex. 67, at 8-9.)

Cornell recommended that Pacific Bell be prohibited from marketing PB Com long distance service on incoming customer calls to establish telephone service, to move service, or to change interLATA long distance carriers. Moreover, she urged that Pacific Bell be instructed not to use customer

proprietary records on behalf of PB Com unless it was willing to share those records with long distance competitors of PB Com.

AT&T and MCI witnesses testified that the long distance market in California already is highly competitive, and that entry of PB Com, with corporate costs 15% higher than AT&T's, is unlikely to affect prices on any long-term basis.

Economides urged that PB Com be regulated as a dominant carrier, reasoning that it shares the same ownership and interests of Pacific Bell and "can utilize the near monopoly position of Pacific Bell in the local exchange market for anti-competitive purposes, including vertical price squeezes and cross-subsidization." (Ex. C-72 at 18.) In this manner, he said, PB Com should be required to price all services above its cost of non-access components, plus the price for access paid by other carriers. PB Com's price floor should be set at the tariffed prices all carriers pay for wholesale local exchange and toll services, plus the total-service long-run incremental costs PB Com incurs for other service components.

The interexchange carrier witnesses also recommended that PB Com be required to follow the more detailed Part 32 Uniform System accounting method, and that it be subject to an annual audit of its affiliated transactions. AT&T and MCI also urged the Commission to require that Pacific Bell's access charges be priced at competitive levels, thus reducing what they termed a principal source of cross-subsidization between Pacific Bell and its long distance affiliate.

10. Position of TURN

TURN, representing residential and small business telephone users, believes that PB Com will contribute little to long-run price relief for long distance service and that its entry into local toll service may actually harm consumers by taking business away from Pacific Bell, which then could seek

higher rates to compensate for the loss. TURN's two witnesses, Regina Costa and Thomas J. Long, testified that Pacific Telesis internal documents show that because Telesis costs are 15% higher than AT&T's, any gains PB Com makes in the long distance market will be based on the market power of its affiliate, Pacific Bell, rather than on competition based on efficiency or lower costs. In its brief, TURN comments:

> "PacBell Comm's public story...is that PacBell Comm will be a separate affiliate that should be treated the same as any other new player trying to break into the interLATA and intraLATA markets. The story also holds that PacBell's customers have no reason to fear any impact on PacBell resulting from PacBell Comm's entry into the marketplace. The applicant also insists that PacBell Comm will be the tonic that the interLATA market needs in order to cure that market's competitive anemia.
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> " Few cases have underscored as well as this one the value of discovery and cross examination in testing the validity of an applicant's assertions. Simply put, PacBell Comm's cover story crumbled in the face of cross examination and particularly when held up against the 'highly confidential' internal documents that disclose the [Pacific Telesis Group] family's true intentions....[T]he evidentiary record discloses that PacBell and PacBell Comm will pursue a coordinated effort to exploit PacBell's monopoly power as much as regulators will let them. The record shows that the applicant has no substance to support its feel-good optimism about the impact of its plans on PacBell's financial health. Thanks to the evidentiary hearings, we now know that PacBell Comm's plan for success in the interLATA market depends not on cost or efficiency advantages but on its plan to exploit PacBell's monopoly power." (TURN Opening Brief, pp. 7-8.)

TURN's witnesses attacked the plans by which PB Com would joint market its long distance service by having Pacific Bell customer service representatives seek to sell such service on virtually all incoming calls to Pacific Bell. They stated that Pacific Bell receives tens of millions of calls each year because of its position

as a monopoly local exchange carrier, that unrestricted marketing of PB Com on most of those calls would be an abuse of Pacific Bell's monopoly power, and that the planned use by Pacific Bell of customer records on behalf of PB Com would discriminate unfairly against other long distance competitors.

To cure these and other defects, Long made the following recommendations in his testimony:

* PB Com should be authorized to provide interLATA long distance service, but it should not be authorized to provide local exchange or intraLATA service.

* If PB Com is permitted to provide local or intraLATA services, such services should be regulated exactly as they would be regulated if they were provided by Pacific Bell. (TURN also supports ORA's recommendation that no facilities-based local or intraLATA service be authorized.)

* With respect to interLATA long distance service, PB Com should be treated as a dominant carrier and required to establish price floors that are based on total service long run incremental costs.

* Pacific Bell should be permitted to jointly market PB Com services through mail and outbound telemarketing. On inbound calls to Pacific Bell, joint marketing should be allowed only by a staff separate and distinct from Pacific Bell service representatives. The separate staff should have no more access to customer CPNI than the marketing personnel of competing long distance providers.

* Customers should be advised of their rights to deny access to CPNI.

11. Position of ICG Telecom Group

The ICG Telecom Group presented no witnesses at hearing, but it participated in discovery and in cross-examination, and it has filed opening and reply briefs. ICG makes essentially four recommendations:

1. In view of PB Com's decision to continue to seek authority to resell the intraLATA toll services of Pacific Bell, the Commission should take steps to ensure that Pacific Bell does not suffer financial harm through the loss of high value customers to PB Com.

2. In order to ensure that PB Com does not benefit from discriminatory use of CPNI on its behalf by Pacific Bell, the Commission should require Pacific Bell to use a separate staff of customer service representatives when it engages in joint marketing on behalf of PB Com.

3. Based on PB Com's statements that it expects to purchase telecommunications services from Pacific Bell pursuant to tariffed rates, the Commission should prohibit PB Com from buying services or unbundled network elements from Pacific Bell through special contracts.

4. The Commission should recognize that Pacific Telesis will have strong incentives to allocate PB Com costs to Pacific Bell, which then can seek to recover those costs in the "NRF review" and "franchise impacts" cases that the Commission may hear later this year. Accordingly, the Commission should serve notice that it will consider the costs and revenues of Pacific Bell and PB Com as though they were a single firm.

ICG Telecom is particularly concerned that when PB Com acts as a reseller of Pacific Bell's intraLATA toll services, opportunities for shifting costs to Pacific Bell become available (so that costs stay within the new regulatory framework mechanism, thereby limiting Pacific Bell profits and ratepayer sharing), while opportunities for shifting revenues to PB Com are also increased (so that revenues stay outside of the new regulatory framework sharing mechanism). If the Commission does not implement safeguards, ICG states, it could "end up with Pacific in dire financial circumstances pleading that it must have 'regulatory reform.'" (ICG Telecom Group Reply Brief, p. 12.)

Like TURN, ICG Telecom also urges the Commission to require that joint marketing of PB Com services be done by a separate staff of Pacific Bell customer service representatives to prevent discrimination in favor of PB Com. According to ICG, joint marketing then would proceed in the following manner:

> "If a 'regular' Pacific Bell CSR learns that an inbound caller wishes to discuss the selection of an interLATA service provider, the CSR can: (1) provide an appropriate equal access message regarding the customer's right to choose an interLATA carrier from a randomly generated list of carriers and/or (2) process the caller's request for a particular carrier (if such a request is made by the caller, and then, and only then, if the customer has not selected an inter- and intraLATA carrier or has indicated that he/she wishes to select or learn more about the services of PB Com, (3) offer to refer the caller (on the same call...) to a 'specially trained Pacific Bell service representative' who can discuss with the caller the rates, terms and conditions of services offered by PB Com." (ICG Telecom Group Reply Brief, pp. 16-17.)

12. Position of California Cable Television

California Cable initially urged the Commission to find that the evidence in this proceeding shows that Pacific Bell and PB Com will act in concert, rather than on an arm's-length basis, to assure maximum profits for their parent company, Pacific Telesis. Because of this "symbiotic relationship," California Cable urged that dominant carrier regulation be applied to PB Com, just as it is to Pacific Bell, in order to curb potential abuses in providing equal access to other carriers, preventing misuse of CPNI, and curbing joint marketing practices that could be anticompetitive.

Following PB Com's announcement that it was willing to forgo its request for local exchange authority, California Cable states that the need for dominant regulation of PB Com "is substantially lessened." It continues, however, to urge restrictions "regarding Pacific's use of its monopoly bottleneck to misuse CPNI and ignore [the] equal access requirement." (California Cable Reply, p. 3.)

13. Position of Sprint

Sprint presented testimony recommending that PB Com's intrastate service offerings and rates be regulated under dominant carrier status, and that PB Com's purchase of carrier access services, wholesale services and unbundled elements be at terms available to PB Com's competitors. On cross-examination, Sprint acknowledged that it has plans in place to enter the California local exchange market in competition with Pacific Bell. After hearings closed, Sprint notified the Commission on January 31, 1997, that because of the FCC's recent order on Non-Accounting Safeguards, Sprint had concluded that its interests did not require submission of briefs in this proceeding.

Issues

14. Local Exchange Authority

PB Com initially sought authority to provide resold local exchange service, as well as interLATA long distance and intraLATA toll service, in order to bundle telephone services and offer customers one-stop shopping. PB Com witnesses testified that having a single telephone company for all services appeals to many consumers, and that long distance carriers, particularly MCI, already are offering one-stop shopping in certain California markets.

The FCC in its order on Non-Accounting Safeguards concluded that the Telecommunications Act does not bar an affiliate like PB Com from providing local exchange service, provided that the arm's-length requirements of § 272 of the Act are not circumvented by a transfer of access facilities to the affiliate.[17] The FCC also noted that state commissions could regulate affiliates offering local and

[17] FCC Order 96-149, ¶ 309.

long distance service differently than they could an affiliate offering only long distance service.[18]

ORA, TURN and long distance companies opposed PB Com's entry into the local exchange market, arguing that such a move could mean increased income for Pacific Telesis as a whole, even though it would take revenue away from Pacific Bell. TURN commented:

> "Such an outcome would be in the obvious interest of the [Pacific Telesis] shareholders, but contrary to the interest of PacBell's captive customers who likely would be asked to pay higher rates to bolster PacBell's finances." (TURN Opening Brief, p. 19.)

Long distance carriers also presented evidence to show that Pacific Bell already has difficulty in filling change orders for other carriers that seek to provide resold local exchange service, at one time limiting such changes to 400 a day, increasing to about 2,000 per day five days a week earlier this year, as contrasted with up to 80,000 daily intraLATA changes that Pacific Bell is able to process because that procedure is more automated. AT&T witnesses said that adding PB Com orders to switch local exchange customers could further overwhelm Pacific Bell's capacity, and could provide an opportunity for preferential treatment of Pacific Bell's affiliate.

Much of this argument was made moot when PB Com announced in its opening brief that it was willing to forgo its request for local exchange authority because, in its view, the FCC order on Non-Accounting Safeguards permits joint marketing of PB Com services by Pacific Bell with no additional restrictions. According to PB Com, this capability obviates its need to be a competitive local exchange carrier. PB Com cautioned, however, that its withdrawal of the request

[18] Id., ¶¶ 310, 311.

for local exchange authority was premised on its not being "burdened with a host of restrictive conditions which limits its ability to compete." (PB Com Opening Brief, p. 2.)

14.1. Discussion

An applicant for a certificate of public convenience and necessity has the burden of showing that the public interest requires that we grant the authority sought. (P.M.T. Co. (1938) 41 CRC 817.) The California Supreme Court has stated that the Commission has "the duty to consider all facts that might bear on" the public interest. (United States Steel Corp. v. Public Utilities Com. (1981) 29 Cal.3d 603, 608.)

PB Com at hearing presented no evidence of the effect on Pacific Bell (and Pacific Bell ratepayers) of PB Com competition in the local exchange arena. Every customer switched from Pacific Bell local service to PB Com local service would mean a reduction in revenue for Pacific Bell (the difference between collecting a retail rate and a reseller wholesale rate for that customer). If history is any guide, Pacific Bell would seek to offset revenue losses through increased rates or additional charges.

Confidential Pacific Telesis documents introduced into evidence make it clear that the corporation is at least aware that PB Com could offer lower-priced packages of telephone services, including local exchange, to high-value customers, while seeking additional charges for Pacific Bell services to offset the loss of business to PB Com. Under such a scenario, Pacific Bell in effect would be subsidizing its affiliate, potentially in violation of the cross-subsidization prohibitions of the Costa Bill, PU Code § 709.2(c)(3).

The only justification PB Com offers for seeking local exchange service is its enhanced ability to provide one-stop shopping for consumers who want all of their telephone services provided by a single carrier. As PB Com's

own witnesses testified, however, a customer's perception of being served by a single company essentially is achieved when Pacific Bell can jointly market its own services and those of a long distance affiliate that shares the Pacific Bell name.

PB Com states that the FCC in its Non-Accounting Safeguards order has found that the Telecommunications Act not only permits PB Com to enter the local exchange market but appears to prohibit state regulations that would prevent such entry.[19] While we do not agree with the inference that this Commission is preempted in its authority to deny PB Com's application to provide local telephone service,[20] it is not necessary for us to reach that jurisdictional question.

We find that PB Com has in fact asked to withdraw its application for local exchange authority, and we grant that request. We reject PB Com's effort to condition its withdrawal on how the Commission deals with joint marketing matters. The Commission's jurisdiction to decide an issue that an applicant has put forward for decision cannot be conditioned on whether the applicant is satisfied with the Commission's decision.

We find further that PB Com has failed in this proceeding to meet its burden of showing that public convenience and necessity require the granting of local exchange authority. ORA and TURN, in particular, have presented evidence showing the likelihood that PB Com's entry into the local exchange market could cause substantial financial harm to Pacific Bell ratepayers, and PB Com has failed to rebut that showing. Further, PB Com has failed to show

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[19] Id., ¶¶ 312-315.

[20] The Commission, among others, successfully challenged an FCC order that purportedly preempts state authority over certain aspects of intrastate telephone service. See California, et al. v. FCC, et al. (8th Cir. 1997) 124 F.3d 934.

effective safeguards that it would put in place to prevent loss of revenue by Pacific Bell based on PB Com's local exchange offerings.

If such authority were to be granted in any subsequent proceeding, we would be compelled on this record to regulate such authority under dominant carrier regulation, as proposed by TURN and other parties, or to condition such authority upon our approval of the study recommended by ORA that would demonstrate that Pacific Bell's net income would not be reduced as a result of our action. The FCC has recognized the authority of individual states to impose this type of regulation or condition, or both, on affiliated companies seeking to provide integrated telephone services.[21]

15. IntraLATA Authority

PB Com seeks authority to provide resold and facilities-based intraLATA authority. Resold intraLATA capacity would be purchased from Pacific Bell at terms available to any carrier, then marketed by PB Com in conjunction with its long distance service. With facilities-based authority, PB Com could construct its own transmission facilities to carry intraLATA traffic.

While the record shows that relatively little competition exists in the local exchange market, there are, by contrast, hundreds of telephone carriers in California seeking to provide long distance and intraLATA service. Our decision in the IntraLATA Presubscription Phase of the Alternative Regulatory Frameworks proceeding required Pacific Bell to make intraLATA equal access (the ability to place local toll calls through another telephone carrier without having to dial additional numbers) available to competing carriers at the time

[21] FCC Order 96-489, ¶ 317.

that PB Com begins providing long distance service.[22] PB Com witnesses testified that their company must be able to bundle long distance and local toll service in order to compete effectively.

Only TURN urged initially that the Commission deny intraLATA authority to PB Com, and it acknowledged in its brief that such a ruling could conflict with the FCC's Non-Accounting Safeguards order.[23] If the Commission grants intraLATA authority, TURN urges that such service be regulated in the same manner as Pacific Bell's intraLATA authority (with new regulatory framework price floor and price ceiling requirements) to prevent attempts to steer business to PB Com in order to evade price floor requirements.

ORA does not object to PB Com's application for intraLATA authority, but it opposes PB Com's request for facilities-based authority, expressing a concern that Pacific Telesis would construct new facilities for PB Com instead of Pacific Bell. PB Com witnesses testified that the new affiliate has no intention of constructing new facilities that would be redundant with those operated by Pacific Bell. PB Com's director of regulatory and external affairs testified that he anticipates no need for construction of intraLATA facilities in PB Com's early years of operation, but he believes such authority would be useful if conditions change.

The difficulty with that, according to ORA witness Elfner, is that facilities-based authority, if granted, would not be limited. Despite what PB Com intends

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[22] D.97-04-083, issued on April 23, 1997. A motion was recently filed by AT&T, CALTEL, MCI and Sprint to modify D.97-04-083 to authorize intraLATA equal access by February 8, 1999, whether or not PB Com has commenced offering long distance service. See also AT&T Corp.,et al. v. Iowa Utilities Board, et al. (January 25, 1999; No. 97-826).

[23] FCC Order 96-489, ¶ 312.

at this time, ORA is concerned that open-ended authority in the intraLATA market would tempt PB Com's parent company, Pacific Telesis, to divert resources from the Pacific Bell network to a PB Com network. Elfner testified:

> "Under PB Com's proposal, PTG [Pacific Telesis Group] would have an incentive to devote scarce capital resources to PB Com's network, instead of PacBell's. Diversion of capital from PacBell's network to PB Com's may allow PTG to retain high value customers of PB Com, while also retaining PacBell customers that are not as likely to be lost to competitors. As a result, investment in PacBell's network may be less than otherwise, thereby affecting PacBell's service quality and slowing the introduction of new services." (Ex. C-64, p. 28.)

Elfner testified that a Telesis business plan describes new services that would be offered by PB Com, rather than Pacific Bell. If such services were facilities-based, he said, those capabilities would apparently be available only to PB Com and its customers, and not to PB Com's competitors, since PB Com is not required to make its services available for resale.

Sprint's witness Purkey raised similar concerns, recommending that PB Com be required to file for Commission approval when it seeks to construct intraLATA facilities. Such a filing, Purkey testified, would permit the Commission to monitor whether PB Com facilities were being built at the expense of improvements to the Pacific Bell system.

On rebuttal, PB Com witness Jacobsen termed Sprint's proposal "entirely inappropriate." He testified:

> "None of PB Com's competitors have to obtain approval before constructing each specific facility. Under the price cap form of regulation adopted in D.89-10-031, the Commission no longer pre-approves Pacific Bell's construction because its new regulatory framework/price-cap arrangement eliminates the need for pre-approval of plant additions. It makes no sense for a

> pre-approval process to apply to PB Com when the Commission has already abandoned it for Pacific Bell." (Ex. 2, pp. 10-11.)

Jacobsen testified that the separate operating requirements and the audit requirements imposed by the Telecommunications Act will prevent inappropriate coordination of construction by Pacific Bell and PB Com.

15.1. Discussion

PB Com has presented persuasive evidence that it can purchase intraLATA capacity from Pacific Bell (on terms available to other carriers) and package that capacity with long distance service in an offering that can enhance competition in the long distance and toll markets in California. No party except TURN opposes PB Com's entry into the intraLATA market, based on its plans for reselling such service after purchasing it from Pacific Bell.

By contrast, however, PB Com has presented no evidence of a need for facilities-based intraLATA authority, other than a vague desire to have that authority in the event that a need for intraLATA facilities develops. On cross-examination, PB Com witnesses could provide no example of intraLATA facilities likely to be required in the early years of PB Com's operation, with the possible exception of tandem switches.

Balanced against that showing is ORA's evidence, although for the most part speculative, that facilities authority could provide an incentive for Pacific Telesis to divert capital investment from Pacific Bell intraLATA service to PB Com intraLATA service, to the detriment of Pacific Bell and its ratepayers. Similarly, competition could be affected, in that while Pacific Bell is required to make its facilities-based intraLATA service available for purchase by other carriers, PB Com faces no such requirement.

Our order today grants PB Com's request for authority to offer resold intraLATA service. We reject the arguments of some parties that PB Com

should be required to purchase intraLATA capacity only from Pacific Bell, since that would impede the ability of PB Com to compete and to seek out the most advantageous capacity agreement available in different parts of the state. Under the Telecommunications Act, intraLATA capacity that PB Com can purchase from a facilities-based carrier will also be available to PB Com's competitors.

The original proposed decision in this matter denied PB Com's request for facilities-based authority for intraLATA service, without prejudice to PB Com's right to renew that request if and when a need for such authority presented itself. In comments to the proposed decision, however, PB Com argued that the record supports granting limited facilities authority in Pacific Bell territory, and unlimited facilities authority outside Pacific Bell's franchise territory. PB Com states that this would respond to the objections of ORA and Sprint that unlimited authority in Pacific Bell territory could cause Telesis to construct facilities for PB Com at the expense of facilities that would have been built for Pacific Bell.

On reflection, we have decided to grant this more limited request by PB Com for facilities-based authority, since we believe that it will contribute to competition. We note that reply comments of other parties do not appear to oppose the request, with the exception of ORA, which opposes in-region intraLATA authority. Accordingly, our order today grants facilities-based intraLATA authority to PB Com outside of Pacific Bell's franchise territory, and it grants limited facilities-based authority within Pacific Bell territory. The limit permits construction of tandem switches and other network elements that will permit PB Com to offer common features for both intraLATA and interLATA long distance services. However, PB Com is not authorized to construct intraLATA transmission and end-office switching facilities in Pacific Bell's franchise territory pending a further showing.

We note that PB Com has complied with environmental requirements for facilities-based authority.[24] The environmental review process for facilities-based authority can be the most time-consuming aspect of a request for new facilities, and thus we do not anticipate an unreasonable delay in authorizing additional intraLATA facilities for PB Com if a legitimate need develops and is presented to us. By requiring that PB Com seek that authority at the time it has specific plans for other facilities construction, both the Commission and other parties will have an opportunity to weigh the request based on actual construction instead of speculation of what construction might occur.

16. InterLATA Long Distance Service

The Telecommunications Act contemplates that Bell operating companies may enter the long distance market through separate subsidiaries after meeting substantial conditions. Hence, no party opposes PB Com's application to become a long distance carrier, although virtually all parties other than PB Com urge restrictions on the marketing of that service.

PB Com witnesses stated that their company, initially, will provide long distance service through capacity purchased from Sprint. However, PB Com also seeks facilities-based interLATA authority so that it may provide long distance service through its own switches and facilities. PB Com witnesses testified at hearing that current plans are to add relatively few facilities, limited primarily to tandem switches, until the company's share of the long distance market grows. PB Com witness Jacobsen testified that PB Com expects to have 1 million long

[24] Negative declaration recommended by the Commission's Energy Division, Decision-Making Support Branch, dated January 13, 1997, on behalf of PB Com and seven other

Footnote continued on next page

distance customers after its first year of operation, or about 5% of California's interLATA revenues, if the company achieves its market penetration targets.

The timing of PB Com's entry into the long distance market is prescribed by the Telecommunications Act. First, the Bell company affiliate (PB Com) must obtain state certification through a proceeding like this one. Next, the Bell affiliate must obtain FCC approval to provide in-region long distance service.

The Act provides that a Bell operating company may provide in-region long distance service through a separate affiliate if the FCC finds, as one option, that the Bell operating company has entered into a state-approved interconnection agreement with a provider of exchange service.[25] If an interconnection agreement is in place, the FCC then must find, after consultation with this Commission, that Pacific Bell's interconnection agreements meet the requirements of a competitive checklist for unbundling, access to emergency, operator and directory services, access to telephone numbers, number portability, dialing parity, reciprocal compensation, and resale.[26] In California, the checklist requirements are being considered in another forum drawing participants from the Commission's Local Competition and OANAD proceedings.

When the statutory conditions are satisfied, the FCC then must determine whether the service is broadly consistent with the public interest, consulting with the Department of Justice in doing so.[27] The FCC is required to make its decision

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telephone carriers. By our order today, we adopt the recommendation as to the facilities authority granted.

[25] 47 U.S.C. § 271(c)(1)(A).

[26] Id., § 271(c)(2)(B) and § 271(d)(2)(B).

[27] Id., § 271(d).

on Pacific Bell's application within 90 days of the date on which the application is made.[28]

The Telecommunications Act contains several provisions intended to protect the Bell companies during this transition period. First, interexchange carriers serving more than 5% of the nation's access lines may not jointly market resold Bell company local exchange service with their long distance service until the Bell operating company gains the right to sell long distance service in that state. Second, a state may not require intraLATA toll dialing parity until the incumbent Bell company has been authorized to offer interLATA service, or until three years after enactment of the Act.[29]

Initially, Pacific Bell had indicated that it would seek FCC authority to provide long distance service through PB Com beginning as early as April 1997. However, applicant now states that its intent is to enter the long distance market in California early in 1999.

PB Com has shown convincingly in this proceeding that its entry into the long distance market will bring increased competition in that market, and will encourage PB Com and its competitors to offer lower prices and new services to California consumers. PB Com will be a strong competitor, bringing technical expertise, a sound financial base, a recognized name, and a reputation for reliable service.

Our order today grants PB Com's application for authority to provide resold and facilities-based long distance service in California, subject to the conditions set forth in this decision.

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[28] Id., § 271(d)(3).
[29] Id., § 271(e).

16.1. Use of Pacific Bell Facilities

The FCC in its Non-Accounting Safeguards order prohibits a Bell operating company from sharing its transmission and switching facilities with its long distance affiliate on the basis that the affiliate then could not be found to be operating independently, as required by the Telecommunications Act.[30] The FCC further ordered that an affiliate like PB Com could not operate, install or maintain Bell operating company transmission or switching facilities, nor call upon a Bell operating company to assist it with the facilities of other companies. Pacific Telesis, among others, is opposing these provisions of the FCC order.[31]

On March 6, 1997, California Cable, AT&T and MCI petitioned to reopen the record in this proceeding to receive into evidence the declaration of Telesis chairman Philip J. Quigley in federal court in Washington, D.C., and to permit parties to file supplemental briefs dealing with the declaration. The Quigley declaration states that Telesis in October 1996 determined that PB Com should enter the long distance market in California primarily as a facilities-based carrier, relying on transmission and switch facilities that Pacific Bell already has in place.[32] The petitioning parties alleged that the Quigley declaration contradicted PB Com's testimony in this proceeding.

By ALJ Ruling dated March 21, 1997, it was ruled that the Commission would take official notice of the Quigley declaration in this proceeding. Parties were permitted to file supplemental briefs on an expedited

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[30] FCC Order 96-489, ¶ 158.

[31] See, Bell Atlantic Telephone Companies, et al. v. Federal Communications Commission, et al., No. 97-1067, United States Court of Appeals for the District of Columbia Circuit.

[32] Declaration of Philip J. Quigley, Bell Atlantic Telephone Companies, supra. Pacific Bell operates an interLATA administrative network, which it is permitted to do for internal communications purposes.

schedule. Supplemental briefs were filed on March 28, 1997, and PB Com's reply was filed on April 4, 1997.

The petitioning parties allege in their briefs that PB Com witnesses led the Commission and other parties to believe that PB Com would enter the long distance market primarily by reselling capacity it would purchase from Sprint. By contrast, they state, the Quigley declaration makes clear that Telesis at the time of our hearing intended to have PB Com use the facilities that Pacific Bell had installed for its own corporate long distance services. AT&T and MCI in their joint brief state:

> "The fact that Pacific Bell Communications plans to provide long distance service using the facilities of its sibling local exchange monopolist clearly heightens the risk of monopoly leveraging and anticompetitive cross-subsidization. If Pacific Telesis succeeds in its plan to have Pacific Bell incur all of the network, maintenance and switching costs for the long distance services provided by Pacific Bell Communications, then the Telesis family will have a multitude of new avenues for cross-subsidizing their new subsidiary. In fact, Pacific Telesis' plan to spend 'tens of millions of dollars' to upgrade Pacific Bell's internal interLATA network to make it usable for long distance offerings of Pacific Bell Communications appears to be a virtual gift to give Pacific Bell Communications an early competitive advantage." (AT&T and MCI Joint Supplemental Brief, pp. 5-6.)

California Cable, the ICG Telecom Group and ORA filed supplemental briefs expressing similar concerns. ORA urged the Commission to audit any network expenditures by Pacific Bell on behalf of PB Com, and to require Pacific Bell to make network services available to all carriers if it later is permitted to provide such services to PB Com. Other parties stated that the contradictory positions of PB Com and Telesis further supports the recommendation that PB Com be regulated as a dominant carrier.

PB Com in its response denied any contradiction in evidence, stating that its application sought facilities-based authority for long distance service and that PB Com had explicitly reserved the right to become a facilities-based carrier through Pacific Bell or its own resources if it were permitted to do so. Initially, however, its intention, as stated at hearing, was to provide long distance service by buying Sprint capacity at wholesale rates and reselling it at retail rates.

16.1.1. Discussion

While PB Com in its testimony stated that, at some point in the future, it might purchase interLATA switch and transport services from Pacific Bell, the thrust of its testimony was that, at least initially, it planned to enter the long distance market as a reseller. PB Com presented no evidence reflecting the view of the Telesis chairman that the new affiliate would rely primarily on the interLATA transmission and switch facilities of Pacific Bell, augmented by tens of millions of dollars in investments to upgrade that system. As a result, our record is incomplete as to the anticompetitive effects, if any, of PB Com reliance on the transmission facilities of Pacific Bell.

As the ICG Telecom Group points out, the issue could be an important one in light of the Costa Bill's requirement that we find that "there is no improper cross-subsidization of intrastate interexchange service." (PU Code § 709.2(c)(3).)

On the other hand, the issue appears moot in view of the FCC's prohibition on the use by PB Com of Pacific Bell transmission and switch facilities. We tend to agree that PB Com was less than candid in discussing all of its plans for entering the long distance market. At the same time, we recognize that PB Com is dealing with uncertainty about its market entry, and that many of the plans it had developed in late 1996 were contingent on FCC orders that had not yet been issued.

We believe that ORA's recommendations strike a reasonable balance in dealing with this issue. Our order today requires that the propriety, cost and industry availability of any network services provided by Pacific Bell to PB Com be considered in an audit of PB Com. Additionally, our order prohibits PB Com from accepting network services from Pacific Bell that are not available to all telecommunications providers on a non-discriminatory basis. Presumably, these requirements will be of little moment if the current FCC prohibitions continue to apply. If the FCC prohibitions change, these requirements will help assure PB Com's compliance with the antidiscrimination provisions of the Costa Bill.

17. Joint Marketing

17.1. FCC Requirements

The FCC's order on Non-Accounting Safeguards permits a Bell operating company like Pacific Bell to market its affiliate's long distance and intraLATA service on all inbound calls, provided that the Bell operating company also informs new customers of their right to select the long distance carrier of their choice.[33]

The FCC reasoned that the ability of Pacific Bell to market PB Com services on inbound calls from customers was part of the balance struck by Congress. The Telecommunications Act "opens local markets to competing providers by imposing new interconnection and unbundling obligations" on Pacific Bell.[34] In exchange, the Act permits Pacific Bell to provide long distance

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[33] FCC Order 96-489, ¶ 292. ("Specifically, the BOCs must provide any customer who orders new local exchange service with the names and, if requested, the telephone numbers of all of the carriers offering interexchange services in its service area....As part of this requirement, a BOC must ensure that the names of the interexchange carriers are provided in random order.")(Footnotes omitted.)

[34] Id., ¶ 8.

service once the competitive checklist is satisfied; but because the local market will not be immediately competitive, Congress requires that, for a period of at least three years, Pacific Bell's long distance service must be provided by a separate affiliate.[35] The FCC surmises that this separate affiliate requirement prevents Pacific Bell from gaining all of the economies of scope of vertical integration, with the exception that Pacific Bell can jointly market the long distance and intraLATA service of its affiliate.[36]

The FCC noted that when AT&T, MCI or Sprint resell Pacific Bell's local service, they are prohibited from offering one-stop shopping until Pacific Bell's affiliate, PB Com, has in-region interLATA authority.[37] The FCC commented that the limitation prohibiting one-stop shopping until Pacific Bell through its affiliate enters the long distance market reflects the intent of Congress to "provide parity between the Bell operating companies and other telecommunications carriers in their ability to offer 'one-stop shopping' for telecommunications services."[38]

After the original Proposed Decision was issued in May 1997, the FCC on February 26, 1998, released its Decision FCC 98-27, Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 96-115 (the CPNI Order). After receiving comments by most of the parties that participated in this proceeding, the FCC concluded that a carrier's customer proprietary records may be used by a carrier to market an affiliate's long distance service if

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[35] Id., ¶ 9.
[36] 41 U.S.C. § 272(g)(2) and (3).
[37] FCC Order 96-489, ¶ 277.

[38] Id., ¶ 277.

the customer gives permission for such use.[39] The FCC also ruled that a carrier, without explicit customer permission, may access CPNI to market services related to those that a customer already is receiving from that carrier.[40] The CPNI Order, interpreting Section 222 of the Telecommunications Act of 1996, expressly overruled that part of the FCC's earlier order interpreting Section 272, where it required that competitors of a Bell operating company must have access to the Bell company's CPNI equivalent to that of the long distance affiliate of the Bell company.[41]

In other words, under the FCC's CPNI Order, if a customer subscribes only to Pacific Bell's local service, Pacific Bell may use the customer's CPNI to market offerings related to local service (e.g., caller ID, call forwarding) without seeking the customer's permission, on the assumption that such permission is implied. However, under the FCC rules, before Pacific Bell representatives may refer to customer proprietary records to market PB Com long distance service, they must ask the customer for permission to do so. Customer authorization may be granted orally, in writing, or electronically. In order to ensure that customers are informed of their statutory rights before granting approval, carriers are further required to provide a one-time notice of customers' CPNI rights prior to any solicitation for approval. The FCC reasoned that this "total service approach" offers convenience for the customer while preventing the use of CPNI in ways that the customer would not expect.[42]

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[39] CPNI Order, at ¶ 53-55.
[40] Id. at ¶¶ 4, 21-26.
[41] FCC 96-489, Non-Accounting Safeguards Order (December 1996).

[42] CPNI Order, at ¶¶ 53-55.

We are guided by the FCC's interpretation of the Telecommunications Act. Additionally, however, in authorizing the long distance authority sought by PB Com, we are governed by the mandates of the PU Code. Specifically, in considering the matter of Pacific Bell's joint marketing of PB Com services, we are required by the PU Code § 709.2(c) to determine:

> "that there is no anticompetitive behavior by the local exchange telephone corporation, including unfair use of subscriber information or unfair use of customer contacts generated by the local exchange telephone corporation's provision of local exchange telephone service," and
>
> "that there is no substantial possibility of harm to the competitive intrastate interexchange telecommunications markets." (PU Code § 709.2(c)(2) and (c)(3).)

As discussed in the original Proposed Decision, during the evidentiary phase of this proceeding, a Pacific Bell witness testified that customer service representatives will make certain that new customers (defined as those seeking initial phone service or phone service at another location[43]) are informed that they have options for long distance service, and that Pacific Bell will continue to comply with the nondiscrimination requirements of the Telecommunications Act and the PU Code. He and PB Com witnesses testified that joint marketing activities will be conducted fairly, and that further restrictions are unnecessary.

PB Com witnesses justified the company's plans for aggressive sales efforts on incoming calls to Pacific Bell on the basis that PB Com will begin its long distance service with zero customers, and it will face entrenched and

powerful competitors like AT&T, MCI and Sprint. Joint marketing of its long distance service by Pacific Bell, the witnesses said, is the single most important advantage PB Com has in gaining a foothold in the long distance market.

17.2. Applicants' Argument

SBCS and PB Com argue that the May 1997 Proposed Decision (and the Alternate Decision as well) must be revised to reflect the FCC's CPNI Order. As to the Proposed Decision, SBCS and PB Com state:

> "The FCC rejected proposals which would have required the use of a separate sales force or other general access restrictions to restrict carrier access to CPNI. Thus, while the FCC's CPNI Order does not explicitly preempt this Commission's authority to impose a separate sales force requirement, it makes clear the FCC's view that such a restriction on the ability of a carrier to market the services of its affiliate is not required to afford CPNI protection to customers and would run directly counter to the Congressional goal of promoting increased competition and efficiency." (Initial Brief of SBCS/PB Com, at 22-23.)

Applicants assert, correctly, that the separate sales staff requirement of the Proposed Decision was based primarily on an interpretation of California's Costa Bill, PU Code § 709.2. Applicants assert that the FCC's CPNI Order provides useful guidance in that interpretation. The task of this Commission, applicants state, "should be to establish rules which are consistent with both federal and state legislative requirements." (Applicant's Reply Brief, at 7.) Applicants state:

> "By requesting the parties to address the FCC's CPNI Order, the Commission is asking what these provisions of Section 709.2(c)(2) of

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[43] "A customer orders 'new service' when the customer either receives service from the BOC for the first time, or moves to another location within the BOC's in-region territory." FCC Order 96-489, ¶ 292.

> the Public Utilities Code mean. It is asking what constitutes an 'unfair use' of subscriber information in the context of joint marketing. The FCC has wrestled with this very question for months and has had the benefit of comments from the full spectrum of telecommunications parties from across the country. It has determined that it is fair to use subscriber information in joint marketing as long as customer permission is obtained or the customer already subscribes to the affiliate's service.
>
> "The Commission is also asking what constitutes an 'unfair use' of customer contacts in light of the FCC's Order....The FCC has determined that it is fair for carriers to joint market to customers on inbound calls, precisely because all carriers can do so. Other carriers hold CPNI and other carriers receive inbound calls from customers, and they can and will use such information and such contacts to market their services and those of their affiliates." (Reply Brief of SBCS/PB Com, at 23-24, emphasis in original.)

Applicants state that the CPNI Order concludes that the pro-competitive purposes of the Telecommunications Act are best served by permitting carriers to perform joint marketing without the extra expense and customer inconvenience associated with a separate sales force. The Costa Bill contains the same pro-competitive thrust, according to applicants. Based on the FCC's conclusions that joint marketing on inbound calls is both fair and pro-competitive, applicants state that this Commission should adopt the FCC's approach to the treatment of CPNI in joint marketing and that it should reject the separate sales force requirement of the Proposed Decision.

17.3. Opposition Views

All other parties to this proceeding urge the Commission to adopt the position taken in the May 1997 Proposed Decision and to maintain its requirement that Pacific Bell establish a separate sales staff without access to CPNI to market PB Com long distance service. To do otherwise, they argue, would be to ignore the evidence at hearing showing that Pacific Bell intends to

use its near-monopoly position as a local exchange carrier in California as the primary means to secure customers for the PB Com long distance service. These parties assert that the separate staff requirement would be an interim one, since the requirement that Bell operating companies conduct long distance service through an affiliate is to end in three years, unless extended by the FCC.[44]

ORA notes, and no party disputes, that the FCC's CPNI Order does not preclude the separate sales staff requirement of the Proposed Decision. Indeed, ORA adds, the Commission in its comments to the FCC urged that states should have flexibility in fixing rules for joint marketing and CPNI because competitive conditions in a particular state may not be properly reflected in a uniform national policy.[45] ORA argues that, unlike the FCC, the Commission is bound by PU Code § 709.2(c), which requires us to determine that there will be no anticompetitive use of Pacific Bell's CPNI or customer contacts in marketing an affiliate's long distance service. The Proposed Decision concluded that such anticompetitive use had been shown. ORA asserts that, if that finding stands, Article 3, Section 3.5 of the California Constitution requires the Commission to comply with Section 709.2 of the Code even if such compliance were deemed inconsistent with the FCC's CPNI Order.[46]

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[44] Telecommunications Act § 272(f)(1).

[45] Comments of the People of the State of California and the Public Utilities Commission of the State of California on the Notice of Proposed Rulemaking, CC Docket No. 96-115, June 10, 1996, p. 5.

[46] Article 3, Section 3.5 provides, in pertinent part:

> "An administrative agency...has no power:...(c) to declare a statute unenforceable, or to refuse to enforce a statute on the basis that federal law or federal regulations prohibit the enforcement of such statute unless an appellate court has made a determination that the enforcement of such statute is prohibited by federal law or federal regulations."

In a joint filing, AT&T and MCI agree with the position taken by ORA. Additionally, they contend that separation of the Pacific Bell sales force is in keeping with a District Court injunction against Pacific Bell and its use for marketing purposes of long distance billing information provided to it under billing contracts by AT&T, MCI and others.[47] AT&T and MCI state that since there is no way presently for a Pacific Bell service representative to have access to CPNI without also seeing long distance calling patterns, the separate staff requirement is the only way to be sure that CPNI will not be used improperly.

TURN in its brief criticizes what it calls "the FCC's track record of flip-flopping with respect to issues that present a tension between competitive equity and CPNI access." (TURN Opening Brief, at 4.) It states that the FCC in its 1996 Non-Accounting Safeguards Order (FCC 96-489) interpreted Section 272 of the Telecommunications Act to require that a Bell company's affiliate and the Bell competitors should enjoy equivalent access to CPNI. In the CPNI Order, where the focus was on Section 222 of the Act, the FCC overruled its previous order and, according to TURN, held that Bell companies may share CPNI with affiliates on terms that are not available to competitors. Commissioner Susan Ness dissented on this portion of the CPNI Order. TURN continues:

> "The most glaring oversight in the CPNI Order is the failure to recognize that Pacific Bell and other BOCs will gain huge and unfair advantage over their competitors if they are able to capitalize upon the millions and millions of inbound calls that they will receive, not because they are able competitors, but because they are the historic providers of monopoly local service...As the [Proposed Decision] found, Pacific intends to turn each one of these calls into a marketing opportunity and to compound that advantage by gaining immediate access to customer CPNI that will allow a targeted sales message.

[47] AT&T Communications of California, Inc., et al. v. Pacific Bell, et al., No. C 96-01691 CRB, Order of Judge Charles R. Breyer (N.D.Cal., April 6, 1998).

> "....The FCC's response to the potential advantages of the [incumbent local exchange carriers] is to assert that customer approval should be a safeguard against anticompetitive abuses. (¶ 59). Nonsense. The FCC plainly overvalues customer approval as a competitive safeguard. Few, if any, customers will deny access to information that Pacific's service representatives say can be used to get the customer a better deal." (TURN Opening Brief, at 8; emphasis in original.)

ICG Telecom, urging adoption of the separate staff requirement, argues that it is this Commission, not the FCC, that should exercise jurisdiction over the essentially intrastate activities of Pacific Bell and its customer service representatives, citing the series of Ninth Circuit decisions in support of state jurisdiction over intrastate telecommunications issues.[48] ICG Telecom asserts that the FCC's CPNI Order does not and legally cannot stand in the way of this Commission enforcing the requirements against anticompetitive practices in PU Code § 709.2.

[48] People; PUC, et al. v. FCC (9th Cir. 1990) 905 F.2d 1217; People; PUC, et al. v. FCC (9th Cir. 1993) 4 F.3d 1505; People; PUC, et al. v. FCC (9th Cir. 1994) 39 F.3d 919.

California Cable argues that if the separate sales staff requirement is not adopted, the Commission should require additional hearings to determine whether SBCS, like PB Com, intends to use the monopoly power of Pacific Bell as its primary tool for soliciting long distance subscribers. Pursuant to the FCC CPNI Order, California Cable would permit the separate sales staff to use local exchange CPNI of Pacific Bell if long distance billings can be deleted from that CPNI and if equivalent information is made available to PB Com competitors.

17.4. Discussion

Our decision today tracks the guidelines of the FCC's CPNI Order in dealing with Pacific Bell's marketing of its own services and use of customer records on inbound calls. We believe that the FCC's findings on permitted use of CPNI by carriers and the FCC's clarification on joint marketing reflect the type of balanced approach intended by Congress in the passage of Sections 222 and 272(g) of the Telecommunications Act.

We reject the proposal that Pacific Bell must have separate sales representatives to market the long distance services of its affiliate. Similarly, we reject the proposal that these sales representatives would be denied access to Pacific Bell's CPNI in serving callers. Like the FCC, we recognize that the customer would be inconvenienced by any artificial requirement that the customer must deal with two different customer sales representatives to discuss or make changes in the customer's package of services.

When evaluating the fairness of Pacific Bell's use of CPNI in marketing its affiliate's long distance services, it is important to keep in mind that other carriers maintain their own CPNI on their customers, and they are free to use that CPNI to market related services to new customers.

We conclude that the FCC's rules governing use of CPNI in the context of joint marketing are fair both to customers and to competitors, and are fair both for purposes of the Telecommunications Act and California's Costa Bill. The non-discrimination and fairness provisions of the Costa Bill and the Telecommunications Act are similar, and they address common concerns.

We find no basis for interpreting the Costa Bill differently than the FCC has interpreted the Telecommunications Act. The Costa Bill was passed prior to the enactment of the Telecommunications Act, and its purpose was to accelerate the opening of the California interexchange market to competition and to authorize Pacific Bell to compete in that market. There is nothing in the language of the Costa Bill suggesting that it should be interpreted to impose restrictions on Pacific Bell's entry into long distance that are more onerous than federal law. It is black letter law that the courts and this Commission should interpret statutes dealing with the same subject matter in a manner which attempts to harmonize their provisions and avoid potential conflict.[49] Absent some compelling state interest not present here, it makes no sense from a policy perspective for California to adopt rules different from those of other states and from those governing interstate telecommunications.

The FCC has found that the federal act's framework for balancing customer privacy concerns against the needs of the competitive market extend to both interstate and intrastate use and protection of CPNI.[50] To avoid customer confusion and inconvenience, our decision in this matter should be consistent with the FCC rules on the use of CPNI, which provide a workable and fair

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[49] Long Beach Police Officers' Assn'n v. City of Long Beach (1988)46 Cal.3d 736.
[50] CPNI order, at ¶¶ 14-16

method of implementing the new competitive market for telecommunications in California.

Accordingly, our order today provides that Pacific Bell customer service representatives may use the customer's proprietary records to market offerings related to local service without seeking the customer's permission, on the basis that use of such information is expected by the customer and consent is implied.[51] However, before asking if the customer would like to learn more about the services of Pacific Bell's long distance affiliate, the service representative must first advise that the customer has numerous choices for long distance service. This process also follows the guidelines set forth in the FCC's CPNI Order.[52]

Finally, our order today permits the Pacific Bell representative to directly market the affiliate's long distance services and, with the verbal consent of the customer, to access the customer's proprietary records to better serve those seeking to learn more about these new services.

The FCC's CPNI Order sets forth a thoughtful analysis of the interaction of the Telecommunications Act's provisions regarding privacy of customer information (Section 222), non-discrimination (Section 272) and the overall goal of promoting increased competition in telecommunications markets. These same concerns and goals are evident in California law, specifically in the Costa Bill. The conformance of the FCC's rule with those of this Commission will, in our judgment, best serve the telecommunications needs of California consumers

[51] Id. at ¶¶ 4, 21-26.

[52] CPNI Order at ¶¶ 4,87,109. Additionally, a carrier is required under the FCC rules to send a one-time notification to customers of their rights regarding CPNI.

18. Dominant Carrier Regulation

AT&T and MCI, joined by TURN, urge the Commission to require that PB Com be regulated as a dominant carrier, subject to the cost imputation, price floor and tariffing restrictions applicable to Pacific Bell. ORA urges dominant carrier regulation if its other recommended safeguards are not adopted. The major concern of the parties is that Pacific Bell can avoid restrictions on its market power by a concerted effort with PB Com to direct high value customers to a less stringently regulated PB Com.

TURN notes that the Commission in Re Local Exchange Competition, D.96-03-020 (March 13, 1996), addressed pricing flexibility, recategorization of retail services, rules for the use of customer-specific contracts, and rules for bundling of services by incumbent local exchange carriers. According to TURN, the applicant's proposal to be treated as a nondominant carrier with respect to local service "is a transparent end run around the regulations that the Commission has found necessary to restrain PacBell's market power." (TURN Opening Brief, p. 35.)

As conceded by California Cable, however, the need for dominant carrier regulation of PB Com is substantially lessened by applicant's withdrawal of its request for local exchange authority. PB Com will take no local exchange revenue from Pacific Bell, nor does it seem likely that PB Com can be used by Pacific Telesis as a vehicle for evading local exchange rules imposed on Pacific Bell.

The corrected record shows that while AT&T, MCI and Sprint have respectively 44.5%, 19.4% and 9.7% of national long distance revenue according to FCC statistics, applicant estimates that at the end of its first full year it will have a 5% share of California long distance revenue. PB Com witness Jacobsen testified that if PB Com is saddled with dominant status, regulatory restraints

will make it difficult to compete with other long distance carriers. For example, he testified, dominant status would mean that PB Com would have to develop cost-based price floors, with full imputation of costs, for each service it offers, submit supporting cost studies to the Commission staff, then respond to challenges by intervenors in what could be lengthy hearings. He testified that delays in price changes would make it difficult to bring lower prices and promotions to the market quickly, thus forestalling innovative pricing and products.

We conclude that PB Com's withdrawal of its request for local exchange authority removes much of the impetus for dominant carrier regulation. Like the FCC, we believe that such regulation, in these circumstances, "would not conform with the deregulatory, pro-competitive goals of the 1996 Act,"[53] and with the deregulation objectives of this Commission. As PB Com notes:

> "Companies in competitive industries do not set their prices on the basis of cost of service studies, they certainly do not impute costs where none exist, and they do not give their competitors advance warning of their price changes. They price on the basis of the market, and then work very hard to ensure that their costs are below the prices which they are able to charge." (PB Com Opening Brief, p. 43.)

Because the evidence shows that PB Com cannot achieve dominant market power in the foreseeable future, and because existing regulations and the measures we adopt today curb PB Com's use of Pacific Bell's market power, we will regulate PB Com as a nondominant provider of intraLATA and interLATA services.

[53] FCC Order 96-489, ¶ 258.

19. Audit Requirements

While we decline to impose dominant carrier regulation on PB Com, we agree with ORA that additional audit requirements are desirable. The record in this proceeding is replete with evidence that PB Com and Pacific Bell, quite understandably, will cooperate to the maximum extent permitted by law in marketing PB Com's new services. The record also shows that there are opportunities, through inadvertence or otherwise, for the Telesis companies to slip over the line of permissible behavior. Indeed, a Pacific Telesis witness on cross-examination by AT&T acknowledged that there have been errors in the recording, valuation and payment by PB Com for confidential information transmitted to it by Pacific Bell. While he testified that the errors were inadvertent and would be corrected, he was compelled to agree that an audit could have identified the errors and could have permitted early correction.

Section 272(d) of the Telecommunications Act requires that a Bell affiliate like PB Com "shall obtain and pay for a joint federal/state audit every two years conducted by an independent auditor to determine whether such company has complied" with the accounting and structural safeguards required by the Act,[54] and to report the results of that audit both to the FCC and to this Commission. In its Accounting Safeguards order issued on December 24, 1996, the FCC requires formation of a joint federal/California audit team and requires that the first audit of transactions between Pacific Bell and PB Com take place one year after PB Com begins service, with similar audits every two years thereafter.[55]

As ORA witness Elfner testified, the FCC audit will focus on accounting requirements of the Telecommunications Act and on compliance with FCC rules.

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[54] 47 U.S.C. § 272(d)(1).
[55] FCC Order 94-490, ¶ 198, 203.

However, California's existing affiliate transactions rules are tailored more precisely to Pacific Bell than are those of the FCC.[56] We believe that it is prudent to require that these California-distinct matters be examined in a separate audit conducted at the same time, and in cooperation with, the FCC audit.

The FCC has delegated authority to its Common Carrier Bureau to form the joint audit team in cooperation with the Commission. Our order today directs our Office of Ratepayer Advocates to consult with the Common Carrier Bureau on the timing and retention of the independent auditors who will conduct the audit, and then arrange for an audit of Commission affiliate transaction rules (including any network services provided by Pacific Bell) and cost allocation rules either as part of the joint FCC/state audit, or as a separate audit in conjunction with the joint audit, with costs to be borne by the applicant. A similar audit would be required each two years thereafter at the time of subsequent FCC/state audits.

20. Use of Pacific Bell Name

TURN's witnesses testified that PB Com obviously expects to rely on the Pacific Bell name to attract long distance customers. PB Com witnesses testified that they will make little or no effort to try to explain to callers that PB Com is an affiliate company operating independently from Pacific Bell. In view of this, TURN argues, PB Com should pay a royalty (TURN proposes 5% on gross revenues) to Pacific Bell for as long as PB Com uses the Pacific Bell name.

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[56] The Commission in Pacific Bell rate case proceedings imposed affiliate transaction rules to ensure that ratepayers are indifferent to transactions between Pacific Bell and Telesis affiliates. (See Decisions 86-01-026, 87-12-067 and 92-07-072.) Among them: non-tariffed services provided by Pacific Bell are priced at the higher of fully distributed cost plus 10%, or market; a 25% transfer fee applies to transferred employees; a 13% referral fee applies to sales made by Pacific Bell employees; transfer of an asset worth $100,000 or more must be reported to the Commission in advance.

"Obviously," TURN states, "if a potential licensee...wanted to make use of the PacBell name, PacBell would charge for that privilege. The same result should obtain here." (TURN Opening Brief, p. 39.)

PB Com's witness Emmerson testified that PB Com's use of the Bell name does not create a subsidy of PB Com by Pacific Bell, adding:

> "Unless using PacBell's brand name imposes an incremental cost on PacBell, there cannot be a subsidy created by such use, even if that use is free. The use of the brand name could only impose a 'cost' on PacBell if PB Com intended to degrade the Pacific name in some way." (Ex. 103, p. 20.)

Emmerson testified that PB Com's use of the name was likely to enhance rather than degrade the name, given the additional exposure to customers and the expanded scope of service which PB Com will provide.

The Commission has considered this issue before. In 1993, in a decision involving the spin-off of PacTel Cellular, it was held that no compensation was owed by the affiliated company for its use of the Telesis name, stating:

> "The name and reputation of a utility is not an asset to which ratepayers have a claim. Indeed the utility has never included good will in the rate base of a utility for ratemaking purposes. It follows that ratepayers have never had to pay through rates of return on the value of good will." (Re Pacific Telesis Group (1993) 51 CPUC2d 728, 754, citing D.88-01-063, 27 CPUC2d 347, 369 (1988).

TURN argues that the Pacific Telesis case is distinguishable, because here TURN is not stating a claim in the name of ratepayers, but rather for Pacific Bell in an effort to protect its financial viability. However, TURN has not demonstrated that Pacific Bell will incur any cost or financial harm as a result of PB Com's use of the Bell name. Nor has it shown that the value of the name will be dissipated in any way.

Accordingly, we decline to require payment of a royalty by PB Com for its use of the Pacific Bell name.

21. Access Charges

AT&T and MCI urge the Commission to require that Pacific Bell's access charges be priced at the level of incremental cost before PB Com is permitted to enter the market. AT&T's witness testified that because Pacific Bell still holds a monopoly over access to the local exchange network where all long distance calls must originate or terminate, the danger exists that it could arrange to charge PB Com less for that access and impose a price squeeze on competitors.

PB Com's economist witness testified that the access charge price squeeze theory has no merit. First, PB Com has stated that at least initially it will be purchasing interLATA capacity from Sprint. Thus Sprint, not PB Com, will be Pacific Bell's access customer. Second, this Commission and the FCC both require that Pacific Bell provide access services, or any other transmission or switching service, to PB Com at the same prices it provides those services to competitors. Thus, if PB Com obtains intraLATA capacity from Pacific Bell, it will do so at tariffed rates available to other carriers.

AT&T and MCI raised much the same access charge argument before the FCC in connection with a Bell affiliate's purchase of unbundled elements with which to provide local exchange service. The FCC rejected the argument on unbundled elements, stating that it will address access charge reform in a separate proceeding.[57] Moreover, the FCC concluded that MCI's argument – that opportunities for discrimination and cross-subsidy are greater when a Bell operating company provides network elements to its affiliate than when it

[57] FCC Order 96-489, ¶ 314. The separate proceeding is the Access Charge Reform Notice of Proposed Rulemaking.

provides resold services – is speculative. To the extent that concerns over discrimination arise, the FCC said, there are safeguards in Sections 251 and 252 of the Telecommunications Act to address those concerns.

We agree with the FCC that the access charge concerns expressed by AT&T and MCI are speculative. As PB Com notes, access charges in California are the lowest in the nation; this Commission has led the way on reform of access charges. There is no evidence that manipulation of access charges presents a serious risk in this case, nor is this application proceeding the forum in which access charges need to be further reviewed.

22. Part 32 Accounting

PB Com asks that we depart from our customary practice of requiring a new telecommunications company to keep its books and records in accordance with the Uniform System of Accounts (USOA)[58] specified in Part 32 of Title 47 of the Code of Federal Regulations. PB Com notes that the FCC in its Accounting Safeguards order did not impose Part 32 accounting on Bell affiliates, concluding that generally accepted accounting principles (GAAP) were sufficient.[59]

Part 32 accounting requirements have been imposed on all interLATA and intraLATA carriers authorized to do business in California. As AT&T witness Dianne Toomey noted, this accounting system is the one commonly used both by management and by the Commission in performing audits and in monitoring compliance with affiliate transaction rules. It has the advantage of familiarity and conformity both for the Commission and for our staff.

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[58] Part 32 of Title 47 of the Code of Federal Regulations delineates the rules for the USOA for telecommunications companies.
[59] FCC Order 96-490, ¶ 170.

We see no reason to make an exception for PB Com in these accounting requirements. The FCC has elected not to impose Part 32 accounting requirements on interexchange affiliates of local exchange carriers, but there is nothing in the FCC order that precludes states from imposing the Part 32 requirements on these carriers. We elect to do so.

23. Other Proposed Restrictions

The parties have proposed numerous additional restrictions on Pacific Bell's provision of services to PB Com. Because our order today precludes PB Com's entry into local exchange service and defers consideration of some facilities-based intraLATA authority, the need for many of these proposed restrictions is either eliminated or lessened. Nevertheless, we will discuss the additional proposals briefly and explain our reasoning for not adopting them at this time.

23.1. Showing of Pacific Bell Indifference

ORA urges the Commission to condition its grant of authority to PB Com to resell intraLATA service on the completion of a study which demonstrates that Pacific Bell's net income will not be reduced as a result of granting such authority. TURN agrees, although its witness candidly added that "I'm skeptical about how those studies actually get reviewed and how seriously they end up being taken."[60] As ORA's witness acknowledged, such a study would require assumptions of how many intraLATA customers would switch from Pacific Bell to PB Com versus the number of customers who otherwise would switch from Pacific Bell to competing intraLATA providers. We are not persuaded on this record that the time and effort to produce and evaluate such a

[60] Transcript, Vol. 10, p. 1207.

study are justified in light of PB Com's decision to forgo its request for local exchange authority. As we have noted, such a study can be considered if PB Com later reinstates its request for local exchange authority.

23.2. Non-Tariffed Goods and Services

Noting evidence that PB Com has in place agreements to receive 28 non-tariffed services from Pacific Bell, ORA urges that the Commission require that all such agreements (except joint marketing agreements) be terminated, and that future agreements be limited to those available under tariff or to those non-tariffed goods or services that are critical or essential to PB Com's operation. (Since the time of this testimony, applicant states that the agreements in place between Pacific Bell and PB Com to provide non-tariffed goods and services have been terminated, and have been replaced with 13 contracts between Pacific Bell and SBCS. Applicant states that, pursuant to FCC Order 96-490, at ¶ 122, each of these contracts may be viewed at the SBC Communications website (www.sbc.com).)

ORA witness Elfner testified that existing contracts may harm Pacific Bell to the extent that they divert employee attention from Pacific Bell to PB Com, and that they drain regulatory resources in overseeing cost allocation rules. He noted that the Commission in the Pacific Bell Information Services case (1992) 45 CPUC2d 109, limited services by Pacific Bell to its new subsidiary to those which the subsidiary could not reasonably obtain on its own or through third-party vendors.

The FCC in its Non-Accounting Safeguards order prohibited a Bell company's long distance affiliate from obtaining, operating, installing and maintaining services related to transmission and switching facilities from the Bell company, concluding that such services create the opportunity for

operational integration that could preclude independent operation.[61] However, the FCC declined to limit further sharing of services, commenting:

> "We find that, if we were to prohibit the sharing of services, other than [network operating, installation and maintenance], a BOC and a section 272 affiliate would be unable to achieve the economies of scale and scope inherent in offering an array of services. We do not believe that the competitive benefits of allowing a BOC and a section 272 affiliate to achieve such efficiencies are outweighed by a BOC's potential to engage in discrimination or improper cost allocation."[62]

PB Com witnesses testified that this Commission's affiliate transaction rules recognize that Pacific Bell will provide services to its affiliates, and they specify how those services must be priced to ensure ratepayer indifference to the transaction. For services received from Pacific Bell, PB Com must pay the higher of fully distributed cost plus 10% or market value. Further, PB Com witnesses noted that Pacific Bell services available under tariff must be purchased by PB Com through the tariff, rather than under contract.

We are not persuaded that it is necessary to impose restrictions on services Pacific Bell will provide to PB Com beyond those already present in the FCC rules and in our own affiliate transaction rules. Allowing Pacific Bell and PB Com to achieve economies of scale and scope will reduce overall costs, with the ultimate beneficiaries being consumers who will pay lower prices for telephone services. Like the FCC, we believe that this advantage outweighs the potential for discrimination or improper cost allocation that are prohibited by our existing rules.

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[61] FCC Order 96-489, ¶ 163.
[62] Id., ¶ 179.

23.3. Employee Transfers

ORA proposes that the Commission prohibit the transfer of employees from Pacific Bell to PB Com except on a documented showing that Pacific Bell would be indifferent to a particular employee leaving, that is, that other employees were available to take on the work of the departing employee, or that the departing employee was no longer necessary to Pacific Bell. ORA's witness noted that 67 of PB Com's first 80 employees came from Pacific Bell, and that 60% of PB Com's vice presidents were recruited from Pacific Bell.

PB Com claims that ORA's reliance on an early check of the PB Com roster overstates the percentage of former Pacific Bell employees, and that there has been a significant drop in the percentage of former Pacific Bell employees as a result of hiring in 1996. Another PB Com witness stated that the ORA proposal would be unfair to employees:

> "PacBell does not have mastery over its employees, nor do they 'belong' to PacBell's ratepayers. They should be free to take their training and experience to PacBell's competitors or any other firm, and they will do so if PacBell cannot give them attractive opportunities."[63]

ORA has not shown that the Pacific Bell transfers to PB Com are harmful to Pacific Bell, and the 25% transfer fee that PB Com pays Pacific Bell under the Commission's affiliated transaction rules provides compensation to Pacific Bell for any training expenses incurred in replacing an employee. The Commission requires quarterly reporting of employee movement to and from Pacific Bell, including information on why the Pacific Bell employee was released and whether he or she was replaced, and this early warning system should help

[63] Emmerson, Ex. 103 at 13.

us monitor whether a problem is emerging. We decline on this record to impose additional constraints on employee transfers to PB Com.

23.4. Proprietary Information

AT&T and MCI urge that the Commission establish additional safeguards on proprietary information provided by Pacific Bell to PB Com. At the time of hearing, it was not clear whether there was a requirement for other carriers to be notified when Pacific Bell provides such data to PB Com. The FCC's Accounting Safeguards order clarifies this matter. The FCC determined that a Bell operating company should:

> "...provide a detailed written description of the asset or service transferred and the terms and conditions of the transaction on the Internet within 10 days of the transaction through the company's home page....The information must also be made available for public inspection at the public place of business of the BOC."[64]

Accordingly, while there is no FCC requirement for Pacific Bell to notify other parties of the transfer of proprietary information, the requirement that this information appear on Pacific Bell's Internet home page and at its principal place of business appears to respond to the concerns raised at hearing.

23.5. Other Limitations

A number of parties have proposed various other requirements on PB Com, including pricing restrictions, a prohibition on special contracts between PB Com and Pacific Bell, and a requirement for quarterly financial reports. We find that the evidence in support of these proposals is unpersuasive in light of the existence of our affiliate transaction rules and the safeguards established in the FCC orders related to Bell operating company affiliates.

24. Comments on Alternate Decision

This decision was distributed to the parties on January 14, 1998, in accordance with PU Code § 311 and Rule 77.6 of the Rules of Practice and Procedure. Comments were filed on January 21, 1999, and reply comments were filed on January 26, 1999.

All parties except the applicant object vigorously to our removal of the separate sales force requirement and a prohibition on use of CPNI by Pacific Bell in marketing an affiliate's long distance service. These restrictions were recommended in the proposed decision of the ALJ, who relied on provisions of the Costa Bill and on evidence at hearing that Pacific Bell plans to market its affiliate's long distance service on millions of incoming calls. AT&T, MCI, TURN, ORA, ICG Telecom Group and California Cable all accuse the Commission in this decision of ignoring the record evidence.

In fact, we have carefully reviewed the evidence. Like the ALJ, we find that Pacific Bell plans an "aggressive" approach to marketing incoming calls. However, we also note the testimony of PB Com witnesses justifying this aggressive approach to marketing on the grounds that PB Com (now SBCS) will begin with zero customers and will face entrenched and powerful competitors such as AT&T, MCI and Sprint, who now control the bulk of the long distance market.

We analyze this aggressive marketing approach in light of the market conditions facing SBCS and in light of both state and federal requirements and safeguards. We conclude, as did the FCC, that such an approach is fair and necessary if competition is to be fostered. The Pacific Bell marketing plans in the

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[64] FCC Order 96-490, ¶ 122

record that have been characterized as taking "maximum advantage" of market power and using customer records (after asking a caller's permission to discuss long distance service) are practices that the FCC in its CPNI Order found to be pro-competitive and consistent with the Telecommunications Act.

AT&T and TURN allege that our decision fails to include a finding on the question of the fairness of the proposed joint marketing of SBCS services. That is incorrect. Our decision concludes that the FCC's rules governing the use of CPNI in joint marketing are fair to both competitors and customers and are fair both for purposes of the Telecommunications Act and the Costa Bill. We conclude that there is no language in the Costa Bill that prohibits joint marketing and, in our judgment, there is no language that imposes different requirements than the Telecommunications Act. The Costa Bill is clear on its face that "[t]he Commission shall authorize fully open competition for intrastate interexchange telecommunications service" as soon as permitted by federal law. (PU Code § 709.2(a).)

ORA objects that our decision would permit aggressive joint marketing without imposing specific scripting and sequencing requirements on Pacific Bell service representatives. As we have noted, however, equal access requirements will apply to these representatives, who are obligated to inform customers that they have numerous choices for long distance service. We are unwilling to require detailed sequencing and scripting requirements that would involve the Commission in micro-management of what will be a competitive service.

Based on the comments of the parties, we have made non-substantive corrections and changes to our decision where warranted.

Findings of Fact

1. PB Com is a California corporation, wholly owned by Pacific Telesis, and is the long distance affiliate of Pacific Bell.

2. The Telecommunications Act of 1996 requires that the entry of a Bell operating company like Pacific Bell into the in-region long distance market must occur through a separate affiliate.

3. The separate affiliate requirement is to expire three years after the Pacific Bell affiliate begins service, unless the time period is extended by the FCC.

4. To begin long distance service, PB Com must obtain authority both from this Commission and from the FCC.

5. PB Com filed its application in this proceeding on March 5, 1996, seeking a certificate of public convenience and necessity to provide resold and facilities-based interLATA and intraLATA service, and local exchange service.

6. After hearings, PB Com announced that it was willing to forgo its request for local exchange authority because, in PB Com's view, FCC rulings make that authority unnecessary.

7. Protests to PB Com's application were filed by the California Telecommunications Coalition, representing long distance carriers, TURN, and others; the Association of Directory Publishers, and the Commission's Division of Ratepayer Advocates (now the Office of Ratepayer Advocates).

8. On August 9, 1996, parties were advised that Commission consideration of Pacific Bell compliance with the FCC competitive checklist requirement would be considered in another proceeding, rather than in this proceeding.

9. Ten days of hearing were conducted between December 2 and December 19, 1996, with final briefs filed on February 14, 1997.

10. At the request of several parties, the ALJ on March 21, 1997, took official notice of a declaration by a Pacific Telesis officer and permitted filing of briefs on that subject by April 4, 1997.

11. Section 272(b) of the Telecommunications Act requires, among other things, that the long distance affiliate of a Bell operating company shall operate

independently, maintain separate accounts, have separate officers and directors, obtain credit without reliance on the Bell company, and conduct all transactions with the Bell operating company on an arm's length basis.

12. Section 272(c) of the Telecommunications Act requires, among other things, that a Bell operating company may not discriminate between its long distance affiliate and other telecommunications entities, and shall account for all transactions with its long distance affiliate pursuant to FCC accounting principles.

13. Section 272(e) of the Telecommunications Act requires, among other things, that a Bell operating company shall fulfill orders from unaffiliated telephone companies as quickly as it does for its affiliated companies; shall not provide certain facilities and services to an affiliate unless they also are available on the same terms to unaffiliated companies; shall charge an affiliate or impute to itself the same access charges assessed on others; and shall provide interLATA and intraLATA facilities to its long distance affiliate on the same terms as such facilities are made available to others.

14. PU Code § 709.2(c) requires this Commission, before it authorizes interLATA long distance competition, to determine that all competitors have nondiscriminatory access to exchanges; that a local exchange company does not make unfair use of subscriber information or customer contacts based on the company's provision of local exchange service; that there is no improper cross-subsidization of intrastate service; and that there is no substantial possibility of harm to competitive intrastate telephone markets.

15. PB Com has presented evidence intended to show that it already is constrained by federal and state regulations, and that further regulations will hinder its ability to compete with dominant long distance carriers.

16. Long distance carriers, joined by ORA and TURN, have presented evidence intended to show that Pacific Bell's marketing power gives the Telesis companies an unfair advantage that, unless constrained, will work to the long-term disadvantage of competition and consumers.

17. PB Com showed at hearing that AT&T, MCI and Sprint collectively control 95% of consumer long distance revenue and dominate the residential long distance market with 93% of households; however, later FCC data submitted by AT&T and MCI show that AT&T, MCI and Sprint have respectively 44.%, 19.4% and 9.7% of national long distance revenue, and that the three companies have 85.2% of the nation's presubscribed lines.

18. PB Com showed that the ability to offer one-stop shopping, i.e., a bundled product of local, local toll, long distance and other services, is important in marketing telecommunications services.

19. PB Com will utilize a variety of marketing techniques but expects to obtain from 50% to 60% of its new customers through Pacific Bell marketing efforts.

20. Pacific Bell intends to use customer proprietary information in marketing PB Com services after obtaining customer permission to do so.

21. Under the Commission's affiliate transaction rules, PB Com states that it will pay the tariff rate for services received from Pacific Bell under tariff; that it will pay the higher of fully distributed cost plus 10%, or market rate, for Pacific Bell services not offered under tariff; that it will pay a transfer fee of 25% of the annual salary of any Pacific Bell employee hired by PB Com; and that it will pay for Pacific Bell sales activities at the higher of fully distributed cost plus 10%, or market rate, plus an additional 13% for a successful sale.

22. Under the Commission's affiliate transaction rules, Pacific Bell must report to the Commission any pending sale or transfer to PB Com of an asset valued in

excess of $100,000, and it must seek advance approval of any guarantee of securities or debt obligations for PB Com.

23. ORA presented evidence intended to show that approval of PB Com's application without restrictions is likely to reduce Pacific Bell revenues and cause Pacific Bell's network to deteriorate.

24. ORA presented Pacific Telesis internal documents that purported to show plans to migrate high value customers from Pacific Bell to PB Com.

25. The Telesis companies have provided no documented projections of toll revenues, customers, or net income expected to be lost by Pacific Bell as a result of PB Com's application.

26. ORA presented evidence intended to show a risk that, with facilities-based service, PB Com would receive Telesis resources that otherwise would go to the Pacific Bell system.

27. ORA presented evidence intended to show that PB Com should be regulated as a dominant carrier to reduce the risk of anticompetitive behavior by Pacific Bell, and that price floors for PB Com service are necessary to be sure that such services are not subsidized and priced below cost.

28. MCI presented expert testimony estimating that it will be at least five years before most California customers have a choice of facilities-based local exchange carriers.

29. Pacific Bell serves 94% of the intraLATA residential customers in its service area and Pacific Bell has a monopoly in the provision of access service, the service that long distance carriers need to originate and terminate long distance calls.

30. Pacific Telesis is coordinating the relationship between Pacific Bell and PB Com and intends to select and manage the firms that will provide advertising and conduct market research.

31. Pacific Telesis corporate costs are 15% higher than AT&T's costs.

32. Pacific Bell receives many millions of calls each year from consumers because of its long-standing position as the monopoly local exchange carrier in its territory.

33. TURN witnesses presented evidence intended to show that Pacific Bell would violate state law if it tries to market PB Com services on virtually all incoming calls.

34. Sprint plans to enter the California local exchange market in competition with Pacific Bell.

35. Pacific Bell has encountered difficulty in filling change orders for other carriers that seek to resell local exchange service, at one time limiting such changes to 400 a day, increasing later to 2,000 per day five days a week.

36. Every customer switched from Pacific Bell local service to PB Com local service would mean a reduction in revenue from Pacific Bell.

37. Relatively little competition exists in the local exchange market, but there are hundreds of telephone carriers in California seeking to provide long distance and intraLATA service.

38. PB Com anticipates only limited need for facilities-based intraLATA service in its early years of operation.

39. No party opposes PB Com's application to become a long distance carrier, but virtually all parties except PB Com propose restrictions on the marketing of that service.

40. Telesis opposes an FCC order that precludes PB Com from sharing long distance transmission and switch facilities of Pacific Bell.

41. The Telecommunications Act prescribes the timing of PB Com's entry into the long distance market.

42. FCC Order 96-489 permits Pacific Bell to market PB Com's long distance service on inbound calls, provided that Pacific Bell informs callers for new service that they have a choice of long distance carriers.

43. Pacific Bell intends to use aggressive marketing techniques in garnering business for PB Com.

44. By prior Commission decisions, we authorized competition in providing interLATA telecommunications service. By D.94-09-065, 56 CPUC2d 117 (1994), we authorized competitive intraLATA services effective January 1, 1995, for carriers meeting specified criteria.

45. PB Com has demonstrated that it has the required amount of cash available to meet its start-up expenses.

46. PB Com has demonstrated that its management possesses the requisite technical experience to operate its service.

47. PB Com has submitted with its application a draft of its initial tariff, and this tariff complies with Commission requirements.

48. The Commission has routinely granted nondominant interexchange carriers an exemption from the Rule 18(b) requirement that the application be served on cities and counties in the proposed service area.

49. Exemption from the provisions of PU Code §§ 816-830 has been granted to other resellers.

50. The transfer or encumbrance of property of nondominant carriers has been exempted from the requirements of PU Code § 851 whenever such transfer or encumbrance serves to secure debt. (See D.85-11-044, 19 CPUC2d 206 (1985).)

51. The Proposed Decision in this application was issued in May 1997 and was withdrawn on October 15, 1997, pending an order of the FCC in its CPNI proceeding.

52. The FCC on February 26, 1998, released its Decision FCC 98-27, dealing with permissible uses of CPNI under Section 222 of the Telecommunications Act of 1996.

53. Applicant on April 17, 1998, filed a motion asking that this proceeding be reopened to consider changes to the Proposed Decision in light of Decision FCC 98-27.

54. Applicant on April 17, 1998, also moved to substitute SBCS for PB Com because of the merger of Pacific Telesis Group into SBC Communications, Inc.

55. SBCS has agreed to be bound by all presentations and commitments made on behalf of PB Com.

56. A Prehearing Conference was conducted on June 25, 1998.

57. Assigned Commissioner Neeper on July 2, 1998, ruled that further evidentiary hearings were not necessary, and he invited parties to brief the issues of the substitution of SBCS for PB Com and of the FCC's ruling on CPNI.

58. Briefs were filed on August 25, 1998, and reply briefs were filed on September 11, 1998, at which time this matter was deemed submitted for Commission decision.

Conclusions of Law

1. An applicant for a certificate of public convenience and necessity has the burden of showing that the public interest requires that the authority sought be granted.

2. PB Com has asked to withdraw its application for local exchange authority, and that request should be granted.

3. PB Com's attempt to place conditions on its withdrawal of part of its application should be rejected.

4. PB Com's application for authority to provide resold intraLATA service should be granted.

5. PB Com's request for authority to provide facilities-based intraLATA service should be granted, with limitations applicable to Pacific Bell franchise territory.

6. PB Com's application to provide resold and facilities-based interLATA service should be granted, subject to the requirements of the Telecommunications Act of 1996 and FCC and Commission rulings.

7. Pacific Bell should be required to comply with FCC and Commission requirements in performing joint marketing on behalf of PB Com.

8. Pacific Bell customer service representatives who will do joint marketing on behalf of PB Com should have access to Pacific Bell's CPNI, subject to FCC and Commission restrictions..

9. PB Com should be regulated as a nondominant provider of intraLATA and interLATA services.

10. ORA should be directed to arrange an audit of PB Com, with emphasis on affiliated transaction and cost allocation compliance, as part of, or at the same time as, the joint FCC/state audit, with costs to be borne by PB Com.

11. PB Com should not be required to pay a royalty for its use of the Pacific Bell name.

12. The order in this proceeding should not address access charge reform.

13. PB Com should not be required at this time to conduct a study demonstrating that Pacific Bell's net revenue will not be reduced as a result of granting operating authority to PB Com.

14. No restrictions need be imposed on Pacific Bell services to PB Com beyond those already in place.

15. No additional constraints are necessary on the transfer of Pacific Bell employees to PB Com.

16. No further requirements are necessary beyond those imposed by the FCC on reporting of proprietary information provided by Pacific Bell to PB Com.

17. Applicant has the financial ability to provide the proposed service.

18. Applicant has made a reasonable showing of technical expertise in telecommunications.

19. Public convenience and necessity require the interLATA and intraLATA services that will be offered by PB Com.

20. PB Com is subject to:

a. The current 2.4% surcharge applicable to all intrastate services except for those excluded by D.94-09-065 as modified by D.95-02-050 to fund Universal Lifeline Telephone Service (PU Code § 879; Resolution T-16098, December 16, 1997);

b. The current 0.25% surcharge applicable to all intrastate services except for those excluded by D.94-09-065 as modified by D.95-02-050 to fund the California Relay Service and Communications Devices Fund (PU Code § 2881; Resolution T-16090, December 16, 1997);

c. The user fee provided in PU Code §§ 431-435, which is 0.11% of gross intrastate revenue for the 1996-1997 fiscal year (Resolution 4789);

d. The current surcharge applicable to all intrastate services except for those excluded by D.94-09-065, as modified by D.95-02-050, to fund the California High Cost Fund-A (PU Code § 739.30; D.96-10-066, pp. 3-4, App. B, Rule 1.C.; set by Resolution T-15987 at 0.0% for 1998, effective February 19, 1998);

e. The current 2.87% surcharge applicable to all intrastate services except for those excluded by D.94-09-065, as modified by D.95-02-050, to fund the California High Cost Fund-B (D.96-10-066, p. 191, App. B, Rule 6.F.); and

f. The current 0.05% surcharge applicable to all intrastate services except for those excluded by D.94-09-065, as modified by D.95-02-050, to fund the California Teleconnect Fund (D.96-10-066, p. 88, App. B, Rule 8.G., set by Resolution T-16165, effective August 1, 1998).

21. PB Com should be exempted from the Rule 18(b) requirement of service of the application on cities and counties.

22. PB Com should be exempted from PU Code §§ 816-830.

23. PB Com should be exempted from PU Code § 851 when the transfer or encumbrance serves to secure debt.

24. The application should be granted to the extent set forth below.

25. Because of the public interest in competitive interLATA and intraLATA services, the following order should be effective immediately.

26. SBCS should be substituted as the applicant in place of PB Com, with SBCS subject as a successor in interest to all of the commitments and obligations applicable to PB Com.

27. The application should be approved and this decision should be adopted.

ORDER

IT IS ORDERED that:

1. The motion of Pacific Bell Communications (PB Com) pursuant to Rule 2.6 to amend the application to substitute Southwestern Bell Communications Services, Inc. (SBCS) in place of PB Com is granted, subject to the condition that SBCS is bound directly and indirectly in the same manner as PB Com by the Commission's rules and regulations, including affiliate transaction rules.

2. The motion of PB Com to reopen this proceeding to consider Decision 98-27 of the Federal Communications Commission (FCC) in its CC Docket No. 96-115 is granted.

3. A certificate of public convenience and necessity is granted pursuant to PU Code § 1001 to SBCS to operate as a facilities-based and resale interLocal Access and Transport Area (interLATA) carrier and as a facilities-based and resale intraLocal Access and Transport Area (intraLATA) carrier, subject to the terms and conditions set forth below.

4. SBCS's request to withdraw its application to operate as a facilities-based and resale competitive local carrier is granted; to the extent that SBCS continues to seek authority to provide local exchange authority, that request is denied.

5. SBCS's authority to provide facilities-based intraLATA service is limited in Pacific Bell franchise territory to construction of tandem switches and other network elements that will permit SBCS to offer common features for both intraLATA and interLATA long distance services; SBCS is not authorized to construct intraLATA transmission and end-office switching facilities in Pacific Bell's franchise territory without further approval of the Commission.

6. The authority granted today is conditioned upon SBCS and Pacific Bell compliance with the FCC's and this Commission's requirements for joint marketing of interLATA and intraLATA services.

7. The authority granted today is conditioned upon SBCS and Pacific Bell compliance with the FCC's and this Commission's requirements for access to Pacific Bell's Customer Prorietary Network Information.

8. The authority granted today is conditioned upon a periodic audit to be conducted, at SBCS expense, under auspices of the Commission's Office of Ratepayer Advocates (ORA) of SBCS's compliance with the Commission's affiliate transaction rules and cost allocation rules. The ORA is directed to consult with the Federal Communications Commission (FCC) Common Carrier Bureau to coordinate the audit with the joint FCC/state audit to be conducted by the Common Carrier Bureau.

9. Without obtaining prior approval of this Commission, SBCS is prohibited from accepting network transmission and switching services from Pacific Bell unless such services are available to all telecommunications providers on a nondiscriminatory basis.

10. Except as set forth in these ordering paragraphs, all further restrictions and limitations on SBCS's authority proposed by protestants in this proceeding are denied.

11. SBCS's exercise of the authority granted herein is conditioned upon SBCS's compliance with the requirements of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, 47 U.S.C. §§ 151 et seq., and compliance with requirements of this Commission.

12. SBCS shall file a written acceptance of the certificate granted in this proceeding.

13.a. Applicant is authorized to file with this Commission tariff schedules for the provision of interLATA and intraLATA service. Applicant may not offer interLATA and/or intraLATA service until tariffs are on file. Applicant's initial filing shall be made in accordance with General Order (GO) 96-A, excluding

Sections IV, V, and VI, and shall be effective not less than one day after filing. Applicant shall comply with the provisions in its tariffs.

b. Applicant is a nondominant interexchange carrier (NDIEC). The effectiveness of its future tariffs is subject to the schedules set forth in Ordering Paragraph 5 of D.90-08-032 (37 CPUC2d 130 at 158), as modified by D.91-12-013 (42 CPUC2d 220 at 231) and D.92-06-034 (44 CPUC2d 617 at 618):

> "5. All NDIECs are hereby placed on notice that their California tariff filings will be processed in accordance with the following effectiveness schedule:
>
> "a. Inclusion of FCC-approved rates for interstate services in California public utilities tariff schedules shall become effective on one (1) day's notice.
>
> "b. Uniform rate reductions for existing services shall become effective on five (5) days' notice.
>
> "c. Uniform rate increases, except for minor rate increases, for existing services shall become effective on thirty (30) days' notice, and shall require bill inserts, a message on the bill itself, or first class mail notice to customers of the pending increased rates.
>
> "d. Uniform minor rate increases, as defined in D.90-11-029, for existing services shall become effective on not less than five (5) working days' notice. Customer notification is not required for such minor rate increases.
>
> "e. Advice letter filings for new services and for all other types of tariff revisions, except changes in text not affecting rates or relocations of text in the tariff schedules, shall become effective on forty (40) days' notice.
>
> "f. Advice letter filings merely revising the text or location of text material which do not cause an increase in any rate or charge shall become effective on not less than five (5) days' notice."

14. SBCS may deviate from the following provisions of GO 96-A: (a) paragraph II.C.(1)(b), which requires consecutive sheet numbering and prohibits

the reissue of sheet numbers, and (b) paragraph II.C.(4), which requires that "a separate sheet or series of sheets should be used for each rule." Tariff filings incorporating these deviations shall be subject to the approval of the Commission's Telecommunications Division. Tariff filings shall reflect all fees and surcharges to which applicant is subject, as reflected in Conclusion of Law 20.

15. SBCS shall file as part of its initial tariff, after the effective date of this order and consistent with Ordering Paragraph 3, a service area map.

16. Prior to initiating service, SBCS shall provide the Commission's Consumer Services Division with SBCS's designated contact person(s) for purposes of resolving consumer complaints and the corresponding telephone number. This information shall be updated if the name or telephone number changes, or at least annually.

17. SBCS shall notify this Commission in writing of the date interLATA and intraLATA service are first rendered to the public within five days after service begins.

18. SBCS shall keep its books and records in accordance with the Uniform System of Accounts specified in Title 47, Code of Federal Regulations, Part 32.

19. SBCS shall file an annual report, in compliance with GO 104-A, on a calendar-year basis using the information request form developed by the Commission and contained in Attachment A.

20. SBCS shall ensure that its employees comply with the provisions of PU Code § 2889.5 regarding solicitation of customers.

21. The certificate granted and the authority to render service under the rates, charges, and rules authorized will expire if not exercised within 12 months after the effective date of this order.

22. The corporate identification number assigned to SBCS is U-5800-C, which shall be included in the caption of all original filings with this Commission, and in the titles of other pleadings filed in existing cases.

23. Within 60 days of the effective date of this order, SBCS shall comply with PU Code § 708, Employee Identification Cards, and notify the Direct of the Telecommunications Division in writing of its compliance.

24. SBCS is exempted from the provisions of PU Code §§ 816-830.

25. SBCS is exempted from PU Code § 851 for the transfer or encumbrance of property, whenever such transfer or encumbrance serves to secure debt.

26. SBCS is exempted from Rule 18(b) of the Commission's Rules of Practice and Procedure to the extent that the rule requires SBCS to serve a copy of its application on the cities and counties in which it proposes to operate.

27. If SBCS is 90 days or more late in filing an annual report or in remitting the fees listed in Conclusion of Law 20, the Telecommunications Division shall prepare for Commission consideration a resolution that revokes the applicant's certificate of public convenience and necessity, unless the applicant has received the written permission of the division to file or remit late.

28. The application is granted, as set forth above.

29. Application 96-03-007 is closed.

30. This order is effective today.

Dated February 4, 1999, at San Francisco, California.

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners

I will file a written concurrence.

/s/ HENRY M. DUQUE
Commissioner

DRAFT

ATTACHMENT A
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TO: ALL INTEREXCHANGE TELEPHONE UTILITIES

Article 5 of the Public Utilities Code grants authority to the California Public Utilities Commission to require all public utilities doing business in California to file reports as specified by the Commission on the utilities' California operations.

A specific annual report form has not yet been prescribed for the California interexchange telephone utilities. However, you are hereby directed to submit an original and two copies of the information requested in Attachment A no later than March 31st of the year following the calendar year for which the annual report is submitted.

Address your report to:

California Public Utilities Commission
Auditing and Compliance Branch, Room 3251
505 Van Ness Avenue
San Francisco, CA 94102-3298

Failure to file this information on time may result in a penalty as provided for in §§ 2107 and 2108 of the Public Utilities Code.

If you have any question concerning this matter, please call (415) 703-1961.

Information Requested of California Interexchange Telephone Utilities.

To be filed with the California Public Utilities Commission, 505 Van Ness Avenue, Room 3251, San Francisco, CA 94102-3298, no later than March 31st of the year following the calendar year for which the annual report is submitted.

1. Exact legal name and U # of reporting utility.

2. Address.

3. Name, title, address, and telephone number of the person to be contacted concerning the reported information.

4. Name and title of the officer having custody of the general books of account and the address of the office where such books are kept.

5. Type of organization (e.g., corporation, partnership, sole proprietorship, etc.).

   If incorporated, specify:

   a. Date of filing articles of incorporation with the Secretary of State.

   b. State in which incorporated.

6. Commission decision number granting operating authority and the date of that decision.

7. Date operations were begun.

8. Description of other business activities in which the utility is engaged.

9. A list of all affiliated companies and their relationship to the utility. State if affiliate is a:

   a. Regulated public utility.

   b. Publicly held corporation.

10. Balance sheet as of December 31st of the year for which information is submitted.

11. Income statement for California operations for the calendar year for which information is submitted.

(END OF ATTACHMENT A)

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Category	Proposed Additional Safeguards/Restrictions	Resolution of Issue Via the FCC's Recent Rulings
Joint Marketing	Pac Bell not allowed to market PBCom interLATA services to customers who call Pacific Bell for their local service. (AT&T- Kargoll, pg. 4 & 15; MCI- Connell, pg. 9; TURN-Costa pg. 6-7, Long Pg. 13)	The FCC ruled that BOCs are allowed to joint market PBCOM interLATA service on inbound calls regarding local service. FCC 96-489 ¶ 292
	PBCom must obtain a study of market value of joint marketing services provided by PacBell. (ORA-Elfin, pg. 64)	The FCC found that existing FCC and state accounting safeguards are adequate to protect against improper cross-subsidization, and it declined to impose any additional accounting rules on intrastate services. FCC 96-490 ¶ 44
	Joint Marketing for PBCom performed by separate and different service reps than those that take orders for PacBell services. (MCI-Connell, pg. 9; TURN-Costa, Pg. 12)	The FCC ruled that noadditional regulations are necessary to implement joint marketing and that BOCs will be permitted to engage in the same type of marketing activities as other service providers. FCC 96-489 ¶ 291
	PBCom required to use name substantially different than Pac Bell. (ORA-Elfin, pg. 70)	The FCC imposed no restrictions on the use of BOC names by 272 affiliates.
	Apply 13% referral fee to all PBCom sales revenues generated by PacBell. (ORA-Elfin, pg. 57-58)	The FCC ruled that no additional regulations are necessary to implement joint marketing and found that existing FCC and state accounting safeguards are adequate to protect against improper cross-subsidization. FCC 96-489 ¶ 291, FCC 96-490 ¶ 44
Affiliate Transactions	PBCom required to compensate Pacific Bell for use of its name to ensure against cross subsidization by Bell. (AT&T-Kargoll, pg. 8)	The FCC ruled that no additional regulations are necessary to implement joint marketing and found that existing FCC and state accounting safeguards are adequate to protect against improper cross-subsidization. FCC 96-489 ¶ 291, FCC 96-490 ¶ 44
	PBCom required to use Part 32 (USOA) (AT&T-Toomey, pg. 5, 10)	The FCC ruled that 272 affiliates must maintain their books in accordance with GAAP instead of Part 32 Accounting. FCC 96-490 ¶ 91

Category	Proposed Additional Safeguards/Restrictions	Resolution of Issue Via the FCC's Recent Rulings
liate sactions inued)	Quarterly financial reports by PBCom available for public review. (AT&T-Toomey, pg. 7, 10)	FCC will not review affiliate prices or profits. The FCC rejected AT&T's suggested annual audit, relying instead on biennial audits. FCC 96-489 ¶258, FCC 96-490 ¶203
	Annual outside audits over and above FCC Part 64 attestation audit. (AT&T-Toomey, pg. 7-8, 10)	The FCC rejected AT&T's suggested annual audit, relying instead on biennial audits. FCC 96-490 ¶203
	Discontinue provision of non-tariff employee consulting services except those required for joint marketing. (ORA-Elfin, pg. 50-51)	The FCC permits the sharing of administrative and other services ... they decline to impose a prohibition on all shared services. FCC 96-489 ¶168
	Commission examination of PBCom's transactions and relationships after operations begun for compliance and test for new safeguards (ORA-Elfin, pg. 77)	The FCC permits the sharing of administrative and other services ... they decline to impose a prohibition on all shared services. FCC 96-489 ¶168
	If a Pac Bell rep wants to use CPNI to sell PBCom services it must get customer approval for use by all unaffiliated carriers and notify all carriers that the information is available. (AT&T Kargoll, pg. 10)	The FCC states that it will address CPNI issues in a subsequent order in CC Docket No. 96-115. FCC 96-489 ¶300
	Bell should not be allowed to ask for permission to use CPNI "when customers would be most likely to see a benefit from granting permission" (MCI- Cornell, pg. 10)	The FCC states that it will address CPNI issues in a subsequent order in CC Docket No. 96-115. FCC 96-489 ¶300
lation	Dominant regulatory status for PBCom's services (with tariff filings, cost support and price floors in all markets) (AT&T-Kargoll pg. 14 & Economides, pp. 27-28; TURN-Costa, pp. 12-13 & Long, pg. 13; MCI-Cornell, pg. 13; ORA-Elfin, pp. 73-74; Sprint-Purkey, pg. 9; CCTA-Kahn, pg. 23)	FCC will not review affiliate prices or profits. FCC rules that further rules on predatory pricing are not necessary because federal antitrust law applies to predatory pricing and the danger of successful predation is small. FCC 96-489 ¶258

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Category	Proposed Additional Safeguards/Restrictions	Resolution of Issue Via the FCC's Recent Rulings
Regulation (continued)	Full imputation (price floors) for all PBCom services. (AT&T-Economides, pg. 28; MCI-Cornell, pg. 13)	The FCC rejected proposals that it review 272 affiliates' prices and profits to ensure that prices cover access charges and other costs, citing, in part, the "enormous administrative burden" on the Commission. FCC 96-489 ¶ 258
	PBCom should not be allowed to provide local or intraLATA service. (TURN-Long, pg. 13; CCTA-Kahn, pp. 7 & 23)	The FCC ruled that 272 affiliates are not prohibited from providing local exchange services in addition to interLATA services. FCC 96-489 ¶ 258 The FCC also rules that competition in the local market would not be harmed if a 272 affiliate offers local exchange services to the public that are similar to local exchange services offered by the BOC.
	Restrict PBCom from becoming a facilities-based LEC until effective local competition. (MCI-Cornell, pg. 15)	The FCC found that 272 affiliates can offer local exchange service without limitation on the nature of the facilities it uses to provide that service. FCC 96-489 ¶¶ 312-314
	Restrict PBCom to provide only local or intraLATA toll services it buys from Pac Bell (ORA-Elfin, pg. 32)	The FCC found that 272 affiliates can offer local exchange service without limitation on the nature of the facilities it uses to provide that service. FCC 96-489 ¶¶ 312-314
	Require PBCom to file an application to build facilities or buy or sell assets. (Sprint-Purkey, pg. 9-10)	The FCC found that 272 affiliates can offer local exchange service without limitation on the nature of the facilities it uses to provide that service. FCC 96-489 ¶¶ 312-314
	Require PBCom to file advice letters for introduction of new services and rate changes effective on 40 days notice. (Sprint-Purkey, pp. 10-11)	The FCC found no basis to conclude that 272 affiliates should be considered incumbent LECs, and it found that the danger of successful predation is small. These findings are not consistent with treatment as a "dominant" carrier. FCC 96-489 ¶¶ 312, 258

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Category	Proposed Additional Safeguards/Restrictions	Resolution of Issue Via the FCC's Recent Rulings
s Charges	PacBell's access charges must be set no higher than economic cost before PBCom authorized to operate. (MCI-Cornell, pg. 13)	The FCC explained that they intend to address access charges in a separate proceeding. FCC 96-489 ¶ 258, 314
	PBCom can only buy access from PacBell tariff and not on contract basis. (Sprint-Purkey, pg. 15)	The FCC found that BOCs may provide volume and term discounts to their 272 affiliates just as they must for unaffiliated carriers. FCC 96-489 ¶ 257
Resale	The Commission should require Pacific Bell to provide verifiable measures of its performance in providing services and facilities to affiliated and unaffiliated carriers. (AT&T-Kargoll, pg. 12 & Economides pg. 28)	The FCC found that the existing accounting rules and biennial audit requirements are adequate protection against the potential for improper cost allocation, and that its enforcement authority under §§ 271(d)(6) and 208 are available to address potential discrimination in provisioning. FCC 96-489 ¶¶ 162, 257
yees	No PacBell employee transfers to PBCom unless proven that PacBell is not harmed. (ORA-Elfin, pg. 43)	This issue is not explicitly addressed by the FCC, although its ruling with respect to the sharing of non-operational services would appear to be consistent with no bar on the transfer of employees.
	As condition of certification, develop a plan to ensure PacBell net income not reduced as a result of PBCom. Require public review before submitted to Commission. (ORA-Elfin, pg. 33)	This issue is not explicitly addressed by the FCC, although its refusal to promulgate additional accounting rules and restrictions would appear to go against this recommendation.

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COMPARATIVE ADVANTAGE ANALYSIS

Advantages of PacBell and PacBell Comm

Advantages Derived from Former Monopoly	*Limitations/Conditions*
Start with a ubiquitous network for local service and began (as of early 1996) with 100% of local service customers (*See, e.g.*, 3 Tr. 440-441, Pitchford).	
Start with a name that is synonymous with local service; generally a good reputation because regulation ensured sufficient revenues to provide high quality service. (Ex. 65 at 73, Elfner; 2 Tr. 230, Jacobsen)	
Have valuable (and private) customer information derived from the billing they have done for all local service and for many long distance companies. (Ex. 65, p. 67, Elfner)	PacBell's agreements with long distance carriers may prevent them from using the long distance customer information without permission of the long distance carrier; parties are seeking restrictions on PacBell's ability to use long distance and other private information that could partly neutralize this advantage with respect to marketing of PacBell Comm services
Almost all residential customers still must contact PacBell for local service (3 Tr. 440-441, Pitchford); those who have a choice generally only can only get resale of PacBell's service, which offers limited price and features competition to PacBell	
Depending on the size and location of the business, most businesses have little or no choice of local service providers.	Some large businesses and government offices in major downtown areas have a choice of a facilities-based competitor.

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For resale of PacBell's local service, PacBell has the ability to provide less favorable treatment (*e.g.*, with respect to service ordering) to competitive carriers than PacBell Comm and its own retail customers, to the extent that regulators do not prevent such discriminatory treatment. (There is often a time lag for regulators to act and regulators are reluctant to get involved in complex commercial disputes.) (Ex. 65, pp. 9-10, 34, Elfner; ICG Op. Br. at 10-14).	Obvious discrimination will likely be detected by competitors and halted by regulators. But complex business practices (*e.g.*, service ordering) can allow for subtle discrimination that is difficult to detect and prove. (ICG Op. Br. at 10-14).
When competitors are able to use PacBell's unbundled network elements (UNEs), PacBell will have the same ability to provide less favorable treatment to competitors than it provides to PacBell Comm. (See above.)	(See above.)
Even for customers who have a choice for local service, a large portion will continue to contact PacBell first simply because of inertia (Ex. 65, p.65, Elfner; Ex. C-21, PB3006085).	
Because customers must get local service in order to get any telephone service, they are likely to call a local service provider first before they think about who to use for toll and long distance service (*See* Ex. 65, p.68, Elfner).	
PacBell receives a huge number of inbound calls from existing customers regarding changes to their service, such as ordering new features, changing their directory listing, or requesting a PIC change. These calls are marketing opportunities. (Ex. C-13, PB3007301, PB 3007303; Ex. C-100, pp. 6-7, Costa; Ex. C-21, PB3006085).	

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PacBell has monopoly or at least significant market power for the following types of services: local, custom calling services, intraLATA toll. (D.96-03-020 at 53, 55; 10 Tr. 1204, Long).	
Customers are accustomed to providing personal and private information to PacBell in order to secure local service (e.g., social security number, driver's license number, how many people will be using phone and for what purpose, how many lines in the house). Unless regulators restrain such behavior, PacBell can ask these and other questions and gain valuable marketing information without the customer realizing that the information is serving only PacBell marketing purposes. (10 Tr. 1211-1212, Long; Ex. C-30, PB3001561; Ex. C-100, pp. 11-12, Costa).	TURN has asked the CPUC in this case to require PacBell to inform customers when information they are requesting is not necessary in order to obtain telephone service. (Ex. 101, p. 14, Long; Ex. C-100, pp.11-12, Costa).
PacBell has monopoly power over the access service competing long distance providers need in order to provide toll service. (Ex. 65, pp.72-73, Elfner; 10 Tr. 1204, Long; Ex. 99, p.12, Costa).	Effective regulation – especially imputation and price floor requirements for PacBell Comm – could at least partly neutralize this advantage
Ability to cross-subsidize PacBell Comm services if costs of services and assets (e.g., marketing services, value of PacBell name) are not imputed into PacBell Comm's costs and used in determining price floors. (Ex. 101, pp. 12-13, Long; Ex. 65, p. 18, 73, Elfner; 10 Tr. 1208-1209, 1214-1215).	Effective regulation (proper price floors) can neutralize this advantage

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Advantages of AT&T

Advantages Derived from Former Monopoly	*Limitations/Conditions*
Strong name recognition and even some confusion with some customers who think that AT&T never stopped providing local service (1 Tr. 229-230, Jacobsen; Ex. 44, p. 17, Sofman).	
Residual market power with respect to some parts of the long distance market -- the basic toll and directory assistance services used by residential and small business customers (10 Tr. 1205, Long).	
Has an over 50% share of the overall long distance market (on a minutes of use basis) and has an even larger percentage of total presubscribed long distance customers in California. (9 Tr. 1103, Kargoll).	Unlike PacBell, long period of choice among competing providers makes it difficult to assess the extent to which existing market share reflects customers retained because of former monopoly status as opposed to customers won or retained through effective marketing
Has a customer base comparable in size to PacBell's customer base. (1 Tr. 129, Jacobsen).	Customers of long distance and toll services have fewer reasons to make inbound calls than customers of local service.
Has huge financial resources. (C-103, pp.17-18, Emmerson).	PacBell and SBC, when combined, will also have tremendous financial resources, but still not as large as AT&T.

Advantages of Competitive Local Carriers (CLCs) In General

Advantages	*Limitations/ Conditions*
Ability to choose the geographic areas and customer classes they serve with local service. (D.96-03-020 at 46).	Limited service offerings are often more a function of necessity than choice, since marketing and advertising become more efficient as scope of service area increases
Ability of their customers to obtain complete bundles of telecommunications service in a single call (*E.g.*, 9 Tr. 1106-1107).	Large long distance carriers cannot yet do this if their local service is obtained from resale of PacBell. (FCC 96-489). Once PacBell Comm begins service, this advantage will be neutralized since PacBell will be able to jointly market a full bundle of PacBell/ PacBell Comm services. (Under TURN proposal, to obtain PacBell Comm's service, customer would have to be transferred to a separate sales staff at PacBell) (Ex. 101, p.13, Long).
Ability to target special prices and special promotions to a limited geographic area or class of customers. (Ex. 45, p. 16, Sofman).	Such targeted promotions are more costly than generalized prices and promotions, including the costs of specialized billing. This advantage is neutralized at least in part by PacBell's authority to enter into customer specific contracts with its customers (D.96-03-020 at 56-58); PacBell Comm would have the same authority.

Attachment D
List of Appearances

Applicant: William H. Booth and David Discher, Attorneys at Law, for Pacific Bell Communications; and McCutchen, Doyle, Brown & Enersen, by Terry I. Houlihan and Gregory Bowling, for AT&T Communications of California, Inc.

Protestants: Peter A. Casciato, Attorney at Law, for Association of Directory Publishers; Goodin, MacBride, Squeri, Schlotz & Ritchie, by John Clark, Attorney at Law, for California of Long Distance Telephone Companies, Inc. (CALTEL); Alan Gardner, Glenn Senow, Cynthia Walker and Darleen Clark, for California Cable Television Association (CCTA); Blumenfeld & Cohen, by Stephen P. Bowen, Karen M. Potkul, and Christine A. Mailloux, Attorneys at Law, for MCI Telecommunications Corp.; Willam C. Harrelson, Attorney at Law, for MCI Telecommunications, Inc.; Renee Van Dieen, for Sprint Communications Company; and Lesla Lehtonen, Attorney at Law, for California Cable Television Association (CCTA).

Intervenors: Richard Purkey, for Cable Television Association (Sprint); Thomas J. Long, Attorney at Law, for The Utility Reform Network; and McCutchen, Doyle, Brown & Enersen, by Rebecca Lenaburg, Attorney at Law, for AT&T Communications of California, Inc.

Interested Parties: Prima Legal Services, by Lee Burdick, Attorney at Law, for Cox Calfiornia Telecom, Inc. ; Carrington Phillip, Attorney at Law, for Cox California Telcom, Inc.; Roger P. Downs, for Cox California PCS, Inc.; Traci Bone, Joseph Faber, and Michael Morris, Attorneys at Law, for Teleport Communications Group; Bruce Holdridge, for ICG Access Services, Inc.; Dhruv Khanna, Sr., Attorney at Law, for Intel Corporation; Elaine M. Lustig and Kathleen S. Blunt, for GTE California, Inc.; Martin A. Mattes, Attorney at Law, for Intel Corporation and California Payphone Association; E. Garth Black, Mark P. Schreiber, and Sean P. Beatty, Attorneys at Law, for Roseville Telephone Company, Calaveras Telephone Company, California-Oregon Telephone Co., Ducor Telephone Company, Foresthill Telephone Co., Happy Valley Telephone Company, Hornitos Telephone Company, The Ponderosa Telephone Company, Sierra Telephone Company, Inc. and Winterhaven Telephone Company; Earl Nicholas Selby, Attorney at Law, for ICG Telecom Group (formerly ICG Access Services, Inc.); and Jerry Varcak, for Bank of America.

Office of Ratepayer Advocates: Rufus G. Thayer, Janice L. Grau, and James S. Rood, Attorneys at Law.

Telecommunications Division: Robert Benjamin and Charles Christiansen.

(END OF ATTACHMENT D)

A.96-03-007
D.99-02-013

Henry M. Duque, Commissioner, concurring:

I concur with the reasoning and results of this decision. I file this formal concurrence in order to alert SBC of my willingness to investigate any abusive uses of customer proprietary network information brought to the attention of this Commission.

Today's decision and the rules it adopts follow the FCC's national regulations concerning the use of customer proprietary network information adopted in February of this year. The major alternative to this approach would require separate staff to market Pacific and SBC services. This arrangement would produce a cumbersome customer-service situation. A customer would need to provide identical information to more than one service representative before completing an order. Lengthening this process for ordering phone service does not serve the public interest. Our decision today wisely rejects this approach.

Recent developments, however, have alerted me to the real potential for the abuse of customer information for marketing purposes. Last April, the United States District Court for the Northern District of California found that a marketing scheme of Pacific Bell involving the use of customer information violated the Uniform Trade Secrets Act. In August, the court held Pacific liable for damages of $1,520,000 to AT&T, MCI, and Sprint. Thus, abuses of information are not just a "theoretical" but a concrete threat that could undermine the functioning of telecommunications markets.

I take heart that the court identified and sanctioned this misuse of information by Pacific. In my view, promptly acting to sanction a firm's violations of law rather than constructing a rigid edifice of restrictive rules offers the appropriate way for government to proceed in these new markets where we cannot now know the likelihood of any particular marketing abuse. However, if further evidence of the abuse of customer proprietary network information emerges, let me note that the Commission has several methods of acting to sanction and to correct such practices. These include adjudicating complaints filed by competitors, opening a Commission investigation into a firm's practices concerning the use of this information, and acting to modify the rules adopted in today's decision.

Acting quickly in such matters is an obligation of this Commission that I take very seriously.

/s/ HENRY M. DUQUE
Henry M. Duque
Commissioner

February 9, 1999

San Francisco